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

NON-CONFIDENTIAL

Consultation and Draft Determination

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Chapter 1

1 Introduction

1.1 The European Communities (Electronic Communications Networks and Services) (Universal Service and Users' Rights) Regulations 2011[1] ("the Regulations") provide that a universal service provider ("USP") may submit a request for funding ("application") for a net cost (after intangible benefits) from meeting the Universal Service Obligation ("USO") and that the Commission for Communications Regulation ("ComReg") is obliged to assess such a request. The scope of universal service is defined by the Directive 2002/22/EC of the European Parliament, as amended by Directive 2009/136/EC ("the Directive").

1.2 ComReg document D04/11, *"Decision on the Costing of universal service obligations: Principles and Methodologies"* ("D04/11") sets out in detail as to how the USP, should they so choose, is to make an application including how the net cost (after intangible benefits) is to be calculated. D04/11 details how ComReg will assess a USO funding application and the principles it will consider when establishing whether a positive net cost, associated with meeting the USO provision, if any, is an unfair burden on the USP.

1.3 Eircom, as the designated USP, may submit applications for USO funding; in accordance with D04/11, in respect of its financial periods 2009-2010, 2010-2011, 2011-2012, 2012-2013 and 2013-2014, as the designated USP for those periods. The funding application being assessed throughout this document relates to Eircom's USO services for the 2009 - 2010 financial year. Eircom submitted an application on 31 May 2012 for funding in respect of the provision of USO services for the 2009-2010 financial year[2], in line with Decision 32[3] of D04/11. ComReg has assessed the application for funding submitted by Eircom in respect of its consistency with the principles and methodologies prescribed by ComReg in D04/11 and has taken a preliminary view in respect of the positive net cost and as to whether there is an unfair burden. This paper only details ComReg's assessment of the 2009-2010 financial year application.

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[1] S.I. No.337 of 2011

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

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

Chapter 2

2 Executive Summary

2.1 ComReg's aim with regard to universal services is to ensure that basic telephony services are available at an affordable price to all end-user[s] in the State. These basic services are considered essential for everyone. However, there is a risk that, with the operation of market forces alone, they might not be provided to everyone. The USO ensures that everyone, irrespective of location, social standing or income can access basic telecommunications services, thus bringing benefits to those with low incomes who have difficulty in affording a telephone service, consumers with disabilities who need particular services or facilities, and those in rural locations for whom the cost of gaining access to service might otherwise be unreasonable.

2.2 D04/11 details how ComReg will assess a USO funding application and the principles it will consider when establishing whether a positive net cost, associated with meeting the USO provision, if any, is an unfair burden on the USP. A reasonable level of understanding by the reader of the content and decisions set out in D04/11 by the reader is assumed.

2.3 ComReg is cognisant of the significant detail of data and the complexity of the methodologies required of Eircom to ensure compliance with D04/11, and as such recognises the level of effort made by Eircom throughout the entire process and in particular throughout the clarifications stage.

2.4 The funding application being assessed throughout this document relates to the avoidable costs, foregone revenue and intangible benefits associated with the provision of USO services by Eircom for the 2009-2010 financial year. Eircom's estimation of the direct net cost of meeting universal service obligations submitted in its application was €7,720,836; intangible benefits were independently estimated at €1,495,617, resulting in an application, of 31 May 2012, for funding for a positive net cost of €6,225,219, as detailed in the following table.

USO Service **Direct net cost (a)**	***Eircom €***
Uneconomic Areas	514,095
Uneconomic Customers	6,313,884
Directories	-
Payphone	88,608
Services for disabled end users	54,250
Consultancy fees	750,000
Direct net cost	**7,720,836**[4]
Intangible benefits (b)	
Enhanced brand recognition	1,279,842
Ubiquity	-
Marketing	7,896
Life-cycle	207,879
Total Intangible benefits	**1,495,617**
Net cost (after intangible benefits) (c)	
Direct net cost	7,720,837
Less: Total intangible benefits	(1,495,617)
Net cost (after intangible benefits) / Positive net cost	**6,225,219**[5]

2.5 During the assessment process ComReg sought various clarifications and a number of subsequent adjustments to Eircom's estimate were made as a result. These adjustments are listed in paragraphs 2.6 and 2.7. ComReg is of the view that clarifications and certain adjustments during the assessment of any application are to be expected, in particular in this instance as this was the first application being made under D04/11. ComReg is of the view that these adjustments do not have a material impact in respect of the 2009-2010 application and that the data originally submitted by Eircom was acceptable.

[4] The actual sum is €7,720,837
[5] The actual sum is €6,225,220

2.6 Following its assessment, ComReg is of the preliminary view that the following adjustments in respect of the direct net cost, discussed in Chapter 4, are appropriate:

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

2.7 ComReg is of the preliminary view that the following adjustments in respect of intangible benefits, discussed in Chapter 5, are appropriate:

Intangible benefits (b)	**Section reference**	***Eircom €***	***Adjustment €***	***ComReg €***
Enhanced brand recognition	5.3.1	1,279,842	563,856	1,843,698
Ubiquity	5.3.2	-	15,091	15,091
Marketing	5.3.3	7,896	12,541	20,437
Life-cycle	5.3.4	207,879	(43,319)	164,560
Total intangible benefits		**1,495,617**	**548,169**	**2,043,786**

[6] The actual sum is €7,720,837

2.8 As a result of clarifications, ComReg is of the preliminary view that it is appropriate to adjust the positive net cost of €6,225,219 submitted by Eircom, to €5,095,545:

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

2.9 Notwithstanding the adjustments outlined in paragraphs 2.6 and 2.7 and cognisant of Decision 20[8] of D04/11, ComReg is of the view that Eircom's application is fit for purpose. However, ComReg is of the view that recommendations on methodological and data provision improvements discussed throughout this document should be incorporated into any future USO Fund applications, as relevant.

2.10 ComReg is of the view that it is more appropriate to finalise and publish the Sharing Mechanism Decision document at a later stage. Based on the responses to the sharing mechanism consultation ("Document 11/77")[9], which will be published in due course, ComReg is commissioning an expert report in respect of the most appropriate principles of any mechanism established in an Irish context.

[7] The actual sum is €6,225,220

[8] Decision 20 of D04/11 requires that the USO funding application is fit for purpose.

[9] ComReg (2011), "*Consultation on sharing mechanism for any USO Fund: Principles and Methodologies",* October 2011

2.11 Given the very commercially sensitive nature of much of the information relevant to the assessment of Eircom's application, ComReg has strictly maintained the confidentiality of the relevant information, as it is obliged to do under Regulation 15 of the European Communities (Electronic Communications Networks and Services) (Framework) Regulations 2011[10] ("the Framework Regulations") and in accordance with its guidelines on the treatment of confidential information ("Confidentiality Guidelines")[11]. At the same time, ComReg has ensured that this consultation provides enough information for the issues to be comprehensible and for stakeholders to respond to it. Where information of a confidential/commercially sensitive nature is discussed in this document and the consultants' reports, the relevant information has been redacted and a ✂ symbol has been inserted.

2.12 ComReg commissioned expert reports from TERA and Oxera to assist it with its review of Eircom's USO Fund application and the determination of an unfair burden. All three reports (non-confidential versions) are appended to this consultation in order to provide further detail and enhance respondents' understanding of the issues.[12]

2.13 ComReg welcomes responses from all stakeholders to the questions set out in this consultation. ComReg will review and fully take into account all responses it receives and will issue its final decision in due course.

[10] S.I. No. 333 of 2011
[11] ComReg (2005), "*ComReg's Guidelines on the treatment of confidential information*", 05/04
[12] These reports have been redacted as appropriate.

Chapter 3

3 Overview of assessment

3.1 Overview

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

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

3.3 Eircom was designated as the Universal Service Provider ("USP") in 2003, 2006, and has been redesignated from 1 July 2010 to 30 June 2012 and from 1 July 2012 to 30 June 1014.[13]

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

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

- Provision of access at a fixed location;
- Directories;
- Public pay telephones;
- Specific measures for users with disabilities;

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

- Geographically averaged pricing; and
- Control of expenditure.

3.2 Overview of the USO fund application process

3.6 Eircom submitted an application[14] on 31 May 2012 for funding in respect of the provision of USO services for the 2009 - 2010 financial year (year-end 30th June 2010). ComReg issued an information notice on 1 June 2012, ComReg document 12/57.[15] Eircom highlighted that its application sought to follow *"the guidance provided by ComReg in Decision D04/11 of 31 May 2011 to the extent that it was possible and sought to ensure(d) compliance with each individual decision contained in D04/11*."

3.7 Eircom engaged with consultants WIK Consult ("WIK") and Amárach Research ("Amárach") to assist in the preparation of its application. For the purpose of supporting the application in adherence with Decision 22 of D04/11, which requires that *'Financial information shall be provided with an appropriate audit opinion or appropriate report...'*, Eircom also engaged PricewaterhouseCoopers (PwC) to discuss and agree the most appropriate form that any such assurance over the application should take. Arising from this ComReg entered into a tripartite engagement with Eircom and PwC to formulate a set of specific procedures to be carried out on the funding application. The parties to the Agreed Upon Procedures ("AUPs")[16] engagement (in this case Eircom, PwC and ComReg) are responsible for determining whether the scope of the procedures specified is sufficient for their respective purposes in connection with the USO Funding application.

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

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

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

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

Table 1: Eircom's estimates of the direct net cost

D04/11 Decision	ComReg's Assessment
22	ComReg is satisfied that an independent declaration, signed off by the Board of Directors of Eircom, accompanying the application, was provided. Similarly ComReg is satisfied that an AUPs engagement, approved by ComReg was undertaken by PwC to satisfy the requirement.

3.9 With respect to the Decisions 23, 24, 25 and 28 of D04/11 relating to the provision of data, financial models and supporting information, ComReg recognises the substantial data provided and the efforts made by Eircom to ensure information was comprehensive and accurate. ComReg notes that Eircom has made significant effort to source the relevant information from internal IT systems and other sources. Where Eircom was unable to source relevant information, it adopted alternative approaches. ComReg is satisfied that where such approaches are used, Eircom has not materially overstated or understated costs and/or revenues and has in the main complied with the requirements of Decision 19[17] of D04/11. Further information with respect to the issue of limited information is included in Chapter 5 and Chapter 6 as relevant.

Table 2: Eircom's estimates of the direct net cost

D04/11 Decision	ComReg's Assessment
23	ComReg is satisfied that Eircom's application was supported by calculations in software which is reasonably capable of proper access and review. However using the calculation of lifecycle benefits as an example in section 5.3.4 of this document, Eircom and its consultant's must ensure all calculations can be fully validated in a comprehensive format in future assessments.
24	ComReg is satisfied that Eircom's application and supporting models were adequately transparent and sought to fulfil the requirement of Decision 24, in terms of the specific requirements of the application including the format of each USO service and relevant calculations and also in terms of general modelling best practice.
26	ComReg has considered the issues of transparency and confidentiality of certain information in the context of Regulation 11(7) of the Regulations, its Confidentiality Guidelines and international precedent.
28	ComReg is satisfied that Eircom's application and financial models were adequately supported by comprehensive documentation.

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

3.3 Overview of ComReg's assessment

3.10 ComReg's assessment of Eircom's application for funding sought to ascertain whether Eircom adhered to the principles and methodologies set out in D04/11[18], and also required assessing the application for the completeness, relevance and accuracy of data submitted. The overarching approach set out in D04/11 with respect to the assessment and the subsequent determination of whether a resulting positive net cost (if any) constitutes an unfair burden, falls under the following headline areas:

- The assessment of the principles and methodologies for calculating the USO direct net cost; Chapter 4 of this document;
- Principles and methodologies for calculating the intangible benefits of the USO through the provision of USO services; Chapter 5 of this document; and
- Approach to a determination of an unfair burden; Chapter 6 of this document.

3.11 ComReg engaged with external consultants TERA Consultants ("TERA") to undertake an independent review[19] of the principles, methodologies and calculations of the direct net cost element of Eircom's funding application. Separately, Oxera Consulting Ltd ("Oxera") was commissioned by ComReg to undertake an independent review and provide its view[20] on WIK's estimation of the intangible benefits generated through the provision of the USO. Non-confidential versions of these consultants' reports are included as appendices to this document.

3.12 In undertaking the assessment of whether the proposed positive net cost represents an unfair burden on Eircom, ComReg engaged Oxera to assess the application submitted by Eircom in the context of D04/11, the Regulations and European precedent. As this is the first year an exercise of this nature has been undertaken in the context of the Irish market, ComReg informed its assessment with a practical framework developed by Oxera based on its interpretation of the relevant decisions set out in D04/11. The full report[21] prepared by Oxera is included as an appendix to this document.

[18] ComReg (2011), *"Report on Consultation and Decision on the costing of universal service obligations: Principles and Methodologies",* 31 May 2011
[19] TERA Consultants (2013), *"Assessment of Eircom's USO funding application"*, 1 February 2013
[20] Oxera Consulting (2013), *"Assessment of WIK's calculation of intangible benefits*", 1 February 2013
[21] Oxera (2013), *"Does the universal service obligation represent an unfair burden for Eircom?"*, 1 February 2013

3.13 As highlighted in D04/11 *"there may be circumstances where modifications are required to ensure that any limitations that are discovered are overcome"* and "*it is (equally) important to ensure that all stakeholders are aware of the possibility that ComReg will require some degree of flexibility going forward"*. Having undertaken its assessment, ComReg found that clarifications, modifications and a degree of flexibility was required to ensure the most accurate assessment. As such, when undertaking the assessment, clarifications were sought between ComReg, TERA and Oxera with the co-operation of Eircom and its consultants throughout the assessment period. As a result some necessary adjustments were made by Eircom to its application. Further detail on these clarifications and adjustments are highlighted in Chapter 4 and Chapter 5 of this document and the respective consultants' reports. To assist with the efficiency and compliance for future funding applications, ComReg, TERA and Oxera have made recommendations for future assessments which are discussed throughout this paper with further in each consultant report.

3.14 It should be noted that Decisions from D04/11 that are not specifically discussed throughout Chapters 3, 4, 5 and 6 are addressed in Chapter 7 of this document.

Chapter 4

4 Assessment of Eircom's calculation of direct net cost

4.1 Overview

4.1 The legal basis for the assessment of an application is the Directive as transposed by the Regulations. The Directive provides that for a calculation of a direct net cost "…*the net cost of USO is to be calculated as the difference between the net cost for a designated undertaking of operating with the USO and operating without the USO*."[22] In addition, *"…Due attention is to be given to correctly assessing the costs that any designated undertaking would have chosen to avoid had there been no universal service obligation. The net cost calculation should assess the benefits, including intangible benefits, to the universal service operator."*[23]

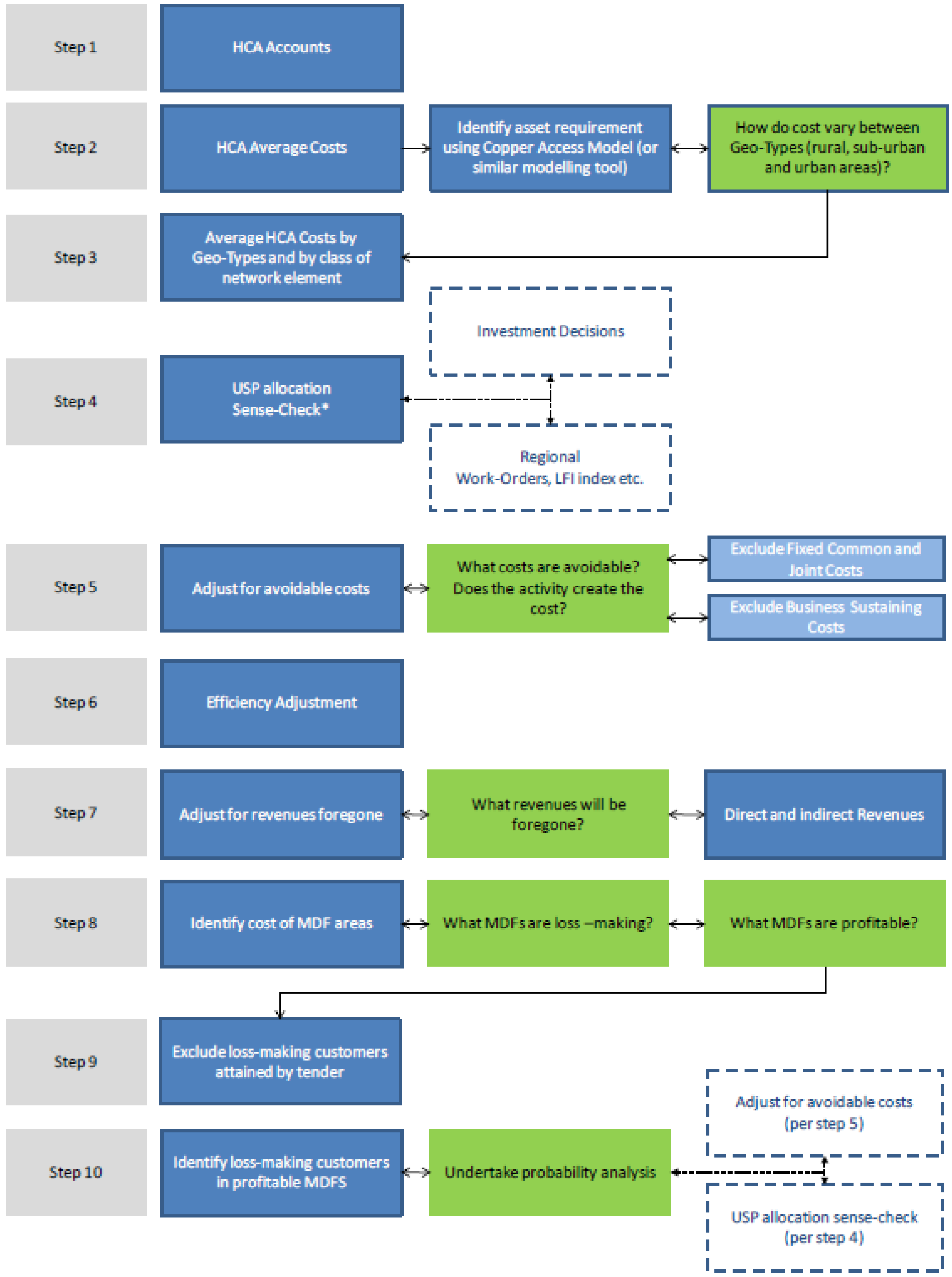
4.2 A key issue in estimating the direct net cost is the definition of the avoidable cost. D04/11 prescribes that "in order *"to identify the "true" cost of the USO, the net cost calculation must take into account those costs that the USP would directly avoid without having the USO (i.e. the requirement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

4.3 Where the USO services, as listed in paragraph 3.5 *"can only be provided at a loss and where it would not have been provided by a commercial operator, ComReg considers it appropriate to include the associated avoidable costs and revenues in a net cost calculation."*[24]

4.4 Figure 1 (pages 19-20) gives an overview of the assessment of the net cost in the context of the overall determination of whether a resulting positive net cost (if any) represents an unfair burden on the USP.

[22] Part A of Annex IV to the Directive
[23] Ibid.
[24] ComReg (2011), *"Report on Consultation and Decision on the costing of universal service obligations: Principles and Methodologies",* 31 May 2011

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



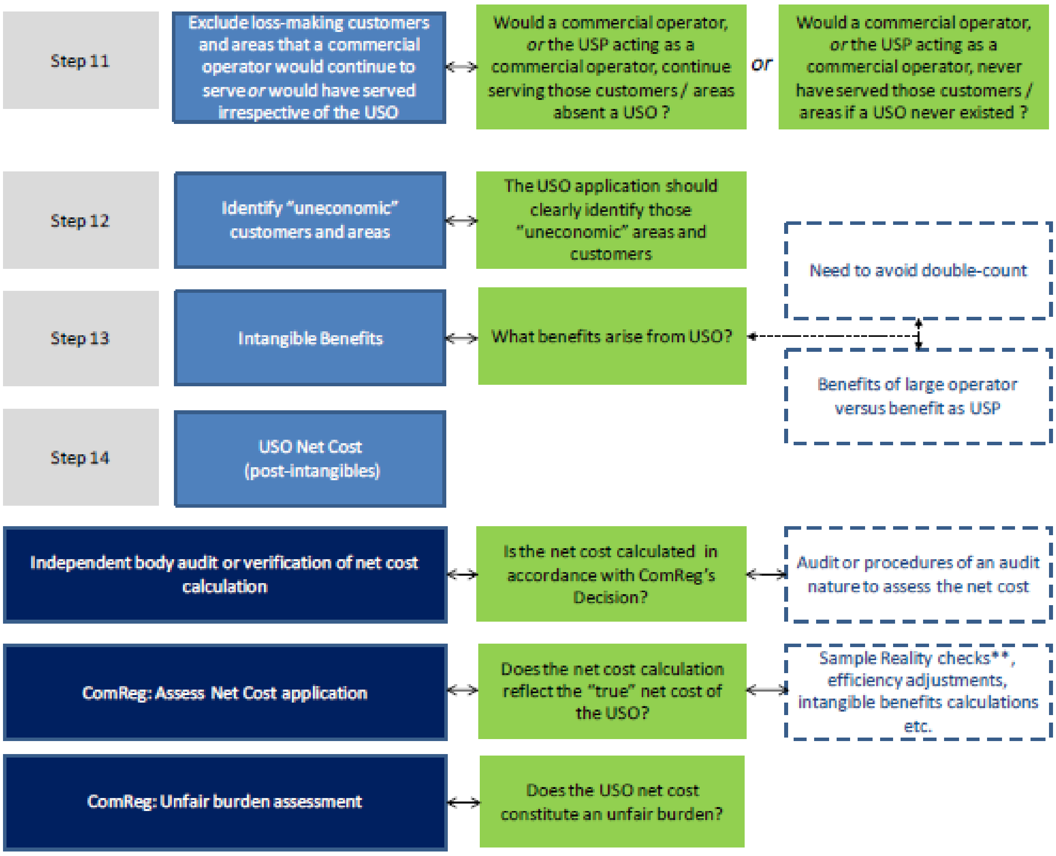


Figure 1: Overview of net cost calculation and unfair burden assessment methodology
Source: ComReg (2011), "Report on Consultation and Decision on the costing of universal service obligations: Principles and Methodologies", 31 May 2011

4.2 Application

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

4.6 A summary of Eircom's estimates of the direct net cost submitted on 31 May 2012[25], included in its comprehensive and detailed funding application, are set out below and fall under the following headings:

- Uneconomic areas;

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

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

USO Service **Direct net cost (a)**	**Section reference**	**Eircom €**
Uneconomic Areas	4.4	514,095
Uneconomic Customers	4.5	6,313,884
Directories	4.6	-
Payphone	4.7	88,608
Services for disabled end users	4.8	54,250
Consultancy fees	4.9	750,000
Direct net cost		**7,720,836**[26]

4.3 The assessment

4.7 ComReg commissioned specialist consultants, TERA, to undertake an assessment of the direct net cost element of Eircom's USO funding application with respect to its adherence to D04/11. TERA's detailed analysis of the application is set out in its report.[27] TERA assessed the methodologies and principles of Eircom's approach and is of the view that Eircom's application is in line with D04/11, as listed in Table 3, below. TERA has made recommendations with respect to specific areas of the application to be included in future USO funding applications. For future applications, as relevant, ComReg recommends that enhancements are implemented by Eircom or any relevant USP.

[26] The actual sum is €7,720,837

[27] TERA Consultants (2013*), "Assessment of Eircom's USO funding application"*, 1 February 2013, Annex 1

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

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

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

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

4.3.1 Revenue data

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

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

4.12 Eircom extracted revenue data for the purpose of its application by identifying the relevant Service Order Codes (SOCs) within the Corporate Data Warehouse (CDW). Cognisant of Decision 29[28], sampling was used by Eircom to establish full year revenue data at main distribution frame ("MDF") level both for retail and wholesale direct revenues where complete detailed data on revenues generated was not available.

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

4.13 The definition of relevant direct revenues is outlined in Decision 4 and Decision 5 of D04/11. Direct revenues are those directly invoiced to a customer or an other authorised operator ("OAO"). Indirect revenues, as defined in Decision 6 of D04/11, include services that are not directly invoiced to a customer. Direct revenues included in Eircom's application are primarily generated from retail services invoiced directly to customers and wholesale services directly invoiced to alternative operators. Indirect revenues included in Eircom's application are primarily generated from interconnection revenues, leased lines, revenues from calls from economic to uneconomic customers and replacement calls. The revenue categories provided by Eircom are detailed in TERA's report[29].

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

[29] TERA Consultants (2013), *"Assessment of Eircom's USO funding application",* 1 February 2013

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

4.3.2 Data sampling and geographic allocation of revenue

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

4.17 Gaining assurance with respect to the use of sampling for geographic allocation where there was a lack of complete data was more complex. Having sought clarification on the issue, TERA confirmed that the difference arising from the approach in contrast to TERA's recommended approach was minimal and did not distort the net cost estimation, as detailed in its report. ComReg in agreement with this does however recommend that complete data on inter-MDF and intra-MDF calls is provided in future assessments, cognisant of the requirements of Decision 7of D04/11.[30]

4.3.3 Replacement call revenue

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

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

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

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

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

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

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

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

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

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

4.3.4 Cost data

4.22 As outlined in D04/11, *"(A)pplying the principle of avoidable costs involves identifying those costs that the USP would directly avoid without having the USO (i.e. the requirement to serve "uneconomic" customers)*".[31] The avoidable cost concept is a fundamental determinant of the net cost calculation. D04/11 substantiates this and outlines ComReg's decision that *"for a cost to be deemed avoidable, it must be directly attributed to a given service. ComReg recognises that while some relevant overheads may not be directly apportioned in the HCA accounts, for example certain costs associated with exchange sites (if deemed uneconomic in their entirety), they are directly attributable to the uneconomic exchange — and should the USP identify that exchange as an area which without having the USO, it would no longer serve, then, for the purposes of the net cost calculation, it would be considered avoidable."*[32]

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

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

[31] Paragraph 3.20, D04/11
[32] Paragraph 3.41, D04/11

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

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

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

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

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

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

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

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

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

4.31 Local access CAPEX cost categories were primarily ascertained in the accounts at an MDF level and as highlighted by TERA *"data reflects the actual depreciation profile"*[33]. For all remaining CAPEX cost allocation keys were applied. Avoidability analysis at a customer level proved more complex, further detail is set out in section 1.2.1.2 of TERA's report. Eircom made the following assumptions with respect to avoidability: overhead cables are fully avoidable outside housing areas and underground cables are only partially avoidable; overhead cables in isolated areas, the portion of the cable that is outside a housing area was considered avoidable and the portion of the line within a housing area was not avoidable and underground cable outside a housing area, avoidability increases with line length.

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

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

4.34 As highlighted by TERA, *"(A)n efficiency correction on OPEX has been made using line fault index, which is one of the parameters recommended by ComReg for adjustment"*. Adjustments were integrated by Eircom to local access costs to reflect a ✂ than that specified by ComReg (14.5%)[34], specifically to actual and predicted maintenance costs associated with customer carriers and the copper overhead and underground networks. It is ComReg's view that the principle of an efficiency adjustment was correctly applied and implemented by Eircom.

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

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

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

4.4 Area Model

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

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

Table 6: Compliance with Decision 11 of D04/11

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

4.5 Customer Model

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

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

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

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

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

D04/11 Decision	ComReg's Assessment
10	ComReg is satisfied that Eircom has met the requirements of Decision 10, by excluding customers who were originally considered "uneconomic" and have now become profitable.

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

4.6 Directories and directory enquiry services model

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

- ✂

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

4.42 In respect of Directory services, while Eircom's application claims that the mandated services (Printed Directory and National Directory Database ("NDD"))[35] are economic for 2009-2010, ComReg notes that without the NDD obligation, Eircom would not be able to sell licences for directory enquiries or the direct marketing extract. Eircom submitted a value of zero in its application in respect of directory services. ComReg is of the view that any revenue associated with the NDD which exceeds the cost of the NDD should be included as a negative net cost value as this revenue would not be available to Eircom absent the designation on Eircom to maintain the NDD. ✂. Recognising the level of analysis involved in establishing the level of avoidability with respect to this cost, Eircom estimate that of these costs ✂.

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

Table 8: Compliance with Decision 17 of D04/11

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

4.7 Payphone model

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

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

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

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

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

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

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

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

4.8 Disabled services model

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

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

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

Table 10: Compliance with Decision 18 of D04/11

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

4.9 Consultancy fees

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

4.52 ComReg is of the preliminary view that consultants' fees are disallowed in so far as they relate to the preparation of the USO funding application for the following reasons:

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

- Decision 2 of D04/11 states that "*It is only the portion of costs, both capital and operational expenditure for the given financial year that can be directly attributed to the USP service (i.e the service activity creates the cost*[36]*) and which could have been avoided without the USO, which are included in the net cost calculation*"; and

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

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

4.10 Overlap with intangible benefits

4.53 As part of its assessment, TERA investigated any overlap between direct net cost estimates and intangible benefit estimates to ascertain whether there was evidence of double counting and to ensure input values were correct and consistent. Throughout the assessment as a result of clarifications and minor model changes, TERA made adjustments to direct net cost calculations impacting intangible benefits and Oxera made adjustments to intangible benefits where required. Consistent with comments made by Oxera which follow in the next chapter, key assumptions and calculations which would substantiate information provided by Eircom could not be provided as it would have been too time-consuming and complex to provide. Further commentary on this issue is provided for in Chapter 5. TERA provide detail of its findings with respect to the inter-relation between direct net cost calculations and the calculation of intangible benefits in Chapter 3 of its report.

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

4.54 TERA concluded that the application with respect to any overlap between the direct net cost estimates and the intangible benefits' estimate was in accordance with D04/11. There have been a series of clarifications and subsequent adjustments throughout the assessment process, as detailed throughout this chapter. ComReg has considered the TERA report and is satisfied that the risk of overlap has been addressed and there is no evidence that any overlap exists.

4.11 ComReg's preliminary view

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

4.56 In summary, ComReg is satisfied that the deviations from D04/11 are acceptable and that the application is fit for purpose, giving particular consideration to Decision 20. Therefore, ComReg is of the preliminary view that the direct net cost is €7,139,331 (after a total downward adjustment of €581,506), as follows:

USO Service **Direct net cost (a)**	**Section**	***Eircom €***	***Adjustment €***	***ComReg €***
Uneconomic Areas	4.4	514,095	31,701	545,796
Uneconomic Customers	4.5	6,313,884	141,094	6,454,978
Directories	4.6	-	-	-
Payphone	4.7	88,608	5,298	93,906
Services for disabled end users	4.8	54,250	9,599	44,651
Consultancy fees	4.9	750,000	750,000	-
Direct net cost (a)		**7,720,836**[37]	**(581,506)**	**7,139,331**

[37] The actual sum is €7,720,837

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

Chapter 5

5 Assessment of WIK's calculation of intangible benefits

5.1 Overview

5.1 Decision 35[38] of D04/11 requires that the net cost calculation must assess the benefits, including intangible benefits that accrue to the USP, by virtue of being the USP. It provides that at a minimum, ComReg will consider the following benefits:

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

5.2 With respect to the identification and quantification of the intangible benefit categories listed, ComReg and its consultants have assessed the approach and results that formed part of Eircom's application in line with the decisions set out in Decision 36 of D04/11. The key principles underpinning ComReg's guidance include the following:

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

[38] Regulation 11 (4)(a)

5.2 Application

5.3 In accordance with the requirement of Decision 31 of D04/11 which prescribes that the *"calculation of the benefits of the USO shall be completed by an external expert, independent of the USP".* Eircom engaged with WIK and Amárach to discharge the requirement for an independent expert to ascertain the estimation of intangible benefits. A summary of Eircom's estimations submitted on 31 May 2012[39] included in its detailed funding application are consistent with the intangible benefits categories included in Decision 35 of D04/11, as set out below.

Intangible benefits (b)	Section reference	*Eircom €*	*Adjustment €*	*ComReg €*
Enhanced brand recognition	5.3.1	1,279,842	563,856	1,843,698
Ubiquity	5.3.2	-	15,091	15,091
Marketing	5.3.3	7,896	12,541	20,437
Life-cycle	5.3.4	207,879	(43,319)	164,560
Total intangible benefits		**1,495,617**	**548,169**	**2,043,786**

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

5.5 Intangible benefit estimations for each category submitted by Eircom are outlined in paragraph 5.3. Final calculations assessed by ComReg differ in some cases from those originally submitted by Eircom as a result of clarifications and modifications sought by ComReg and its consultants throughout the assessment process. The causes for clarification requirements are discussed throughout this chapter with respect to each intangible benefit category.

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

5.3 Assessment

5.6 ComReg engaged Oxera to undertake a detailed assessment of the methodologies and calculations[40] applied by WIK and Amárach, on behalf of Eircom as its' independent experts, to establish the estimate of the intangible benefits generated as a result of the provision of USO services. While D04/11 establishes that costs that are incurred in the provision of USO services, that would be otherwise avoidable, are to be considered in the calculation of the direct net cost, it likewise establishes that benefits, both tangible (i.e. direct) and intangible (i.e. indirect), if positive, are to be deducted from the direct net cost.

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

- Developing an understanding of the approaches and methodologies adopted by Eircom and determining their rationale and suitability in calculating the estimation of each intangible benefit category, as listed in paragraph 5.1;
- Evaluating the methodologies adopted in Eircom's application by WIK and the estimates of each intangible benefit category in the context of international precedent, their effectiveness and robust implementation in the overall analysis, while giving due consideration to the requirements set out in Decision 37; and
- Evaluating whether improvements to the methodologies could be incorporated and providing any relevant recommendations for future USO fund applications, in accordance with Decision 37 of D04/11 that provides *"… the receipt of the first USO funding application, ComReg will actively continue to evolve and refine a number of potential methodologies for the purposes of valuing the benefits of the USO*[41]*".*

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

5.3.1 Brand recognition benefits

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

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

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

5.10 The methodology adopted by WIK makes an estimation of the benefit by ascertaining the difference between the benefit derived from two scenarios as follows:

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

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

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

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

5.14 Based on the in depth analysis provided by Oxera and outlined in its report, ComReg has determined that the approach adopted by WIK is broadly appropriate. However, cognisant of Decision 37 of D04/11, Oxera has provided recommendations which serve to inform a more effective practical interpretation of the requirements of D04/11. Oxera noted that although it considers the general conceptual approach adopted by WIK as broadly *"reasonable"* and *"sound",* their assessment highlights a number of shortcomings in the context of the theoretical model and the empirical research used to populate the assumptions of the model. Oxera's report queries the appropriateness of the theoretical approach applied by WIK and its application to the estimation of the counterfactual scenario. Separately, Oxera also queries the reliability of survey data owing to the small sample size used to estimate key parameters of the USO-related premium and the consistency of the questions (as per paragraph 5.10) included in the survey questionnaire. To ensure a full understanding, Oxera provide a step-by-step approach to assessing the shortcomings of the approach adopted in section 2.3 of its report. Oxera outlines that *"the model has a counterintuitive prediction that the benefit of the enhanced brand recognition is independent of the number of subscribers who are willing to pay a USO-related premium".* In addition to this Oxera highlight that the theoretical model is contrary to the supporting discussion provided by WIK in relation to the methodology.

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

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

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

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

5.3.2 Ubiquity benefits

5.18 ComReg is of the view, as set out in D04/11, ubiquity benefits to Eircom may arise as a result of the following:

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

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

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

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

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

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

5.3.3 Marketing benefits

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

- Commercial advantage owing to access to customer data and potential benefit of not, as a result, having to undertake market research;
- Commercial benefit of potentially selling customer data to third parties. While the USP in Ireland may not sell information owing to data protection laws, it may use the information for more targeted promotions, and as such may increase profitability of both uneconomic and uneconomic customers; and
- Potential savings as a result of advertising in economic areas through the use of public payphone and WIFI hotspots.

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

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

5.3.4 Life-cycle benefits

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

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

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

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

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

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

D04/11 Decision	ComReg's Assessment
31	ComReg is satisfied that Eircom's engagement with independent experts for the purpose of the development of suitable methodologies and the preparation of the intangible benefits estimate has ensured that independent experts have completed the necessary calculations.
35	ComReg is satisfied that Eircom's estimations assess the relevant benefits, including intangible benefits, to the USP.
36	Based on the analysis of both TERA and Oxera, ComReg is satisfied that there is no evidence of double counting and benefits accruing as a result of Eircom's USP status are only considered.

37	As discussed in paragraph 5.7, ComReg engaged with Oxera to review the estimate prepared by WIK. ComReg, cognisant of allowances in Decision 37, requested Oxera not only to review the estimate but provide recommendations to ensure the proper evolution of the methodologies used. Furthermore, as set out in D04/11, ComReg reserved its right with respect to implementation of alternative methodologies and as such has adjusted the estimates provided by WIK. Reasoning to support the justification of these adjustments is discussed throughout this chapter and detailed in Oxera's report.

5.4 ComReg's preliminary view

5.30 Oxera concluded that the application was made appropriately and broadly in accordance with D04/11. There have been a series of clarifications and subsequent adjustments throughout the assessment process, as detailed throughout this chapter. ComReg is of the preliminary view that clarifications and certain adjustments during the assessment of any application may be unavoidable and in fact may be necessary to ensure there are no inaccuracies or misinterpretations. ComReg is of the preliminary view that the recommendations do not have a material impact in respect of the 2009-2010 application and furthermore the data submitted by Eircom is acceptable. With respect to Decision 37 of D04/11, the flexibility allowable for the purpose of refining the approach allows for the identification of where improvements can be made. In summary, ComReg's preliminary view is that any deviations from D04/11 are acceptable and that the application is fit for purpose, giving particular consideration to Decision 15 of D04/11[42]. Having reviewed the approach adopted by WIK in the context of the decision document and Oxera's analysis, ComReg is of the preliminary view that the estimate is reasonable. ComReg is of the preliminary view that the intangible benefits estimation requires an upward adjustment of €548,169, therefore giving an adjusted total intangible benefits' estimation of €2,043,876 post assessment, as follows:

[42] Decision 15 of D04/11 prescribes that *"(D)uring the course of ComReg's assessment of a USO funding application, a number of sample "reality" checks will be undertaken."*

Intangible benefits (b)	**Section reference**	***Eircom €***	***Adjustment €***	***ComReg €***
Enhanced brand recognition	5.3.1	1,279,842	563,856	1,843,698
Ubiquity	5.3.2	-	15,091	15,091
Marketing	5.3.3	7,896	12,541	20,437
Life-cycle	5.3.4	207,879	(43,319)	164,560
Total Intangible benefits		**1,495,617**	**548,169**	**2,043,786**

Consultation Question

Q. 3 Following ComReg's assessment, detailed in Chapter 5, do you agree with ComReg's preliminary view that the intangible benefits estimate for 2009-2010 is €2,043,786?

Please provide detailed reasoning to support your views.

Consultation Question

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

Please provide detailed reasoning to support your views.

Chapter 6

6 Determination of an unfair burden

6.1 Overview

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

6.2 The concept of an 'unfair burden' is not defined in the Directive[43] or the Regulations. EU case law[44] confirms that the Directive gives NRAs discretion in determining what constitutes an unfair burden. As such ComReg will determine if the positive net cost of providing the USO represents an unfair burden on the USP on a case by case basis.

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

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

[43] 2002/22/EC
[44] Commission v Belgium, paragraph 44 and 50, Case C -222/08

6.5 ComReg commissioned Oxera to provide practical advice on the implementation of a structured assessment of the process. Oxera has provided a methodology in the form of three cumulative tests, to identify the existence of an unfair burden, based on the guidance and decisions set out in D04/11 and then assessed Eircom's application for the 2009/10 period, according to this methodology. ComReg has considered Oxera's views in the context of international precedent and the unique market characteristics of the industry in Ireland. Oxera's paper *'Does the universal service obligation represent an unfair burden for Eircom*?'[45] considers the following key areas:

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

6.2 Application

6.6 Eircom submitted an application for USO funding on 31 May 2012, which is summarised and discussed in Chapter 4 and 5. The summary table below provides a high level overview of Eircom's application and the preliminary outcome of ComReg's assessment.

Net cost (after intangible benefits) / Positive net cost (c)	*Eircom €*	*ComReg €*
Direct net cost	7,720,836	7,139,331
Total intangible benefits	(1,495,617)	(2,043,786)
Net cost (after intangible benefits) / Positive net cost	**6,225,219**[46]	**5,095,545**

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

[46] The actual sum is €6,225,220

6.7 This proposed determination of whether the proposed positive net cost is an unfair burden is discussed throughout this chapter in the context of both Eircom's application for €6,225,219 and the value proposed following ComReg's assessment of €5,095,545. It is apparent throughout this chapter, that the adjustments proposed by ComReg to Eircom's application relating to the positive net cost do not impact the determination of an unfair burden. It should be noted that the amount applied for, as submitted by Eircom, is what is assessed in Oxera's report.[47]

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

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

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

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

6.9 For the application covering the 2009-2010 period, ComReg is of the preliminary view that the first two criteria included in Decision 38 of D04/11 (paragraph 6.7) are met, as outlined:

- Having undertaken its assessment ComReg has proposed an adjusted direct net cost and an adjusted intangible benefits;

- As set out in paragraph 6.2, ComReg is of the preliminary view that the benefits of the USO do not outweigh the direct net cost and, as such, is of the preliminary view that the assessment has demonstrated the existence of a positive net cost of €5.1m;

6.10 Given this assessment, ComReg subsequently moved to the final component of the assessment as described in subparagraph iii of paragraph 6.8.

[47] Oxera (2013), "Does the universal service obligation represent an unfair burden to Eircom?", 1 February 2013

6.3 Administrative test

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

6.12 As outlined by Oxera *"If the positive net cost of the USO is relatively small, ComReg will assess whether USO financing is justified depending on whether the cost of establishing a sharing mechanism would be disproportionate to the net transfers of the USP".*[48] The objective of this test is to assess whether the costs of implementing a sharing mechanism are below the net revenue that would be collected by the USP from the other market players in the event that a sharing mechanism was implemented.

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

6.3.1 Estimate of the administrative costs

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

6.3.2 Net Transfer to the USP

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

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

6.16 In the absence of having established a sharing mechanism previously, it is reasonable to assume, for the purpose of illustration, that if the sharing mechanism is based on all Electronic Communications Revenues, approximately 70%[49] of a positive net cost would be provided for by other market participants and 30% by Eircom, the USP. As such, ComReg is of the preliminary view that in the instance an unfair burden is found, the net transfer to Eircom for the 2009-2010 assessment period would be approximately €3.6m (c. 70% of €5.1m).

6.3.3 Assessment of administrative costs

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

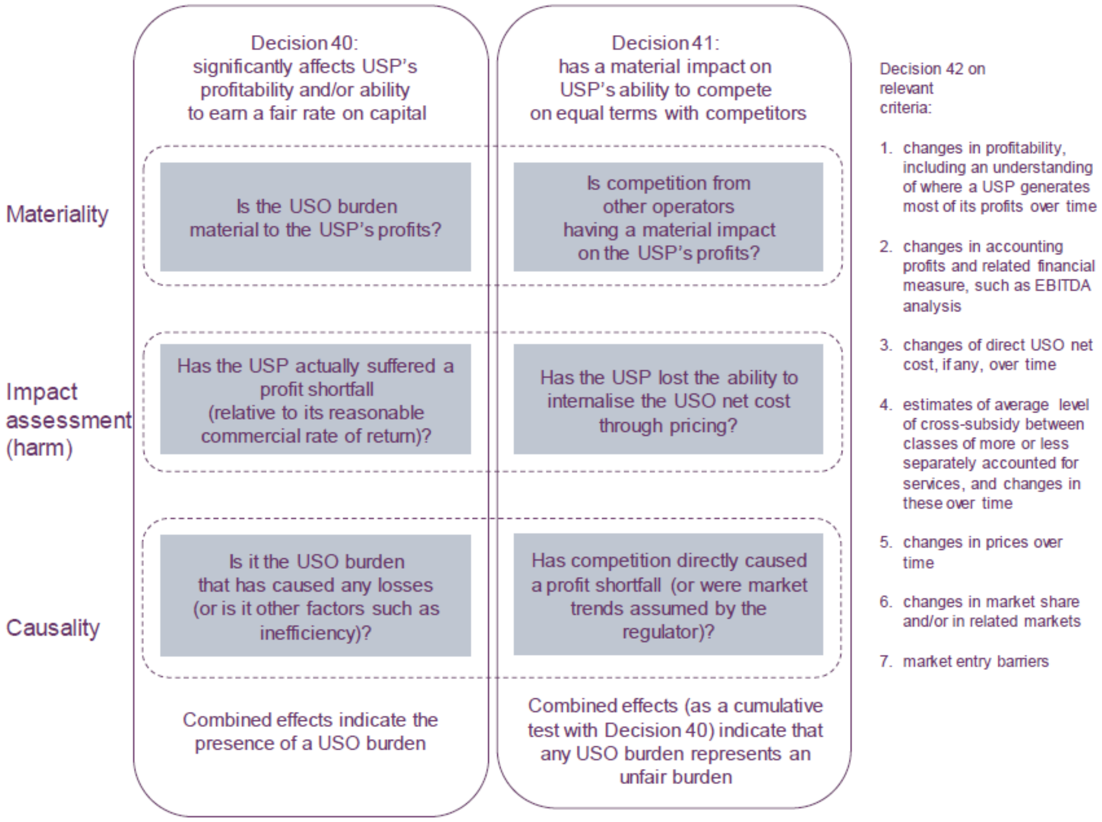
6.18 Since this assessment proposes a positive net cost, ComReg is of the view that the net transfer to the USP would most likely exceed the administrative costs of the sharing mechanism, and therefore, ComReg subsequently undertook the next step of the assessment process, namely assessing the extent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

6.4 Unfair burden assessment

6.19 D04/11 prescribes three cumulative tests to be undertaken when determining the existence of an unfair burden. These tests are summarised in paragraphs 6.20 to 6.24 below. Oxera's report provides detail on the principles and functions of each test and stresses that *"while each of these tests can be assessed objectively, there may not be a single outcome from applying them all in practice, and it will be important to assess their outcomes on a case-by-case basis"*. The methodology with respect to the assessment is outlined in Figure 2.

[49] ComReg quarterly reports for the period 2009-2010, http://www.comreg.ie/publications/publications.583.100023.0.0.p.html

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



Source: Oxera

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

- Materiality;
- Impact; and
- Causality.

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

6.22 Consistent with the requirements of Decision 40 of D04/11 which states that "(*I)f the positive net cost is not relatively small, ComReg will assess whether or not this net cost significantly affects a USP's profitability and/or ability to earn a fair rate of return on its capital employed*", section 6.4.1 considers whether the positive net cost significantly affects the Eircom's profitability or ability to earn a fair return on capital.

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

6.24 Decision 42 provides a list of criteria by which ComReg should evaluate with respect to the profitability test (Decision 40 of D04/11) and the competitive test (Decision 41 of D04/11), these are discussed in section 6.4.2. These criteria are as follows:

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

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

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

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

v. *Changes in prices over time.*

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

vii. *Market entry barriers."*

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

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

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

6.27 In order to fully consider the impact of compensation for the positive net cost of the USO with respect to Eircom's ability to earn a fair rate of return, it was necessary to ascertain the most appropriate profitability measurement for the purpose of the assessment. ComReg is of the view that the most suitable metric against which to assess profitability levels, based on advice provided by Oxera, is the Return on Capital Employed (ROCE). Oxera identified an operating profit[50] measured as ROCE in the appropriate WACC range of 7.77% – 11.08%, with an above midpoint estimate of 10.21%[51] as being most suitable for the assessment. This value was selected to be consistent with ComReg's prior determination on Eircom's cost of capital.[52]

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

Figure 3: Compensation – Impact on ROCE

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

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

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

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

- Scenario 1: In this scenario the ROCE is above the upper range of a reasonable rate of return, compared with the upper range of Eircom's cost of capital (as discussed in paragraph 6.27). As such, it is therefore unlikely that the positive net cost is threatening the ability to earn a reasonable rate of return, however further analysis would be have undertaken to ensure an adequate investigation into materiality and causality.

- Scenario 2: In this scenario the pre-compensation ROCE of 6.8% is below the point estimate of Eircom's cost of capital (10.21%). Compensation of the positive net cost brings the ROCE above the 10.21% benchmark. In this case the positive net cost does not appear to significantly threaten the ability of Eircom to earn a fair rate of return, however further objective analysis and regulatory judgement would be required to investigate further, on a case by case basis.

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

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

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

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

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

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

6.31 The actual performance of business areas relevant to the USO have been assessed by ComReg. These include the core USO business[53], the fixed-line business[54] and the Group level business[55]. It is ComReg's view, particularly in the context of criteria (iv) of Decision 42 of D04/11, that the USO business and fixed line business are the most relevant to the analysis. ComReg is also of the view that the intangible benefits arising from the provision of USO services predominantly benefit the fixed line business, thus reinforcing the relevance of the assessment of the results set out in Figure 4 and Figure 5.

Figure 4: Profitability within Eircom's regulatory accounts

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

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

Source: Oxera

6.32 ComReg is of the view that assessing the impact of the positive net cost would be best served by the regulated accounts. Oxera identified the regulated business to be *"best proxied by Eircom's fixed-line segment, which includes access (rental and connections), voice and data traffic, data communications, and interconnect services".*[56] This view is reinforced by ComReg's requirement for Eircom to maintain separated accounts at the market level. The regulatory accounts serve to provide a higher level of detail of information than that derived from the statutory financial statements, to reflect the performance of parts of the notified operator's business accurately.

[53] USO business - includes regulated wholesale components of Eircom's business that operate the USO network, and the related USO retail business.
[54] Fixed-line business - integrated fixed-line business, including wholesale and retail, and business and residential, including data communications and interconnect services. Mobile services are excluded.
[55] Group level – All or substantially all activities, undertaken by the Eircom Group, both regulated and unregulated, mobile and retail. In principle, it would exclude any businesses that are completely unrelated to the telecoms business, but at present the size of such businesses as a share of total Eircom revenue is very small.
[56] ComReg (2010), "*Response to Consultation Document No. 09/75 and Final Direction and Decision: Accounting Separation and Cost Accounting Review of Eircom Limited",* 10/67, 31 August 2010

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

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

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

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

Source: Oxera

6.34 To conclude this step of the assessment process, it is clear that the results depicted in Figure 5 clearly demonstrate Eircom's ability to earn a fair rate of return without compensation. With the ROCE for the fixed line business ranging from 19% to 26% from 2007 to 2012, it is significantly in excess of the pointed estimate of 10.21% and the upper end of the range of 11.08%. Reflective of this, Oxera state that *"the regulatory accounts (therefore) appear to give a clearer indication that Eircom has been consistently profitable, at the level of the business that has the USO, since 2006."*[57] This objective analysis has to be considered in tandem with the assessment of the materiality and causality of the positive net cost.

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

6.35 As set out in D04/11, ComReg is of the view that it is not appropriate to consider wider business activities impacting the ROCE at Group level, such as goodwill impairment, leveraging and debt in the assessment. This view aligns with the observations made by Oxera with respect to the eircom ltd accounts as filed with the Companies Registration Office (CRO) and the eircom group level accounts[58], *"to the extent that this financial performance is a result of significant borrowing requirements or wider business activities, it would follow from D04/11 that this would not be relevant to the determination of an unfair burden".*

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

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

Figure 6: Threshold analysis

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

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

Source: Oxera

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

6.38 Oxera considered the materiality range in the context of Eircom's regulatory accounts for each business area; the USO business, the fixed line business and the Group level business.[59] This analysis is considered in tandem with Eircom's ability to earn a fair rate of return.

[58] Filed under BCM Ireland Finance Limited
[59] Eircom's 'fixed-line' business includes Eircom's integrated fixed-line business, including wholesale and retail, and business and residential, including data communications and interconnect services. The 'fixed-line' business does not include mobile services. Eircom's 'group level' business includes all

6.39 Taking a high level view of this analysis, ComReg is of the preliminary view that a positive net cost of the USO which is within a threshold range of €6m to €22m may indicate a material impact on the USP, based on aggregated levels of revenue at each business level. Considering the fixed-line business in isolation, the materiality range of €9m to €18m has been ascertained, from a revenue perspective and €8m to €15m from a profitability perspective. Where the positive net cost is close to or within this range, materiality would need to be assessed on a case-by-case basis alongside other tests included in paragraph 6.20. With a proposed positive net cost of €5.1m for the 2009-2010 period, this falls below the lower end of the materiality range and therefore no further investigation would be required.

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

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

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

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

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

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or substantially all activities, undertaken by the Eircom Group, regulated and unregulated, mobile and retail.

6.4.1.4Preliminary conclusion

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

6.45 Formulation of ComReg's preliminary view with respect to Decision 40 of D04/11 primarily owes to the fact that Eircom earned a consistent and reasonable rate of return across all business areas, in particular the fixed line business. Oxera's report clearly states that *"analysis of the USP's profitability does not indicate that, with respect to Eircom's 2009–10 application, the first part of this test (i.e., a significant impact on the USP's profitability) is met. In the absence of a shortfall in profitability, it is in practice impractical to test the causes of the shortfall and in particular whether this results in an inability to compete on equal terms"*[60]. ComReg's preliminary view is that the proposed positive net cost falls below the lower end of the materiality range.

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

6.47 Given the conclusion that the positive net cost of the USO in the 2009-2010 period was not material to the profitability of Eircom, as discussed in section 6.4, ComReg concluded that a competitive distortion test, as defined in Decision 41 of D04/11 was not required for the 2009-2010 assessment.

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

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

6.48 Although it is not necessary for the 2009-2010 application and draft determination under D04/11 to consider Decision 41 of D04/11 for the reasons outlined in section 6.4.1.4 of this chapter, ComReg considers it beneficial to provide an outline of subsequent steps in the determination process, for the purpose of providing context for future applications, as relevant. Should the proposed positive net cost have passed the tests discussed, whereby the positive net cost proved to have a material impact on the USP and causality indicated that the USO business may be a root cause of the impact rendering it *“unable to earn a return consistent with the range identified (in section 3.2), and unable to cross-subsidise the USO”,* ComReg’s assessment would progress to Decision 41 of D04/11.

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

6.50 In subsequent years, should this step in the determination process be required, ComReg would assess, from both a static and dynamic perspective, the relevant criteria set out in Decision 42 of D04/11. This would serve to inform the assessment of relevant changes in the historical market share of the USP and further information on its key competitors by forming a view of whether *“competition is having a negative impact on the USP‘s revenue, or whether other factors, such as a decline in the overall market or the USP‘s lack of efficiency, could be responsible”.*[61] Like Decision 40, the relevant criteria, upon which the test outlined in Decision 41 of D04/11 would be based, are set out in paragraph 6.24.

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

[61] [61] Oxera (2013), *“Does the universal service obligation represent an unfair burden for Eircom”,* 1 February 2013

6.5 ComReg's preliminary view

Based on the analysis undertaken by Oxera with respect to Eircom's financial performance[62], ComReg is of the preliminary view that the positive net cost did not materially impact the profitability of Eircom for the period 2009-2010 for the reasons discussed throughout this chapter, irrespective of whether the positive net cost of either Eircom's application of €6,225,219 or ComReg's estimation of €5,095,545 is assumed. As such, ComReg is of the preliminary view that the positive net cost does not represent an unfair burden on Eircom. This conclusion would mean that a sharing mechanism would not be implemented for the positive net cost of the USO for 2009-2010 financial year.

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

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

Chapter 7

7 Adherence to D04/11

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

D04/11 Decision	ComReg's Assessment
1	Based on the assessment and review undertaken by TERA, ComReg is satisfied that Eircom's funding application adequately satisfies the criteria set out in Decision 1.
2	Based on the assessment and review undertaken by TERA, ComReg is satisfied that Eircom's funding application adequately satisfies the criteria set out in Decision 2.
3	ComReg is satisfied with the calculation of USO revenues on the basis that Eircom have included direct and indirect revenues that it would forego as a result of ceasing to pr ovide services to USO services to uneconomic customers.
4 & 5	ComReg is satisfied that the revenue scope for direct revenue incorporated by Eircom into its funding application corresponds to the definitions set out in Decision4 and 5.
6	ComReg is satisfied that the revenue scope for direct revenue incorporated by Eircom into its funding application corresponds to the definition set out in Decision 6. In addition to this, based on TERA's detailed analysis and findings, ComReg considers the principles and methodology of Eircom's approach to replacement calls to be appropriate.
7	ComReg is satisfied that given the lack of certain data Eircom altered its approach. ComReg would however recommend the provision of all available data in future applications. To substantiate the assessment of Eircom's adherence to the requirements of this decision, ComReg is would refer to comments included in paragraphs 4.12 - 4.17.
8	ComReg is satisfied that Eircom's funding application has been prepared on an avoidable cost basis, reflecting the costs incurred in the provision of the USO which a commercial operator would not ordinarily have provided, considering both OPEX and CAPEX for the 2009-2010 period.
9	ComReg is broadly satisfied that Eircom has adopted the appropriate methodologies in the preparation of cost and efficiency estimates.
10	ComReg is satisfied that Eircom has met the requirements of Decision 10, by excluding customers who were originally considered "uneconomic" and have

	now become profitable.
11	ComReg is satisfied that Eircom has met the requirements of Decision 11, by identifying uneconomic areas at an MDF level.
12	Based on the assessment and review undertaken by TERA respectively, ComReg is satisfied with the depreciation method applied.
13	Uneconomic customers in economic areas shall be identified based on universal account numbers (“UANs”). Eircom indicated that instead of UANs, customers are identified by their number and STD code for the following reasons; A UAN may have several lines and lines may move between accounts and cost information per UAN is not available. ComReg is broadly satisfied that Eircom has met the requirements of this Decision. As there was a lack of information beyond the control of Eircom, Eircom appropriately applied a probability approach, as per the below, in order to identify customers. Given the complexity of the task to identify each uneconomic customer by its number, the probabilistic approach is reasonable.
14	ComReg is satisfied that Eircom has adhered to the requirements of Decision 14 and Decision 12 with respect to the use of probability analysis.
15	Decision 15 of D04/11 prescribes that “(D)uring the course of ComReg’s assessment of a USO funding application, a number of sample “reality” checks will be undertaken". ComReg’s preliminary view is that any deviations from D04/11 are acceptable and that the application is fit for purpose, giving particular consideration to this Decision.
16	Having discussed minor issues with Eircom and having rectified these in the calculation of the direct net cost, ComReg is satisfied with the adjusted estimation of €88,608.
17	ComReg is satisfied with the approach, assumptions and calculations applied by Eircom in arriving at the directories avoidable cost estimate, with the exception of a necessary adjustment with respect to the NDD, as detailed in paragraph 4.41.
18	ComReg is satisfied with the approach, assumptions and calculations applied by Eircom in arriving at the disabled services avoidable cost estimate.
19	ComReg is satisfied that Eircom’s USO funding application is consistent and in accordance with D04/11. Notwithstanding, adjustments outlined in paragraphs 2.6 and 2.7, and also cognisant of Decision 20 of D04/11, ComReg is of the view that Eircom’s application satisfies this decision. ComReg however is of the view that recommendations on methodological and data provision improvements discussed throughout this document must be incorporated into any future USO fund applications. 2.62.7
20	ComReg is satisfied that Eircom’s USO funding application is fit for purpose.
21	ComReg is satisfied that Eircom's USO funding application is based on annual information which coincides with the 2009 - 2010 financial year, with the

	exception of consultant's fees.
22	ComReg is satisfied that an independent declaration, signed off by the Board of Directors of Eircom, accompanying the application, was provided. Similarly ComReg is satisfied that an AUPs engagement, approved by ComReg was undertaken by PwC to satisfy the requirement.
23	ComReg is satisfied that Eircom's application was supported by calculations in software which is reasonably capable of proper access and review. However using the calculation of lifecycle benefits as an example in section 5.3.4, Eircom and its consultant's must ensure all calculations can be fully validated in a comprehensive format in future assessments.
24	ComReg is satisfied that Eircom's application and supporting models were adequately transparent and sought to fulfil the requirement of Decision 24, in terms of the specific requirements of the application including the format of each USO services and relevant calculations and also in terms of general modelling best practice.
25	ComReg is satisfied that Eircom's application identified uneconomic customers appropriately and adequately considered the approaches to their identification as advised by ComReg.
26	ComReg has considered the issues of transparency and confidentiality of certain information in the context of the Regulations 11(7) of the Regulations, its Confidentiality Guidelines and international precedent with respect to the USO.
27	ComReg is of the view that sufficient information on economic payphones was provided by Eircom, particularly in respect of their location and proximity to other payphones operated by Eircom.
28	ComReg is satisfied that Eircom's application and financial models were adequately supported by comprehensive documentation.
29	ComReg is satisfied that data sampling was required when certain data could not be sourced, and that the requirement to do so was reasonably justified by Eircom.
30	ComReg is satisfied that Eircom's application is in accordance with ComReg Decision No. D07/10.
31	ComReg is satisfied that Eircom's engagement with independent experts for the purpose of the development of suitable methodologies and the preparation of the intangible benefits estimate has ensured that independent experts have completed the necessary calculations.
32	ComReg is satisfied that Eircom's application met the submission requirements with respect to timing. Where an extension was sought, ComReg is of the view that this way sought on reasonable grounds and in a manner that adhered to Decision 32.
33	ComReg has no comment with respect to this Decision, as it is not relevant to

	this year's assessment.
34	ComReg has no comment with respect to this Decision, as it is not relevant to this year's assessment.
35	ComReg is satisfied that Eircom's estimations assess the relevant benefits, including intangible benefits, to the USP.
36	Based on the analysis of both TERA and Oxera, ComReg is satisfied that there is no evidence of double counting and benefits accruing as a result of Eircom's USP status are only considered.
37	As discussed in paragraph 5.7, ComReg engaged with Oxera to review the estimate prepared by WIK. ComReg, cognisant of allowances in Decision 37, requested Oxera not only to review the estimate but provide recommendations to ensure the proper evolution of the methodologies used. Furthermore, as set out in D04/11, ComReg reserved its right with respect to implementation of alternative methodologies and as such has adjusted the estimates provided by WIK. Reasoning to support the justification of these adjustments is discussed throughout this chapter and detailed in Oxera's report.
38	Refer to Chapter 6 – "Determination of an unfair burden"
39	Refer to Chapter 6 – "Determination of an unfair burden"
40	Refer to Chapter 6 – "Determination of an unfair burden"
41	Refer to Chapter 6 – "Determination of an unfair burden"
42	Refer to Chapter 6 – "Determination of an unfair burden"

Chapter 8

8 Draft Determination

8.1 Statutory Powers

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

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

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

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

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

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

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

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

8.4 Determination

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

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

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

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

8.6 Pursuant to the determination of the positive net cost and in accordance with Regulation 11(4) of the Regulations ComReg has determined that the positive net cost does not represent an unfair burden on Eircom.

Chapter 9

9 Regulatory Impact Assessment (RIA)

9.1 A RIA is a structured approach to the development of policy, and analyses the impact of regulatory options on different stakeholders. ComReg's approach to RIA is set out in the Guidelines published in August 2007.[63] In conducting the RIA, ComReg takes account of the RIA Guidelines[64] issued by the Department of An Taoiseach in June 2009 and adopted under the Government's Better Regulation programme.

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

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

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

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

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

undertaken, if an application for a USF has been received. Therefore, a RIA is not being undertaken for this determination.

Chapter 10

10 Submitting Comments

10.1 The consultation period will run from Friday 10 May 2013 to Friday 21 June 2013, during which ComReg welcomes written comments. It is requested that comments be cross-referenced to the relevant question numbers from this document.

10.2 Having analysed and considered the comments received, ComReg will publish a response to consultation and Decision in due course.

10.3 In order to promote further openness and transparency, ComReg will publish all respondent's submissions to this consultation. However, ComReg must strictly maintain the confidentiality of any information provided to it in confidence. Electronic submissions should be submitted in an unprotected format so that they can be appended into the ComReg submissions document for publishing electronically.

Chapter 11

11 Consultation questions

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

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

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

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

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

Annex: 1 TERA - Assessment of Eircom's USO funding application

Annex: 2 Oxera - Assessment of WIK's calculation of intangible benefits

Annex: 3 Oxera - Does the universal service obligation represent an unfair burden for Eircom?