Commission for
Communications Regulation

Consultation Paper

Consultation on a Retail Price Cap as a Potential Remedy on Fixed Narrowband Access Markets – Part II.

Consultation and Response to Consultation 06/41

Document No:	**07/48**
Date:	**26 July 2007**

All responses to this consultation should be clearly marked:- "Reference: Submission re ComReg 07/48" as indicated above, and sent by post, facsimile, e-mail or on-line at www.comreg.ie (current consultations), to arrive on or before 5:30pm on Thursday 30 August 2007, to:

Ms Michelle Townshend
Commission for Communications Regulation
Irish Life Centre
Abbey Street
Freepost
Dublin 1
Ireland

Ph: +353-1-804 9600 Fax: +353-1-804 9680
Email: retailconsult@comreg.ie

Please note ComReg will publish all respondents submissions with the Response to this Consultation, subject to the provisions of ComReg's guidelines on the treatment of confidential information – ComReg 05/24

Contents

1 Foreword

On behalf of the Commission for Communications Regulation ("ComReg"), I am pleased to announce the second consultation on a retail price cap ("RPC") as a potential remedy on fixed narrowband access markets.

ComReg has recently carried out an assessment of competition and developments in the markets for retail fixed narrowband access.[1] ComReg provisionally concludes that eircom has maintained dominance in the provision of access services to consumers even in the presence of wholesale regulatory measures and regulation in adjacent markets, such as LLU.[2] Following on from this, ComReg proposes to continue to regulate eircom's retail access services by putting in place an individual price cap each on lower and higher level access markets having had regard to conditions in each of those markets.

A RPC continues to be necessary to prevent eircom from introducing excessive increases in access prices. The objective for imposition of a RPC is to ensure that prices for retail customers reflect efficient cost and that eircom has incentives to deliver services as efficiently as possible. In order to meet this objective, ComReg proposes to introduce, from the end of September 2007, individual price cap(s) on each of the lower and higher level access services. In addition, ComReg proposes to introduce a sub cap on basic telephone line rental (PSTN) within the overall basket cap on lower level access services.

In setting the level of a RPC ComReg has sought to find the best balance between the interest of consumers and the long term sustainability of the industry. ComReg proposes that a CPI-CPI cap (constant prices) on each of the lower and higher level access services for a period of 12 months beginning on the start date of the proposed RPC and a CPI-0 cap (inflationary increases) in subsequent price cap years with a sub cap (CPI-CPI and CPI-0) on basic line rental will best achieve this balance.

The proposals in this document would prevent prices for line rental and connections from rising above the level of inflation, safeguarding consumers until such time as competition is operating effectively. ComReg is mindful that setting too stringent a retail price cap could have a potential adverse effect on service innovation and long term investment. Views on the proposals set out below are sought by 5:30pm on Thursday 30 August 2007.

Mike Byrne
Chairperson

[1] In Document 07/26, ComReg identified a national market for lower level retail narrowband access and a national market for higher level retail narrowband access. Access via analogue exchange lines over copper, FWA and ISDN basic rate access (BRA) and access via ISDN fractional rate access (FRA) and ISDN primary rate access (PRA) respectively.

[2] Local loop unbundling.

2 Executive Summary

2.1 This Document is part of ComReg's ongoing review of the appropriateness, or not, of a retail price cap ("RPC") as a potential remedy for narrowband access services in light of changing market circumstances.[3]

2.2 ComReg's preliminary views on competition are set out in Document 07/26. Following this, ComReg identified that a RPC for these relevant markets may be appropriate. Document 07/26 also indicated that the current Price Cap Order[4] is maintained pending the final outcome of ComReg's consultations on a RPC as a potential remedy on the retail fixed narrowband access markets. A future RPC on these markets, if applied, will constitute a remedy flowing from Regulation 14 of *the Universal Service Regulations*.[5]

2.3 ComReg retained Frontier Economics to undertake an analysis of eircom's efficiency in relation to narrowband access services for purposes of proposing an appropriate level of price cap, if deemed necessary. Based on the final competition assessment and the outcome of the financial modeling, ComReg's proposal is to continue to regulate eircom's retail access services by putting in place an individual price cap each on lower and higher level access services having had regard to conditions in each of those markets. Any RPC remedy will be reviewed in line with any future assessments of SMP in these markets.

2.4 ComReg proposes to impose a CPI-X price control on eircom where CPI is the annual percentage change in the Irish Consumer Price Index and "X" is the adjustment specified by ComReg taking account of such factors as eircom's efficiency, competition and investment.

2.5 The purpose of this document is to set out ComReg's proposals for setting a RPC and the issues that ComReg considers pertinent to the making of a remedy Decision. Its purpose is also to elicit the views of interested parties on those issues and on any other issues that are considered relevant to ComReg's task. ComReg's key proposals are as follows:

- Separately apply a CPI-X price cap each on lower level access services[6] and higher level access services.[7]

---

[3] It follows on from ComReg Document(s) 06/39 "Market Analysis – Retail Narrowband Access Markets", 06/41 "*Retail Price Cap as a Potential Remedy on Fixed Narrowband Access Markets – Part 1*" and 07/26 "Market Analysis – Retail Narrowband Access Markets (response to consultation and consultation on draft decision". These documents should be read in conjunction with this consultation.

[4] Telecommunications Tariff Regulation Order 2003, S.I. 31 of 2003.

[5] The European Communities (Electronic Communications) (Universal Service and Users' Rights) Regulations 2003 which transposed Directive 2002/22/EC of the European Parliament and the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services, in to Irish law.

[6] The provision of telephone exchange lines, ISDN BRA lines, and telephone exchange line and ISDN BRA connection and takeover.

[7] The provision of ISDN FRA and PRA lines, ISDN FRA and PRA connections and takeover.

- eircom's proposed new access prices to remain in place (constant prices) for a period of 12 months beginning on the start date of a RPC with a CPI-CPI cap on each of the lower and higher level access markets and/or services;

- To permit access prices to move in line with inflation in subsequent price cap years with a CPI-0 cap on each of lower and higher level access services;

- Subject basic line rental (PSTN) to a separate sub cap of CPI-CPI for a period of 12 months beginning on the start date of a RPC and move to a CPI-0 cap for subsequent price cap years.

- A price control duration of approximately 3 years in line with the market review process for each of the proposed price controls;

- Carryover should only be allowed on a discretionary and not automatic basis.

2.6 A draft Decision instrument containing the proposed price cap mechanism is included for consultation purposes (Appendix A). A final Decision is planned for the end of September 2007 after a full consideration of the responses to this consultation.

2.7 The remainder of this document is structured as follows:

- Section 3 outlines the process to date in relation to a RPC as a potential remedy on fixed narrowband access markets.

- Section 4 sets out the responses to consultation 06/41 on the potential need for a retail price control and on possible options concerning its scope and ComReg's proposals on the same.

- In section 5, ComReg's methodology and proposals for setting a RPC for the relevant services are outlined.

- Finally, section 6 provides interested parties with details of how and when comments to this consultation should be submitted.

- Appendix A sets out the draft Decision Instrument

- Appendix B sets out the Regulatory Impact Assessment (RIA)

- Appendix C is a Report by Frontier Economics on behalf of ComReg

- Appendix D provides a summary of the consulation questions

3 Introduction

3.1 From Document 07/26, ComReg has provisionally determined that the Markets are not effectively competitive and has concluded that obligations imposed under the Access Regulations or Regulation 16 of the Universal Service Regulations would not alone achieve the objectives of promoting competition whilst protecting the interests of consumers.[8]

3.2 On 21 August 2006, ComReg began the process of consulting on the potential need for a RPC, in the event that ComReg concludes that eircom has SMP in these markets and, on possible options concerning its structure.[9] This consultation document was the first of two consultations in relation to this issue. ComReg set out the provisional view that some form of price control was necessary on some or all retail fixed narrowband access services in order to ensure that prices for retail consumers are at a competitive level. It identified potential options for regulation of the access markets:

- Regulatory forbearance
- Imposing caps on individual markets and/or services, and
- Cost orientation requirements

3.3 ComReg solicited respondents' views on, amongst other things, the appropriate price control structure and indicted that in the event of the view that eircom has SMP being maintained, it would issue a second consultation on a potential level and form of a price cap.[10] ComReg has reviewed carefully and in detail all of the responses it has received to 06/41 and would like to thank all those who responded to the consultation.

3.4 This is the second consultation on a RPC as a potential retail access remedy. It summarizes the substantive issues raised by respondents, identifying the arguments and evidence that ComReg considers most relevant to making decisions about a future access price cap. It also outlines ComReg's proposals on which services should be subject to a price cap. Section 5 outlines ComReg's methodology and proposals for setting a RPC for the relevant services. ComReg's objective is to (i) ultimately determine an appropriate "X" factor for use in a CPI –/+ X formula and (ii) to assess the potential impact on the market of different price cap structures and levels. Frontier Economics has worked with ComReg to identify an appropriate level and form of a RPC. Appendix C sets out their methodology and key recommendations and conclusions based on analysis of eircom's efficiency in relation to narrowband access services.

[8] Set out in s 12 of the Act of 2002.

[9] 06/41 "*Retail Price Cap as a Potential Remedy on Fixed Narrowband Access Markets – Part 1*".

[10] No proposals for the level or structure of any overall price cap or for the need for separate caps or sub caps were made in the initial consultation.

4 Response to Consultation 06/41 and ComReg's Position

4.1 Document 06/41 set out ComReg's preliminary view that some form of a retail price cap continues to be necessary for at least some of the retail services provided by eircom in fixed narrowband access markets.[11] Potential options for *ex ante* regulation were identified for these markets: forbearance, imposing caps and cost orientation requirements.

4.2 ComReg solicited respondents' views on issues ranging from possible objectives for a RPC to which services should be included in any cap and on an appropriate price control structure. It received detailed submissions from 5 industry players (Alto, BT Ireland, eircom, Imagine and Vodafone) and 28 individual respondents. In the following section, ComReg considers which services, if any, should be regulated and the form of any price cap. In each case the summary of the respondents views are presented together with the final position of ComReg.

Appropriateness of a RPC

4.3 Respondents were asked whether they agreed that, in addition to wholesale measures, some form of RPC remedy was an appropriate and proportionate form of regulation in light of changing market circumstances for retail access services.

Respondents views on intervention at the retail level

4.4 With the exception of two respondents, all agreed that a RPC continues to be necessary and that higher level access should also be subject to a RPC. All consumer responses felt that it was necessary to have a RPC continue in particular for basic line rental as this service was seen by respondents to be of most importance. Those respondents who proposed a cap for higher level access services submit that although OAOs have gained greater market share in this market *eircom* remains dominant. They submit that recent instability in the fixed market and the fragile nature of the remaining competition indicates that these consumers still require protection through a specific RPC.

4.5 The two respondents opposing the imposition of a RPC argue that the existing regulatory measures at the wholesale level are sufficient. In addition, price trends would indicate there is an effective competitive constraint on eircom in respect of access services. One respondent submits that higher level products face a different competitive market than lower level, in that substitution to mobile is less relevant, but provision of alternative services is increasing. This respondent argues that a RPC is not required to prevent price increases for higher level consumers and cautions

[11] The current Price Cap Order is maintained pending the final outcome of ComReg's consultations on a RPC as a potential remedy in retail narrowband access markets.

that a RPC which requires price reductions may damage competition and give rise to significant administration costs. The respondent also submits that prospective market developments such as possible vertical separation of the regulated fixed line businesses will act as a constraint on pricing.

ComReg's Position

4.6 ComReg's view on forbearing from intervention in retail access is set out in 06/41,[12] and remains unchanged. To forbear in narrowband access is premature in the face of eircom's continued dominance in both lower and higher level access markets. Document 07/26 highlighted that eircom's market share is over 83% in the lower level access market and approximately 66% in the higher level access market at the end of December 2006. ComReg's SMP analysis noted that eircom's high market share in the lower and higher level access markets had not been appreciably mitigated by other factors. Significantly, the analysis indicated that despite the presence of wholesale regulation (e.g. SB-WLR, CPS, supporting measures and wholesale measures in related access markets such as LLU), competition is not yet effective in the retail narrowband access markets nor is it expected to be within the lifetime of the review. It is of note that while indirect wholesale measures have facilitated the development of limited competition in these markets they have not served to remove eircom's market power. Further, it should be recognised that absent these measures eircom's dominant position would be further enhanced.

4.7 Wholesale-only intervention is not sufficient of itself at this stage to adequately protect consumers who are likely to face larger rises in access prices. It will take time for the intended effect of those conditions to come to full effect i.e., to improve competition in the retail market across all areas and end users. As yet, ComReg does not see indications that these service-based measures, or infrastructure based competition through cable networks or ULL would change the quasi-monopolistic supply structure sufficiently as to remove any need for retail price regulation within the period of this review. ComReg will monitor closely any developments in relation to possible vertical separation of the regulated fixed business. However, there is no evidence at this point to suggest that such a split would be made within the timeframe of this review.

4.8 Concerning a RPC for individual access markest and/ or services, the last consulation also indicated a preference for some form of a price cap on lower level access while leaving open the issue of subjecting higher level access markets and/or services to a price cap remedy.[13] ComReg remains of the view that a RPC on lower level access is the minimum necessary to safeguard consumers against large increases in basic line rental. In the provision of lower level access services (principally residential customers and SMEs) the

[12] Section 4, paragraphs 4.11 to 4.18.

[13] Reasons for the proposed inclusion/exclusion of services were dicussed in section 4 of consulation 06/41.

incumbent operator has maintained a very strong position due in part to high barriers to entry. In the absence of some form of a price control to address eircom's SMP, retail consumers are likely to face larger increases in access prices.

4.9 ComReg has considered the possibility of restricting price control to lower level markets and services, with greater competition for higher level services from Other Authorised Operators (OAOs) directly connecting customers. ComReg is of the view that complete removal of price control on these services is not appropriate at this stage. Since the initial consultation one operator has exited the fixed line telephony market. Mobile services are unlikely to be an effective substitute for consumers of higher level access services. Barriers to entry are such that without regulatory intervention via CPS/WLR competition would be restricted in higher level access. Furthermore, as discussed below, the financial analysis does not provide any evidence that higher level prices should be excluded from the price control.

4.10 ComReg believes that there are strong arguments for maintaining a price control on both higher and lower level narrowband access services. Due to the continued need for a retail price cap on both narrowband access markets and/or services, ComReg considers issues around the structure of a potential future RPC mechanism in the following paragraphs.

Structure of a Price Control

4.11 ComReg identified in 06/41[14] options pertaining to a possible structure of a RPC:

- Overall global cap (containing both higher and lower level access markets with a possibility of sub caps)

- Individual price cap(s) on either each identified SMP market or on specific access service(s).

Respondents views on the form of price control

4.12 Views from respondents on a potential form of a RPC were mixed. In general the majority of industry respondents believe for a number of reasons that a global cap would be appropriate. Two respondents who oppose the imposition of any RPC submit that, should ComReg conclude a price cap is required, a global cap is most appropriate and least burdensome as it allows a degree of pricing flexibility and reduces probable error in modeling costs. One of these respondents believes in competitive markets, a supplier should have flexibility in deciding whether or not to recover initial costs from a connection fee or rental. Another respondent believes that ComReg must avoid any move towards micro-management of individual tariffs by imposing individual caps or sub-caps. However, this respondent submits that a

[14] Paragraphs 4.31 to 4.37.

relaxation of the price control could be achieved by a narrowing of the scope of the global price cap by excluding those services considered most subject to competition.

4.13 One respondent believes that an individual cap on each regulated market is appropriate as tariff rebalancing is no longer required across a number of products. This respondent also believes that individual caps can be tailored to suit the specific market conditions more precisely than a general cap and can protect against potential leveraging in markets. In the event that a global basket is used, on respondent submits that specific sub-caps should also be employed. These respondents are not aware of any change to market conditions that might alter the level of competition in the relevant market review period to warrant dropping price control.

4.14 Respondents were also asked where an individual cap on a specific access market is preferred should this be a narrow cap (for instance, on line rental only) or expanded to include other access services such as connection. In the event that separate individual caps are required either on each of the lower and higher level access market, all but one respondent felt that while the cost of basic line rental is of most importance it is necessary to include all access services in the individual cap (either PSTN or ISDN). One respondent believes that if individual cap are to be applied on lower or higher level access markets then a narrow cap on line rental (either PSTN or ISDN) is most appropriate.

4.15 Finally, one respondent submits that an exception to a narrow cap might be an individual cap for vulnerable users. This respondent believes that and RPC should focus on the basket of services purchased by vulnerable users while allowing flexibility to set prices that reflect both costs and competitive conditions. Another respondent submits that concerns over the protection of low spending customers could be more effectively addressed through strengthening the existing vulnerable user scheme. ComReg notes the views of respondents in this regard and plans to consult on the issue of affordability under the USO Regulations in quarter 4 of 2007. [15]

ComReg's Position

4.16 ComReg proposes to separately apply a CPI-X price cap each on lower level access services and higher level access services. As lower level and higher level access are considered separate markets[16] it is more appropriate to apply separate individual retail price caps on each relevant market (lower and higher access considered separately). The recent competition assessment of these markets indicated greater prospective competition for higher level access services. Competitive pressures would appear to exist in the higher

[15] National legislation requires the designated universal service provider to maintain the affordability of basic services.

[16] In Document 07/26, ComReg identified a national market for lower level retail narrowband access and a national market for higher level retail narrowband access.

level access market even if they are not yet strong enough to counteract eircom's market power. The introduction of a separate cap for higher level access consumers will allow freedom for competition to develop. A cap which might require large price reductions may damage rather than increase competition and such an observation has been considered when setting the X factor for higher level access.

4.17 In Document 06/41, ComReg indicated that it may be appropriate and proportionate for eircom to have some flexibility to alter charges within a general basket cap on overall retail access charges, for example, in the presence of joint or common costs.[17] Frontier Economics analysis of costs show that the level of common costs between higher and lower level access services is relatively small and therefore these markets should be capped separately.

4.18 Including higher level services in a broader basket would allow eircom slightly greater freedom in cost recovery and how it wishes to structure its charges. Since a global cap allows *eircom* a degree of flexibility, it will not necessarily prevent *eircom* from potentially introducing excessive prices increases for access even where it does apply. A specific cap on the lower level access market offers consumers better protection where concerns over exploitation of market power may be most significant. In addition separate baskets for lower and higher level access would increase the certainty around future cost and tariff paths for these consumers and will ensure that the alignment of costs and price in respect of lower level access services is maintained. From above, in relation to higher level access it would be appropriate to developing sustainable markets.

4.19 To the extent that additional protection is needed in respect of basic line rental (PSTN) then an additional specific cap or sub cap within a basket cap for lower level access services might be required to ensure these customers benefit from any price cap control. Placing both connection and rental products in the same basket gives eircom some flexibility to set the relative levels of connection and line rental prices. A specific sub cap to limit eircom's flexibility in the pricing of the basic line rental service (PSTN) within the overall basket cap on lower level access services may be a proportionate and appropriate regulatory response in order to avoid that eircom would introduce, within the boundaries of a basket cap on lower level services, excessive price increases to the detriment of retail consumers. The appropriateness or not of a sub cap is discussed below in relation to setting the X factor for lower level access services.

4.20 Further the competition assessment of narrowband access markets and noting the respondents views, ComReg believes that objectives will be best met by introducing individual caps each on lower level access (connection and rental) and higher level access (connection and rental).

[17] The cost of providing access may be shared with or common to the provision of other services.

Cost orientation

4.21 The views of respondents were mixed as to whether a cost orientation obligation can be an effective control as an alternative to a price cap. One respondent believes a cost orientation obligation on its own would not be sufficient though it could be imposed in addition to a price cap. It was suggested that one advantage of a price cap is that once established it is easier to check compliance than it is to verify cost orientation. Arguments against the imposition of a retail cost orientation obligation alluded to the sufficiency of wholesale obligations and evidence of significant and developing competition at the retail level.

4.22 Document 07/26 set out reasons why the current cost orientation[18] obligation is maintained pending the further consultation on a RPC as a potential remedy for narrowband access markets. In the event that a RPC is imposed or that is no longer warranted following this further consultation on the issue, ComReg proposes to remove the cost orientation obligation once a new RPC, if any, is fully and effectively implemented. The cost orientation obligation would be superfluous to any price cap. Where there are uncertainties in allocating costs to specific services a more effective remedy is to include SMP access services in a retail price control to guard against excessive prices and reward efficiency gains. Price caps are set for a period of years and not revisited in principle until the end of the period. A RPC cap, therefore, may increase the certainty around future cost and tariff paths and may be more appropriate to developing sustainable markets.

4.23 One advantage of price caps is that they give eircom the incentive to lower its costs and run a more efficient business, as they set a maximum price, thus if eircom manages to lower its costs significantly over the period of the cap, it will gain benefits. This does not hold in the case of a cost orientation obligation; thus price caps protect consumers but also give better incentives to operate efficiently.

Conclusion

4.24 In relation to a potential scope and structure of a retail price cap, ComReg's proposal is to separately apply a CPI-X price cap on each of lower level services and higher level services. The objective of protecting against potential excessive pricing is better addressed directly through a RPC and it also has better incentive properties. A cost orientation obligation is superfluous to any price cap and therefore would likely be removed pending the outcome of this further consultation on a RPC as a potential remedy for access markets.

[18] Under Regulation 21 of the European Communities (Voice Telephony and Universal Service) Regulations, 1999.

Q. 1. Do respondents agree with the range of services that ComReg proposes to include in a narrowband access cap? If so, do respondents agree ComReg's objectives are likely to be met with a specific cap on each of lower level and higher level access markets?

5 Proposals for Setting a Retail Price Cap

5.1 Based on the final competition assessment[19] and the outcome of the financial modeling conducted by Frontier Economics (Appendix C refers), ComReg's proposal is to continue to regulate eircom's retail access service by putting in place an individual price cap each on lower and higher level access markets having had regard to conditions in each of those markets. Any RPC remedy will be reviewed in line with any future assessments of SMP in these markets.

5.2 On the basis that individual caps will be set (lower level and higher level access markets and/or services considered separately), ComReg proposes that the level of a cap on each access market will also be set separately.

5.3 Under the terms of the existing Price Cap (Statutory Instrument 31 of 2003) eircom have recently notified its intention to increase certain access prices in by 4.9% with effect from 30 July 2007. If, as proposed by eircom, line rental prices increase prior to the completion of this consultation process and before any final decision on a RPC is made, ComReg proposes to adjust the level of the price cap in the first year of a price control such that eircom's proposed new access prices would remain in place (constant prices) for a period of 12 months beginning on the start date of a RPC. ComReg further proposes to permit eircom's access prices to move in line with inflation in subsequent price cap years.

5.4 In setting the level of a cap ComReg considers the price of basic line rental to be of most importance and will ensure that the efficient cost of this service is recovered in an appropriate way. Thus ComReg proposes to subject basic line rental (PSTN) to a separate sub cap which would also operate on the basis of CPI-CPI for a period of 12 months beginning on the start date of a RPC and move to a CPI-0 cap for subsequent price cap years.

5.5 The following section sets out the proposed approach to setting individual price cap(s) each on lower and higher level access markets and associated X factor(s).

Form of the control

5.6 ComReg proposes to subject eircom's access prices to a CPI-X price control where CPI is the annual percentage change in the Irish Consumer Price Index and "X" is the adjustment specified by ComReg.[20]

---

[19] ComReg has taken in to account all indicators of competition in assessing the appropriateness of a RPC.

[20] The prevailing price control on *eircom* in respect of retail price capped services is a CPI- X price cap.

Appropriate inflation measure

5.7 ComReg proposes that CPI is used as a measure of inflation rather than an industry specific measure or a GDP deflator as the CPI gives consumers clear and predictable signals about prices. To date in Ireland retail price caps on telecommunications services have relied on CPI figures as published by CSO. ComReg see no reason to move to alternative inflation measures because of its advantages in terms of timeliness, lack of revision and general acceptance. The ΔCPI which eircom have been required to use for compliance under the 2003 Price Cap order is calculated using the change in the CPI index for the period December to December. ComReg propose that the CPI figure used under the new caps should be the July to July figure as published by CSO. This represents a recently published figure at the start of the cap year.

Potential cost pass through mechanism

5.8 As any new RPC will be determined with reference, *inter alia,* to *eircom's* cost, in practice, the proposed price control can be considered a hybrid of price cap and cost pass-through methodologies. To ensure competitive neutrality, Frontier Economic's analysis of costs for the provision of retail access services has used ComReg's previously determined forward looking LRIC ULMP charge as an input.[21] For the purposes of their cost analysis, Frontier Economic's takes the cost of the local loop to be the existing ULMP charge and, as such, the focus of their cost analysis is on the retail cost components required to deliver the narrowband access services.

5.9 In the event that local loop costs experience increases different than inflation, the proposed CPI-X formula may be adjusted to allow for "pass through" of some changes, if any, to the real cost of the local loop.[22] A system of pass through could offer eircom the opportunity of passing on reductions generated by any change in the real cost of the loop to retail consumers before the next RPC review or safeguard eircom against increases in loop costs significantly different than inflation.

5.10 However, a key objective of a price cap on lower and higher level access services is to provide consumers with protection against any potential exploitation of market power, such as excessive pricing. Automatic pass through to consumers of changes to real loop cost may not therefore be appropriate. Given forward looking LRIC prices for local loop unbundling a certain level of efficiency is already assumed in the model of the network access costs. ComReg's determination of the ULMP charge set a mechanism for updating the price - the price changes on 1 December each year based on

[21] The base forecast is based on the unit cost being allocated being equivalent to the current ULMP charge, indexed to inflation.

[22] In the event that pass through was deemed appropriate, the price cap formula would then be CPI- X + w.Y, where w is the weight of the local loop in the end to end costing and Y is the real change in local loop cost.

the change in inflation. In addition, there is no guarantee that consumers will automatically benefit from unexpectedly low local loop costs.

5.11 For the purposes of setting a RPC, ComReg does not, at this stage, propose to adjust the CPI-X price control at this stage to allow for an automatic pass through of changes in loop costs. A review of the ULMP charge is planned at the end of 2007. In the event that there was evidence that market conditions had changed such that local loop costs were significantly different than inflation, ComReg may consider a review of the RPC when any determination on ULMP prices is finalized. This proposed approach should achieve a balance between the protection of consumers and the ability of *eircom* to recover appropriate costs in the provisioning of retail narrowband access services.

Q. 2. Do respondents believe that ComReg should continue to regulate eircom through a CPI-X price cap or should there be an adjustment to the price cap formula to permit a cost pass through?

Setting X factors

5.12 One of the key inputs into a CPI-X price control is the efficient level of costs required to deliver current levels of access services provided by eircom as compared to its existing levels of cost. Frontier Economics has carried out, on behalf of ComReg, an analysis of the current efficiency of eircom's cost base and also a forecast of the future operational and financial performance of eircom in relation to narrowband access services. Appendix C sets out the methodology used by Frontier Economics and describes the process of financial modeling underlying the estimation of an appropriate X factor and conclusions of this analysis.

5.13 It is important to note that Frontier Economic's analysis of the cost of provision of narrowband access services is based on the current level of eircom's access prices and does not take into account the wider market analysis conducted by ComReg. The following estimates of X reflect a sensitivity analysis conducted around assumptions underpinning the financial analysis.

5.14 Based on the current level of eircom's access prices and the efficient level of costs including the cost of capital of 11.5%,[23] Frontier Economics derived a range of estimates for X for individual caps on each of the lower and higher level markets:

- The range of estimates for the value of X for a basket of the lower level services is 0 to 2, implying prices being stable or falling slightly in real terms.

[23] The appropriate level of WACC for eircom is currently under review by ComReg.

- The range of estimates for the value of X for a basket of the higher level services is 16 to 18 implying a significant annual reduction in prices in real terms.

5.15 ComReg has used the forward looking financial modeling work, in conjunction with the wider assessment of market power in narrowband access markets, to estimate an appropriate level of a cap for each of the lower and higher level access markets and to assess the potential impact on these markets of different price cap proposals. ComReg has assessed how different levels of cap and structures might affect prices for individual services and how these might affect eircom's revenues and rates of return under a range of different assumptions and scenarios carried out by Frontier Economics.

5.16 As the X factors are not set simply on the basis of expected future efficiency gains, ComReg has considered the potential impact a decision on the level and structure of a price cap may have on consumers, competition and investment.[24] Appendix B sets out seven regulatory options ComReg considered when deciding whether a RPC on the higher and lower level access markets were necessary. It sets out the potential impacts on stakeholders and competition of these options and from the options assessment provisionally identifies the best option.

ComReg's Proposal for a level and structure of a RPC

5.17 For the purposes of setting an appropriate X factor, one key dimension ComReg has considered is the *initial* price if a cap is imposed. Frontier Economics derived a range of estimates for X for each basket cap (lower and higher level access considered separately) based on eircom's current prices. As discussed above, eircom plans to introduce new prices on the 30 July, 2007 and ComReg proposes that the level of any RPC cap be adjusted accordingly. This adjustment could be carried out by an adjustment to relevant access prices at the start of a new price cap, through holding prices constant in the first price cap year or by increasing the level of X over the full period of any price control.

5.18 ComReg does not propose to require eircom to reduce some or all of its access prices at the very outset of the price cap where overall narrowband access revenues appear to be broadly in line with the estimated level of efficient cost. The second option, a CPI-CPI cap (constant prices) in the first year of a RPC would seem to have the advantage of reducing the allowable increase in access prices for that period which would bring access prices again into line with efficient costs over the period of the price control. A constant CPI-CPI cap on eircom's new prices for the first year of the control and a CPI-0 cap thereafter would broadly achieve the same objectives of a CPI-0 cap on eircom's existing access prices over the full period of any cap.

[24] The Memorandum to the Recommendation on Relevant Markets, page 14.

5.19 For transparency and certainty of retail prices for consumers and to ensure new prices are embedded in the market place, ComReg proposes that eircom's planned new access prices should remain in place (constant prices) for a period of time and would propose to apply a CPI-CPI cap on each of the lower and higher level access markets and/or services for 12 months beginning on the start date of a RPC. This implies that eircom would not be permitted to further increase prices for a period of 12 months following the introduction of any new price cap. Application of a CPI-CPI cap would have the effect of protecting consumers from a potential second line rental increase within a period of a year, would bring prices back in line with efficient cost in the lower level market and would not negatively affect competition in the higher level market.

5.20 For the remaining years of any RPC, ComReg proposes to allow eircom's access prices to move in line with inflation. Each of the lower and higher level access services would then be subject to a cap of CPI-0%. This implies that prices for line rental and connections will be maintained broadly in line with their efficient costs or falling slightly in real terms. For lower level access services, Frontier Economic's cost analysis provides the range of estimates for X is 0 to 2%. ComReg proposes to subject prices for lower level access services to a more conservative level of cap, a CPI-CPI cap followed by a CPI-0 cap, as this would prevent prices of basic access services from rising quicker than the rate of inflation safeguarding consumers until such time as competition is operating effectively. It will also ensure that the alignment of costs and price in respect of lower level access is maintained. Note that ComReg is not currently proposing the stricter option on eircom of CPI-2 cap.

5.21 In setting a level of cap for higher level access markets and/or services, ComReg proposes to also subject these prices to a more conservative level of cap, a CPI-CPI cap followed by a CPI-0 cap. From Frontier Economic's cost analysis a more significant real term price reduction might be required to ensure that prices for higher level access consumers are brought in line with efficient cost, as the current level of prices for higher level services are above cost. However, ComReg is mindful that setting too stringent a retail price cap could have a potential adverse effect on competition, service innovation and long term investment. The market analysis indicated greater prospective competition in this market. A safeguard CPI-0 cap will allow further competition to develop in respect of higher level access services which in itself would act as a check on prices.

5.22 Finally, ComReg proposes to subject basic line rental (PSTN) to a separate sub cap of CPI-CPI (constant prices) for a period of 12 months beginning on the start date of a RPC and move to a CPI-0 cap (inflationary increase) thereafter. Placing both connection and rental products in the same basket gives eircom some flexibility to set the relative levels of connection and line rental prices. A specific sub cap to limit eircom's flexibility in the pricing of the basic line rental service (PSTN) within the overall basket cap on lower level access services is a proportionate and appropriate regulatory response in order to avoid that eircom would introduce, within the boundaries of a basket cap on lower level services, excessive price increases to the detriment of retail consumers.

5.23 From above, eircom has recently indicated its intention to increase certain access prices by 4.9% with effect from 30 July 2007. The price of PSTN line rental would change from €24.18 to €25.36 including VAT. The use of a sub cap is aimed at further protecting consumers from potentially larger rises in the price of the basic line rental service and would offer consumers better protection where concerns over exploitation of market power is likely to be most significant. ComReg notes the respondent's views that the cost of basic telephone line rental is of most importance to retail consumers and aims to ensure that the efficient cost of this service is recovered in an appropriate way.

Conclusions

5.24 In relation to an appropriate structure and level of RPC, ComReg proposes that the level of a cap on each access market will be set separately at CPI-CPI (constant prices) in the first price cap year and move to a CPI-0 cap (inflationary increases) for the remaining years of a RPC. In addition, ComReg proposes to introduce a separate sub cap on basic telephone line rental within the overall basket cap on lower level access services again of CPI-CPI in the first twelve months and move to a CPI-0 thereafter.

5.25 ComReg provisionally concludes that the above proposals in relation to the setting of an appropriate structure and level of a RPC will best achieve its objectives of protecting consumers and the long term sustainability of the industry.

Q. 3. Do respondents agree with ComReg's proposal to apply a CPI-CPI cap (constant prices) on each of the lower and higher level access services for a period of 12 months beginning on the start date of the proposed RPC and a CPI-0 cap (inflationary increases) in subsequent price cap years together with a sub cap (CPI-CPI and CPI-0) on basic line rental? Please elaborate your response.

Q. 4. Do respondents agree with ComReg's proposal to introduce a specific sub cap on basic telephone line rental (PSTN) within the overall basket cap on lower level access services of CPI-CPI in the first twelve months and move to a CPI-0 thereafter? Please elaborate on your response.

Start Date for Any New Control

5.26 From above, ComReg expects to introduce a new price cap each on both the lower and higher level access markets at the end of September 2007, if deemed appropriate after a full consideration of the responses to this consultation. The current price cap control operates on an annual basis which runs from 4 February to 3 February in the following year. ComReg proposes that, should a RPC be imposed, any future price cap year would also operate on an annual year basis and would run from the end of September to the end of September. ComReg notes that this would correspond better with eircom's financial year following their change in financial year end in 2007.

Q. 5. Do respondents agree with the approach ComReg proposes to take with regard to the start date and operation of any future price cap year?

Duration of controls

5.27 The duration of price controls is largely a balance between minimising forecast error and providing incentives for efficiency improvements. All other things being equal, a longer duration gives more incentive on the part of eircom to introduce cost reductions. A longer duration also provides greater regulatory certainty for the market and reduces any potential regulatory burden. Too short a price cap control may result in reduced effort by the regulated operator to make efficiency gains over and above those forecast, in the belief that such gains will be clawed back by ComReg in the next price control review.

5.28 The current system for regulating retail prices is 3 or more years. Most models suggest 2-5 years as the optimal period between resetting the price cap. ComReg proposes a price control of approximately 3 years. As basic line rental prices are broadly in line with costs and in view of prospective developments in telecoms markets (market evolution such as the potential introduction of next generation networks) the proposed price control period would appear appropriate. The narrow scope of a price control on access would also suggest that a somewhat shorter price control could be preferable.

5.29 A review in approximately 3 years would align the review of the price cap remedy with the ongoing market analysis process and a review of SMP in these markets. ComReg proposes that for certainty any RPC would remain in place for an indefinite period or until such time as it is amended or withdrawn by a market review. At this time another review is envisaged circa the proposed 3 years.

Q. 6. Do respondents believe the removal or continuation of a price cap should be considered in line with any future assessments of SMP in retail narrowband access markets? If a specific duration is set, what period would be most appropriate? Please explain your response.

Carryover provisions

5.30 ComReg currently has discretion[25] to permit carryover from year to year for a reduction in prices greater than the reduction required or an increase less than the allowable increase by the overall basket cap. Options for carryover include:

- Automatic carryover of unmade price increases or excess reductions beyond the target cap
- Allow carryover from year to year only at the discretion of ComReg
- Do not allow carryover in any instance

5.31 ComReg believes allowing the price capped operator a greater degree of pricing flexibility than a strict annual application of the price cap can bring benefits, particularly if carryover encourages the operator to bring forward additional price reductions or postpone price increases. Where eircom does not make price increases to the permitted level of the cap of CPI-X, this is effectively a real price reduction. Allowing operators to carryover reductions in excess of those required by the price cap to following years offers operators the flexibility to introduce price restructuring in a single year rather than phasing in any changes.

5.32 If some form of carryover is preferable, ComReg's position is that it should only be allowed on a discretionary basis and not automatic to prevent any abuses in market power by *eircom*. In addition, ComReg does not believe that it would not be practical to incorporate carryover from one price cap regime into an entirely new one, which may be set on a different basis to the previous one.

Q. 7. Do respondents agree with ComRegs proposed approach to carryover? In the event that carryover over is permitted under a new price control, should carryover be constrained to unmade increases or should price reductions also be considered? Please give reasons why.

[25] Article 6 of S.I. 31 of 2003.

Compliance

5.33 ComReg proposes to include a regulator provision that eircom is required to comply with the price cap at all times throughout each relevant year. This measure is aimed at further protecting consumers through limiting eircom's flexibility to introduce any price increases early in the relevant year and delaying the corresponding price reductions that are necessary for compliance with the price cap until late in the year.

Q. 8. Do respondents agree that under a new price control, eircom should be required to comply with a cap(s) at all times?

Draft Decision Instrument

5.34 The draft text of the proposed decision instrument is presented in Appendix A. Any future price cap will constitute a remedy flowing from the market analysis process and, as such, will be imposed under Regulation 14 of the Universal Service Regulations. ComReg Document 07/26 indicated that the current Price Cap Order is maintained pending the final outcome of ComReg's consultations on a RPC as a potential remedy on the retail fixed narrowband access markets. If ComReg ultimately concludes that a RPC is appropriate and justified or that such a measure is no longer warranted the existing price cap order (SI 31 2003) will be revoked.

Q. 9. Do respondents agree that the proposed decision instrument set out in Annex A adequately reflects ComReg's proposals for a price cap?

Q. 10. Do respondents believe that the draft text of the proposed decision instrument is from a legal, technical and practical perspective, sufficiently detailed, clear and precise with regard to the specifics proposed? Please elaborate on your response.

6 Submitting Comments

All comments are welcome. However it would make the task of analysing responses easier if comments were referenced to the relevant question numbers from this document.

The consultation period will run from 26 July until 30 August 2007 during which time the Commission welcomes written comments on any of the issues raised in this paper. A draft Decision instrument containing the proposed price cap mechanism is included for consultation purposes (Appendix A). A final Decision is planned for the end of September 2007 after a full consideration of the responses to this consultation.

In order to promote further openness and transparency ComReg will publish all submissions by respondents to this consultation, subject to the provisions of ComReg's guidelines on the treatment of confidential information – ComReg 05/24. We would request that electronic submissions be submitted in an-unprotected format so that they can be appended into the ComReg submissions document for publishing electronically.

ComReg appreciates that many of the issues raised in this paper may require respondents to provide confidential information if their comments are to be meaningful. As it is ComReg's policy to make all responses available on its web-site and for inspection generally, respondents to consultations are requested to clearly identify confidential material and place confidential material in a separate annex to their response. Such Information will be treated subject to the provisions of ComReg's guidelines on the treatment of confidential information – ComReg 05/24.

Appendix A – [Draft] Decision Instrument

PLEASE NOTE: The Draft Decision Instrument below is set out for information purposes only. ComReg has set out its preliminary views in relation to the proposed SMP obligation detailed below which is subject to consideration of any views expressed during consultation by interested parties. This Draft Decision Instrument also contains a number of notes (italicised in bold) intended to assist an understanding of some of its provisions.

1 STATUTORY POWERS GIVING RISE TO THIS DECISION INSTRUMENT

1.1 This Decision Instrument is made by the Commission for Communications Regulation:

1. Having had regard to sections 10 and 12 of the Act of 2002[26];

2. Having (where appropriate) complied with the Policy Directions made by the Minister[27];

3. Having taken the utmost account of the SMP Guidelines[28];

4. Having taken account of the submissions received in relation to Document Nos. ***[the first and second consultation documents on proposed retail price control]***;

5. Having had regard to the analysis and reasoning set out in Document No. ***[the final decision on retail price control]*** which shall be construed together with this Decision Instrument; and

6. Pursuant to and having regard to the significant market power ("SMP") designation on *eircom*[29] and pursuant to Regulation 14 of the Universal Service Regulations[30].

---

[26] The Communications Regulations Act, 2002.

[27] Policy Directions made by the Minister for Communications, Marine and Natural Resources on 21 February, 2003 and 26 March, 2004.

[28] Commission Guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services.

[29] [Insert full reference to SMP designation once finalised and available].

[30] The European Communities (Electronic Communications) (Universal Service and Users' Rights) Regulations 2003 which transposed Directive 2002/22/EC of the European Parliament and the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services, in to Irish law.

[Note: ComReg has notified the SMP designation to the EU Commission for its approval, as it is legally required to do. The SMP designation can not be made final, until the EU Commission has approved it.]

Definitions

1.2 In this Decision Instrument:

"BRA" means basic rate access;

"ComReg" means the Commission for Communications Regulation, established under section 6 of the Communications Regulation Act, 2002;

"Δ CPI" means the annual percentage change in the CPI;

"CPI" means the consumer price index number, as compiled by the Central Statistics Office;

"first relevant year" means any period of 12 calendar months beginning from the date of this Decision Instrument;

"Formula" means $\sum^{n}_{i=1} \Delta Pi \ * (Ri / Rt)$

Where,

n is the total number of services in either all of the higher level services, or the lower level services;

Δ Pi is the percentage change in the tariff (before discounts) for telecommunications service "i" based on the base of the tariff pertaining on the day preceding the beginning of the first relevant year, or thereafter, on the day preceding the beginning of a relevant year;

Ri is the total revenue before discounts for the telecommunications service "i" in *eircom's* financial year ending on or about 30 June in the first relevant year, or a relevant year;

Rt is the overall total revenue before discounts in *eircom's* financial year ending on or about 30 June in *eircom's* relevant year for all telecommunications services in the first relevant year, or a relevant year, for the total number of services in either all of the higher level services, or the lower level services;

"FRA" means fractional rate access;

"higher level services" means the provision of ISDN FRA and ISDN PRA lines, (those being services for which a recurring charge is made by *eircom* for the availability of such lines) and FRA and PRA connection and takeover;

"ISDN" means integrated services digital network, that is a network whereby telephone calls are made over switched end-to-end digital transmission paths;

"lower level services" means the provision of telephone exchange lines and ISDN BRA lines, (those being services for which a recurring charge is made by *eircom* for the availability of such lines) and telephone exchange line and ISDN BRA connection and takeover;

"PRA" means primary rate access;

"relevant year" means any period of 12 calendar months beginning after the first relevant year;

"the provision of Integrated Services Digital Network lines" means a service for which a recurring charge is made by *eircom* for the availability of Integrated Services Digital Network lines (but does not include connection and takeover charges);

"the provision of telephone exchange lines" means a service for which a recurring charge (but does not include connection and takeover charges) is made by *eircom* for the availability of such lines;

[Note: Connection and takeover includes for example, initial connections to eircom's network and/ or services, in situ connections and re-connections. Connection and takeover is subject to a separate charge.]

2 RETAIL PRICE CONTROL

2.1 The retail price controls in this section 2 relate to the markets for higher level and lower level retail narrowband access from a fixed location. The retail price controls in this section apply to higher level services and lower level services provided by *eircom* and as defined in section 1.2.

2.2 *eircom* shall not increase tariffs by more than Δ CPI- Δ CPI in respect of lower level services in the first relevant year.

2.3 *eircom* shall not increase tariffs by more than Δ CPI – 0 % in respect of lower level services in a relevant year.

2.4 Without prejudice to section 2.2, the following adjustment to the Formula shall apply**:** in respect of the provision of telephone exchange lines, *eircom* shall not increase tariffs by more than Δ CPI- Δ CPI in the first relevant year.

2.5 Without prejudice to section 2.3, the following adjustment to the Formula shall apply**:** in respect of the provision of telephone exchange lines, *eircom* shall not increase tariffs by more than Δ CPI- 0 in a relevant year.

2.6 *eircom* shall not increase tariffs by more than ΔCPI- ΔCPI in respect of higher level services in the first relevant year.

2.7 *eircom* shall not increase tariffs in respect of higher level services by more than ΔCPI – 0 % in a relevant year.

2.8 For the purpose of determining compliance with the price controls in sections 2.2, 2.3, 2.6 and 2.7, the Formula shall be applied.

2.9 *eircom* shall comply with sections 2.2, 2.3, 2.4, 2.5, 2.6 and 2.7 at all times throughout the first relevant year and a relevant year.

2.10 ComReg may make the following adjustment to the Formula: to the extent that *eircom* has made, during the first relevant year, or a relevant year, in respect of higher level services, or lower level services, a reduction in tariffs that is greater than the reduction required, or an increase in tariffs that is less than the increase that is permitted by sections 2.2, 2.3, 2.4, 2.5, 2.6 and 2.7, the difference may be taken into account by ComReg in applying sections 2.3, 2.5 and 2.7 in a relevant year, subsequent to a relevant year in which the reduction was made, or the allowable increase was not availed of.

3 WITHDRAWAL OF CERTAIN OBLIGATIONS

3.1 Pursuant to Regulation 9 of the Access Regulations, the obligations on *eircom* relating to transparency and cost orientation under Regulation 21 of the European Communities (Voice Telephony and Universal Service) Regulations, 1999 are withdrawn immediately upon the revocation of the Telecommunications Tariff Regulation Order, 2003.

4 MAINTENANCE OF OBLIGATION

4.1 For the avoidance of doubt, nothing in this Decision Instrument shall in any way (either expressly, or by implication) affect the continuing validity of the Telecommunications Tariff Regulation Order, 2003, which, remains in full force and effect, until expressly revoked by ComReg pursuant to s 7 of the Telecommunications (Miscellaneous Provisions) Act, 1996.

[Note: The intention to revoke the Telecommunications Tariff Regulation Order, 2003 is being notified to eircom by ComReg, in accordance with and under s 7 of the Telecommunications (Miscellaneous Provisions) Act, 1996]

5 STATUTORY POWERS NOT AFFECTED

5.1 Nothing in this Decision Instrument shall operate to limit ComReg in the exercise and performance of its statutory powers or duties under any primary or secondary legislation (in force prior to, or after the effective date of this Decision Instrument) from time to time as the occasion requires.

6 EFFECTIVE DATE

6.1 This Decision Instrument is effective, from the date hereof, until further notice by ComReg.

[Note: The decision instrument is effective as of the date hereof, strictly subject to eircom's, or any other party's right to appeal.

Under the European Communities (Electronic Communications Networks and Services) (Framework) Regulations 2003 (as amended) eircom (or any other party affected by these decisions) has a period of 28 days, from the date they are notified to it (the date of notification is the publication date) to appeal these decisions to the High Court.

So as to vindicate a party's right to appeal, no enforcement action will be taken by ComReg in respect of these decisions (and no breach will be deemed to have occurred in respect thereof) during the 28 day period allowed to lodge an appeal. This is strictly without prejudice to ComReg's statutory powers and duties in respect of enforcement, which may be exercised and performed upon the expiry of the said 28 day period, if no appeal has been lodged within that 28 day period.]

Mike Byrne
Chairperson
The Commission for Communications Regulation
The ● day of ● 2007

Appendix B – Regulatory Impact Assessment (RIA)

6.1 ComReg is conducting a Regulatory Impact Assessment in line with ComReg document 06/69, and taking into account the RIA Guidelines adopted under the Governments Better Regulation program.

6.2 It is proposed that a RPC on lower and higher level access markets would be appropriate, proportionate and justified on the basis of competition in the markets, the financial modeling conducted by Frontier Economics on behalf of ComReg and taking respondent's views into consideration. ComReg sets out here the reasons it considers that some form of a price cap continues to be necessary for at least some of the retail services provided by *eircom* in fixed narrowband access markets.

6.3 This section, together with the rest of this document represents a RIA. It sets out a preliminary assessment of the potential impact of proposed price cap measures. ComReg has taken into account the potential impact of each alternative regulatory option (see below) on consumers, competitors and on *eircom*.

Description of Policy Context and Objectives

6.4 ComReg's current view is that the markets for fixed narrowband retail access are not effectively competitive. For both lower and higher level access markets, in the absence of price control, and given that *eircom* may have SMP, *eircom* would have the incentive and ability to set and/or maintain prices higher than what they would be if competition was effective. ComReg is considering, in addition to wholesale regulation where a RPC as a potential remedy to address the market failure is necessary.

6.5 ComReg's objectives as the national regulator are to promote competition, contribute to the development of the internal market and to promote the interests of end users within the European Union.

6.6 ComReg's principal objectives for a price cap as set out on 06/41 are to address SMP in retail markets by preventing a dominant operator from charging excessive prices and ensuring that the prices of SMP services reflect efficient costs; to facilitate the rapid development of effective competition in the supply of telecommunications services; and to achieve the above objectives by the least intrusive means.

6.7 ComReg's objective, strictly subject to the possibility of ComReg determining, following further consultation, that a RPC remedy would continue to be necessary and justified in relation to the access markets under review, is to (i) ultimately determine an appropriate "X" factor for use in a CPI –/+ X formula and (ii) to assess the potential impact on the market of different price cap structures and levels.

Identify and Describe the Regulatory Options

6.8 ComReg is considering alternatives in regulation such as the option to forbear from intervention in retail access and/or wholesale intervention in place of retail regulation. The regulatory options under consideration include

- Option 1: Maintain Status Quo
- Option 2: Forbear from Regulation
- Option 3: Wholesale intervention only
- Option 4: Cost Orientation
- Option 5: Individual cap on retail lower level access only
- Option 6: Individual cap(s) on both lower and higher level retail access
- Option 7: Apply global price cap basket

Option's 1-4

6.9 As per Document 06/69 maintaining the status quo (option 1) is a regulatory option that needs to be considered, in some cases, as here, this option is being included for benchmarking purposes only. The current price cap is on a basket of services which includes PSTN and ISDN rental and connections and various call types. Maintaining this going forward is not appropriate, given that it derives from a different legal framework.

6.10 With regard to options 2 and 3, ComReg has carried out a thorough, careful and overall analysis of competition and market developments in these relevant markets and believes to forbear in narrowband access is premature in face of eircom's continued dominance in both the higher and lower level access markets.

6.11 Despite the presence of wholesale regulation, competition is not yet effective in these markets. Although wholesale intervention is a necessary condition for promoting competition in retail fixed access, wholesale-only intervention is not sufficient by itself to adequately protect consumers who face rising access prices. The retail minus mechanism does not constrain where *eircom* sets the level of retail and wholesale prices, only the differential between them.

6.12 ComReg considers intervention in these markets over and above wholesale regulation to be appropriate and justified for the reasons set out in Sections 4.7-4.10 and 5.21. i.e. eircom have been provisionally identified with SMP and the results of the financial modeling show price above cost for higher level access.

6.13 ComReg does not consider that it can perform its duties under Regulation 14 of *the USO Regulations* at the present time solely by setting SMP conditions at the wholesale level. In order for ComReg to perform its duties under Section 12 of the Communications Act, 2002 – to promote competition and the interests of consumers – it is necessary to impose some form of a price cap on *eircom* prices in certain retail access markets.

6.14 On that basis ComReg takes the view that some form of a price control continues to be necessary for at least some of the retail services provided by *eircom* in fixed narrowband access markets. The benefits to imposing a price control should accrue primarily to consumers, by protecting them from higher prices. If, say, a price cap results in prices 15% lower than would occur if there was no price cap, and assuming a regulated price level of around €25 per line, with roughly 1.7 million lines, the effect of a price cap would be to benefit consumers by more than €75 million per year. It should be noted that, due to the effect of bundles, not all consumer payments may be affected by changes eircom access prices, but certainly the majority would be.

6.15 The costs to eircom may be the profits foregone by lower prices. However, even if it was assumed that €1 cost to eircom exactly cancels €1 benefit to a consumer, which is probably not the case in terms of societal welfare effects and ComReg's statutory objective to protect the interests of end-users, the total benefit to society of lower prices would be positive, due to the removal of "deadweight loss" caused by monopoly pricing, as is discussed in standard economic texts.[31]

6.16 While there could be administrative costs to eircom of implementation, given the relatively simple structure of the proposed cap, these are likely to be relatively small in nature, and be outweighed by the benefits. This is particularly the case given both eircom and ComReg are experienced in administering price caps.

6.17 Finally, a price cap of the format proposed is, as is recognized in the literature on this topic, "incentive compatible", in that it gives eircom a strong incentive to lower costs and achieve efficiency, as if it does, it can gain from the profits earned. As such, it should not impose any negative indirect costs on eircom, and could, in fact, stimulate it to achieve greater efficiency and lower costs.[32]

6.18 Cost orientation can prevent the SMP Operator form charging excessive prices for specific services such as line rental and prevent any restriction of market entry by charging unreasonably low prices that may harm competition. Where the risk is one of excessive pricing, a cost orientation obligation may no longer be appropriate in the presence of a retail price cap remedy to control access prices, if deemed necessary.

6.19 ComReg do not believe that a cost orientation obligation is appropriate; concerns about predatory pricing are addressed by the presence of a retail-minus approach to WLR pricing and excessive pricing concerns can be better addressed through a retail price cap.

6.20 Cost orientation in addition to a cap would be disproportionate and ComReg propose to remove this obligation once a retail price cap is fully implemented. This serves to diminish the regulatory burden. ComReg consider that consumers should be sufficiently protected by a RPC.

[31] For a full explanation, see, for instance, J. Church and R Ware, "industrial Organization: A Strategic Approach", Ch 2, McGraw-Hill, (2000).

[32] There are numerous papers and books dealing with this issue. See, for example, Church and Ware, Ch 26, (op.cit.)

6.21 Therefore ComReg are of the view that some form of Price Cap is necessary in order to address competition problems in these markets.

Options 4-7 Imposition of Price Caps

6.22 eircom have maintained a very strong position in the lower level access markets due in part to high barriers to entry. ComReg believe a retail price cap on lower level access is the minimum necessary to safeguard consumers against large increases in line rental. As discussed above, ComReg believe that some form of price cap is necessary, as the benefits are very likely to exceed the costs.

6.23 ComReg considered the removal of a price cap from the higher level access market due to the greater level of competition in this market compared to that of the lower level access market.

6.24 However following further analysis ComReg determined that absent regulation eircom would likely be in a position to act to an appreciable extent independently of its competitors and consumers. The exit of some players from the market suggests that the market is volatile and a price cap continues to be necessary. Additionally the financial analysis does not suggest that higher level services should be excluded from any price control. ComReg is mindful that a cap which might require large price reductions may damage rather than increase competition and such an observation will be taken into consideration when setting any X should it be determined as final that higher level access services should be subject to a price cap.

6.25 In light of its objectives ComReg propose the best option is to impose a price cap on lower and higher level access markets.

6.26 As the lower and higher level markets are considered separate markets it may be more appropriate to apply separate individual caps on each relevant market. Differences in competitive levels as well as the cost analysis support treating the two markets as identified in the SMP decision separately.

6.27 A global price cap covering the basket of services would allow eircom a greater degree of flexibility on how is balances charges. However it only acts as a limited constraint on eircom’s ability to increase prices and will not necessarily prevent excessive pricing. It may afford eircom the opportunity to target price reductions at higher level access users and increase their market power by way of cross-subsidy of the higher level access market by lower level access where certain consumer groups or areas may be captive.

6.28 To the extent that additional protection is needed in respect of PSTN line rental then an additional specific cap or sub cap within a basket cap for lower level access services might be required to ensure these customers benefit form any price cap control. Placing both connection and rental products in the same basket gives eircom some flexibility to set the relative levels of connection and line rental prices. A specific sub cap to limit eircom’s flexibility in the pricing of the basic line rental service (PSTN) within the overall basket cap on lower level access services may be a proportionate and appropriate regulatory response in order to avoid that eircom would introduce, within the boundaries of a basket cap on lower level services, excessive price increases to the detriment of retail consumers.

6.29 A global cap combined with a sub-cap on lower level access was also considered as it may prevent potentially excessive prices for basic line rental. However this option would not offer any benefits over a separate cap on both markets combined with a sub cap on basic line rental.

6.30 ComReg is therefore of the view that the most effective remedy is Option 6- the imposition of individual caps on each market, due to its superior means of achieving ComReg's objectives. Excluding higher level access from a price cap at this time is premature, while a global cap may provide eircom with the opportunity to increase PSTN line rental charges disproportionately impacting on those who depend on the telephone but make few calls. It should also be noted that, although there are individual caps, the overall structure of the proposed price cap is still relatively simple, and should not involve significant administrative costs to run.

6.31 ComReg is of the view that in order to limit eircom's flexibility in the pricing of basic line rental, this service should be subject to a specific sub-cap.

6.32 It should also be noted that, although there are individual caps, the overall structure of the proposed price cap is still relatively simple, and should not involve significant administrative costs.

Determine the Impact on Stakeholders

6.33 The following table summarises some of the above analysis:

Scenarios	***eircom***	**OAOs**	**Consumers**
Status Quo	*eircom*'s pricing freedom controlled; though potentially less of a compliance burden relative to price cap on access only. Not appropriate or proportionate response as access markets only under consideration	To the extent that *eircom*'s prices are constrained OAOs competitive opportunity may also be constrained. However, OAOs can and do compete in the presence of price control via WLR.	Protection for consumers, however due to inclusion of fixed to mobile calls in the basket consumers may be at risk of larger PSTN line rental increases should call prices reduce.
Forbearance	Increased pricing flexibility, greater revenues, and potentially less of a compliance burden or administrative cost	May be beneficial for competition as competing providers may be able to identify opportunities and increase competition	No protection for consumers who may face raising retail access prices where there is a designation of *eircom* with SMP and wholesale only intervention is insufficient. Consumers likely to suffer from higher prices.
Wholesale only intervention (if sufficient)	As above	May promote retail competition but contingent on appropriate and /or sufficient wholesale measures	Similar to forbearance case.
Cost Orientation	Significant compliance burden as compared to price cap, plus does not stimulate efficiency.		Prevents prices moving out of line with costs, gives price protection to consumers.
Individual cap on retail lower level access only	*eircom*'s pricing freedom controlled; though potentially less of a compliance burden relative to a wider price cap.	To the extent that *eircom*'s prices are constrained OAOs competitive opportunity may also be constrained. However, OAOs can	Upper control on price increases for lower level access will protect these end users maintaining affordability for basic services.

	Appropriate and proportionate response where *eircom* may raise access prices to the detriment of these consumers. Also, give eircom an incentive to lower costs as it would gain any resulting profits.	and do compete in the presence of price control via WLR.	May not offer adequate protection for customers availing of ISDN who given *eircom*'s SMP may face rises in ISDN access prices.
Individual cap(s) on both lower and higher level retail access with PSTN line rental subject to a specific sub-cap	as above	as above	All end users protected against any risk of access price increases, notably residential and SMEs.
Apply global price cap basket	as above	as above	Potential non uniform competition across retail access markets, some consumers or areas may be captive with limited alternative suppliers. Risk of ineffective regulation where price cuts for higher level access were sustained by price increase lower level access

Determine the Impact on Competition

6.34 In the absence of wholesale line rental competition would be virtually non-existent in the lower level access market and restricted in the higher level access market, therefore forbearing from regulatory intervention is likely to have negative impacts on competition and ComReg is of the view that some form of regulation is necessary.

6.35 Wholesale intervention only may promote competition at the retail level.

6.36 Imposing some form of retail price cap, although constraining competitors ability to increase prices at the retail level should allow competition at the retail level to increase and where other operators identify alternative means by which to supply access.

Assess the Impacts and Choose the Best Option

6.37 ComReg believe the imposition of a price cap to be the option which best achieves its objectives of promoting competition and promoting the interests of end users.

6.38 Further ComReg is of the view that individual sub-caps on the higher and lower level access baskets will achieve these objectives in the most effective manner. A specific sub-cap on PSTN line rental will restrict eircom's ability to increase these prices to the detriment of consumers.

6.39 As with previous price caps, ComReg will monitor compliance on an ongoing basis, and will require eircom to supply compliance statements with any price change that affects either the higher or lower level access basket. At the end of each price cap year ComReg will issue a press release confirming compliance.

6.40 As set out above the price cap will remain in place for an indefinite period or until such time as it is amended or withdrawn by a market review. At this time another review is envisaged in circa 3 years.

Conclusion

6.41 The proposed retail price cap on access is justifiable, in that it is required to ensure that *eircom* does not exploit its market power by raising prices in markets concerned to the detriment of consumers. It does not unduly discriminate against *eircom* in that, while it only applies to *eircom*, the condition is imposed in order to address *eircom*'s clear ability to raise prices above the competitive level in light of its SMP in markets to which the control applies. It is proportionate in that it is the least burdensome means of achieving this aim and can also give eircom a stimulus to make efficiency gains. ComReg considers that it has met the condition of transparency by setting out the potential requirements on *eircom*, the justification for the proposed retail measure, and issuing a public consultation on the same.

ComReg invites comments from interested parties on the above regulatory impact assessment and its underlying analysis.

Appendix C – Report by Frontier Economics on behalf of ComReg

Appendix D – Consultation Questions