Commission for
Communications Regulation

Consultation and Draft Direction

Finalisation of 2002/03 and Revision of 2003/04 Interim Interconnect Conveyance Rates

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All responses to this consultation should be clearly marked:- "Reference: Submission re ComReg 04/69" as indicated above, and sent by post, facsimile, e-mail or on-line at www.comreg.ie (current consultations), to arrive on or before COB, 25 June 2004, to:

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Please note ComReg will publish all submissions with the Response to Consultation, subject to the standard confidentiality procedure.

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1 Foreword [by the Chairperson]

Comreg's review of eircom's proposals to finalise rates for the financial year 2002/03 is almost complete. A submission in relation to revised interim rates for 2003/04 has also been reviewed. A number of issues have been identified in relation to which ComReg and eircom have divergent views. ComReg is now publishing for consultation a number of draft Directions for comment by interested parties.

John Doherty,
Chairperson.

2 Introduction

ComReg received a final cost submission in relation to the 2002/03 Reference Interconnect Offer ('RIO') rates for National Termination, Origination and Transit Rates in November 2003. The submission proposed an increase in the rates from those set as interim for 2002/03 which are in the current published RIO.

ComReg's review has revealed a number of matters where it has formed the preliminary view that eircom should amend its submission. Because of the importance of RIO conveyance rates to the industry and because several of the proposed amendments would have an impact on the calculation for 2003/04 and subsequent years' rates, ComReg believes that it is necessary to consult on the draft direction/measures.

eircom originally proposed that other authorised operators ('OAOs') and Mobile Network Operators ('MNOs') should repay between €3 to €4 million in aggregate in relation to 2002/03. Were all of ComReg's proposals to be adopted in eircom's original submission, ComReg estimates that most OAOs would neither receive nor pay significant retrospective amounts for 2002/03. In the case of 2003/04, were all these proposals to be adopted and eircom's submission left otherwise amended, ComReg estimates that most OAOs (including MNOs) would be due a refund because of the adoption of ComReg Decision Notice D14/03. This would amount to approximately €1.7m in aggregate. However, eircom has within recent days produced new information in relation to volumes which eircom claims will eliminate most of the refund. ComReg is extremely concerned about the timing of the provision of this information and addresses this issue in section 3.6.

3 Issues and Draft Directions

3.1 Gradients

In ODTR 98/52, the Commissioners' predecessor, the Director of Telecommunications Regulation ('the Director'), set out the basis for the application of tariff gradients to arrive at interconnection prices. The principles of calculation using total traffic and total revenues split by day evening and weekend which were put forward by eircom were found to be acceptable, but the ODTR evaluated other, similar, approaches which produced comparable results and also appeared equitable.

In ODTR 99/16, the Director consulted on the methodology behind the setting of the gradients. In this consultation, a hypothetical example of how the gradients are calculated was illustrated. This methodology is still currently in use by eircom when setting the interconnection rates.

The Director asked three questions:-

- Should gradients or a flat rate be used?;
- If gradients were desirable should these be retail gradients or based on some other approach?; and
- What was an appropriate period for collecting sample data?

Responses to these questions were discussed in ODTR 00/31. The general consensus from industry was that gradients based on eircom's retail tariffs provided the most pragmatic and suitable approach, and that the largest possible sample size should be used for data collection. However, concerns were raised over margin squeezes in circumstances where the interconnection gradient was not the same as the retail gradient. Eircom noted that calling patterns were changing, reflecting the development of 24 hour telephone services and internet dial-up. eircom envisaged progressive reductions in peak to off-peak ratios so as to reflect this changing pattern of usage. The Director agreed that the use of the eircom retail gradient was the most suitable, but did not accept eircom's proposals for forward-looking gradients due to the difficulties of accurately forecasting retail price behaviour.

The Director examined these issues again in ODTR 01/11 asking about the merits of real time gradients, where movements in retail prices would be contemporaneously reflected in movements in gradients. In responding to the views of respondents, the Director determined that if eircom were to change their retail gradients by more than 5% it would simultaneously change their wholesale gradients in the same manner.

The extensive discussions of this issue have lead to a consensus that gradients are valuable and may address two issues:

- Underlying cost causality arising from different levels of demand at different times of the week; and

- The need for a retail margin to allow competition to develop in all charging periods, providing alternative services to both business and residential markets.

In practice, the ODTR adopted a pragmatic approach, focused on the need to avoid price squeeze across all time periods. ComReg maintains its belief that a gradient approach based on retail rates can achieve this objective.

Changing call distribution patterns has caused difficulties in eircom's financial year 2002 / 2003. eircom's top down Long Run Incremental Cost ('LRIC') modelling process computes costs by service as a single 24 hour rate to which retail gradients are then applied. The practical effect of this application is to over-recover costs from eircom's wholesale customers when compared with their contribution to 24 hour costs, and, in compensation to under-recover costs from eircom's own retail arm, this happens because eircom's traffic profile in terms of call duration is different to that of OAOs in aggregate.

ComReg has suggested a solution to alleviate this over recovery by amending the current gradient structure used in the eircom model for 2002/03 to reflect the actual costs of the network using the 24 hour rate. eircom have expressed concerns over this approach as it would require two different, parallel, gradients to be applied, one to eircom retail, the other to wholesale customers.

In recognition of the issue, eircom has presented revised gradient calculations which reduce the impact of the problem, but which still allows for a small element of over-recovery from wholesale customers and under-recovery from retail. eircom contend that to use separate gradients for wholesale and retail cost recovery would not give due recognition to the different demands placed on the network at the various times of day, evening and weekend. However, it is by no means clear to what degree eircom's retail gradients reflect these loadings as distinct from being the consequence of specific retail pricing decisions. In addition, it is not clear why eircom, which controls its own retail gradients, should effectively have the ability to unilaterally influence the share of its network costs that OAOs should bear.

As eircom's LRIC modelling is designed to produce a 24 hour rate rather than time of day specific network element costs ComReg does not propose a radical reworking of this model but rather an adjustment of the gradients to ensure parity of recovery of the 24 hour costs by the two groups of users. ComReg does not believe that the use of retail gradients was ever introduced in order to alter the balance of cost recovery by operator. ComReg's preliminary view, in principle, is that each operator's contribution to network costs should be in proportion to its use of the network on a 24 hour rate basis. In practice, to simplify matters ComReg proposes to adjust these rates for OAO traffic in aggregate, rather than by each specific operator.

ComReg would appreciate the views of industry as to the merits or otherwise of the proposed direction, and whether any further alternatives might be available. This direction, if adopted would affect 2002/03 and subsequent years.

Text of Proposed Direction:

eircom is directed to apply parallel gradients to both its wholesale and retail charges, but to adjust the levels of the resulting prices so as to ensure that the amount recovered from each category independently is exactly those costs demonstrated by its LRIC submission (as amended by further Directions set out below) on a 24 hour basis. This Direction is to apply to 2002/03 and subsequent years.

Q. 1. Should ComReg issue the above Direction in section 3.1 in relation to the treatment of Gradients? Is it sufficiently clear and unambiguous to permit implementation? If necessary, please provide suggested amendments to the text with reasons and detailed explanations for your answer.

3.2 Interconnect Links

During ComReg's review of the 2002/03 submission, an accrual for amounts payable to OAOs was noted. eircom has informed ComReg that these accruals relate to unbilled amounts from OAOs who have not billed eircom for amounts owing to them for switch ports. This accrual covers the period from April 2001 to March 2003. In addition, ComReg understands that further provisions for unbilled amounts have been made in 2003/04. It was pointed out by eircom that signed contracts are in place with all the relevant OAOs to substantiate the need for this rolling accrual. ComReg believes that the more recent accruals are necessary and are a legitimate expense in the model, however ComReg does not believe that it is appropriate that OAOs should be charged these costs through interconnection rates when there is the likelihood, based on experience, that a substantial proportion of these charges may never be billed by the relevant OAOs.

Given that eircom's RIO stipulates a two year maximum period for raising interconnect bills, it seems reasonable that all accruals outside that period should be credited back through interconnect charges. ComReg further considers that eircom should share the basis of their accrual calculations with the operators that they are expecting to bill them so that the true value of the payments to be made can be definitively established. It seems in ComReg's view inappropriate that eircom should be able to raise the cost of conveyance rates by creating accruals for amounts that are not subsequently paid.

Text of Proposed Direction:

eircom is directed to adjust its interconnect charge submission for 2002/03 to eliminate all accruals referred to in section 3.2 above that fall outside the two year window for collection of those charges.

eircom is directed to share its accrual calculations for the interconnection links referred to in 3.2 above with the companies to which these monies fall due.

Q. 2. Should ComReg issue the above Directions in section 3.2 in relation to the cost of Interconnect Links? Is it sufficiently clear and unambiguous to permit implementation? If necessary, please provide suggested amendments to the text with reasons and detailed explanations for your answer.

3.3 Bad Debts

Currently eircom's policy in relation to bad debts incurred at the wholesale level is to recharge these provisions across wholesale minutes and calls only.

ComReg addressed this issue in general terms in ComReg 03/57:

"*Unless eircom retail contribute to the cost recovery of Carrier Services billing and admin costs they will be operating at a competitive advantage to other players in the market. For billing costs the solution is straightforward – to recover carrier billing costs across all call types which use the eircom network, for administrative costs it is a little less so – because certain costs are already being directly incurred by eircom retail and are being recovered from that part of the organisation. This offset will be unnecessary under the treatment set out in Decision 5.2 below.*
…………………………

Decision 5.2
Eircom is directed to recover the cost of administration of interconnection from all operators, including eircom retail, that is to say that carrier administration will have a routing factor of 1 for all call types, with effect from 01/04/03 onwards. Separated accounts, (revised) interim and final interconnect pricing submissions must be prepared on that basis. Details of

the calculation of this charge are to be agreed between eircom and ComReg within 6 weeks of the date of this notice."

While ComReg decided that this change should be implemented across Carrier Services administration costs as a whole with effect from 01/04/03 and to rely on eircom's own allocation of these costs between wholesale and retail customers prior to that date, the specific issue of bad debts appears to merit special consideration. In this situation eircom is seeking to recover costs associated with abrupt market exit from wholesale customers who have remained in the marketplace. For eircom retail not to make a contribution to this situation would seem to offer it an unfair advantage in comparison to other purchasers of eircom's wholesale services. It seems therefore appropriate in this instance to require 02/03 wholesale bad debt costs to be recovered in the manner specified for administration costs as a whole from 1 April 2003.

Text of Proposed Direction:

eircom is directed to spread the cost of wholesale bad debts incurred across all traffic, i.e. including eircom retail. This Direction is to apply to 2002/03 and all subsequent years which include a charge for bad debts.

Q. 3. Should ComReg issue the above Direction in section 3.3 in relation to wholesale bad debts? Is it sufficiently clear and unambiguous to permit implementation? If necessary, please provide suggested amendments to the text with reasons and detailed explanations for your answer.

3.4 Carrier Billing System Depreciation period

As part of its review of the Carrier Billing costs ComReg noted that the Carrier Billing System used by eircom is being written off over a period of four years across interconnection traffic. This is as per the recommended regulated period which was set as a general indicator for similar type assets. ComReg is of the preliminary opinion that four years appears to be too short a life span for such a system and believes that eircom's own plans also supports a longer asset life.

Eircom has been asked to demonstrate that the current period is reasonable. The information it has submitted shows:

- Eircom's initial business model anticipated a longer operational lifetime; and
- The company supplying eircom's carrier billing system has been taken over by another organisation and eircom expects that there will be a need

to upgrade or migrate to the successor company's new billing platform in 2006 / 07.

Whether eircom upgrades or migrates its carrier billing capability to its vendor's latest product offering, there will in all likelihood be some continuing benefit to be derived from eircom's initial investment. Further investment will undoubtedly be required but the system as a whole seems certain to endure well beyond four years. Indeed, this is typical, not exceptional, where major billing and operational systems are concerned. ComReg believes that it would be appropriate to extend this depreciation period to a longer but still conservative period of six years.

Text of Proposed Direction:

eircom is directed to adjust the expected useful life of the carrier billing system to 6 years and adjust for the change in accordance with FRS 11 (Impairment of Fixed Assets and Goodwill). This Direction is to apply to 2002/03 and subsequent years.

Q. 4. Should ComReg issue the above Direction in section 3.4 in relation to the useful life of the current Carrier Billing system? Is it sufficiently clear and unambiguous to permit implementation? If necessary, please provide suggested amendments to the text with reasons and detailed explanations for your answer.

3.5 Discriminatory cost accounting

As part of the review, several attempts were made to reconcile the overall revenue and costs as per the eircom Separated Accounts for 2002/03 to the various products offered in the RIO and other services such as Carrier Pre Select, Directory Enquiries, Ancillary Services etc. The aim of such a review was to ensure firstly, that there is no discrimination on behalf of the incumbent when dealing with other operators i.e. that eircom retail contributes its share of the cost of such services and secondly, to ensure that costs, particularly administration costs, are not recovered more than once.

It now appears that eircom provides no evidence of transfer charges from eircom wholesale to eircom retail for the same services. While this has no cash impact on eircom as a whole, it runs contrary to the principles of separation of functions and non-discriminatory treatment.

ComReg requested and received information which purported to clarify the matter. However, having considered this information carefully, ComReg maintains the view that insufficient evidence has been received to be convinced either that eircom retail has paid its appropriate share, or that costs have not been recovered twice across different products and services. Because the burden of proof that its prices are cost oriented lies with eircom, ComReg proposes to reduce the amount of carrier administration cost allocated to conveyance rates by 20% unless eircom can produce satisfactory evidence during the consultation period.

Text of Proposed Direction:

eircom is directed to reduce the costs of their Carrier Administration expense allocated to conveyance rates in the submission for 2002/03 by 20%.

Q. 5. Should ComReg issue the above Direction in section 3.5 in relation to disallowing Carrier Administration costs? Is it sufficiently clear and unambiguous to permit implementation? If necessary, please provide suggested amendments to the text with reasons and detailed explanations for your answer.

3.6 Provision of data by eircom.

In advance of finalising its proposals for interconnect rates for 2003/04 ComReg performed a number of checks to ensure that the data available to it was accurate. Among these checks was a direction to eircom to "confirm that the correct call data in the 2003/04 RIO submission made in December 2003 is accurate..."" issued on 18 May 2004. eircom responded on 20 May 2004 by stating that "the figures already provided are the most accurate, up to date information available at present". However, at a meeting with ComReg held on 9 June 2004 eircom indicated that volumes were likely to be significantly different from those previously submitted and that this change would have a material impact on rates, as described in the introduction. ComReg is gravely concerned by this development. It is particularly concerned because a similar incident occurred earlier in December 2003 which was described in ComReg Document No 04/12. ComReg believes that this behaviour, whether or not it is deliberate, delays the delivery of revised interconnect rates to the market and has the result of prolonging uncertainty. In order to encourage eircom to be pro-active in ensuring its prices are cost oriented on a consistent basis, ComReg is likely to take the view in future that, unless there are mitigating circumstances, where final billed amounts are greater or less than preliminary billed amounts by more than 5%, that eircom will have been in breach of its obligation of cost orientation.

As a consequence of these developments, ComReg will, in future, for important data requests, require by Direction, Chief Financial Officer ('CFO') sign off in relation to submissions made to ComReg. ComReg wishes to obtain the views of all parties as to the specific format of that sign off.

ComReg proposes that in relation to submissions for rates which are proposed to be final (Case A) the CFO sign off should be in the following format:-

'I confirm that the attached submission fairly presents in accordance with the Aaccounting Documents of eircom the costs of service X in relation to period Y and complies with the relevant Decision Notices issued by the Commission for Communications Regulation and its predecessor the Office of the Director of Telecommunications Regulation.'

In relation to proposals for rates for which are intended to be interim in nature and which may be based on forecasts, (Case B) ComReg proposes that the CFO sign off should be in the following format:-

'I confirm that the attached submission represents eircom's best endeavours to estimate the costs in relation to service X for the period Y in accordance with the relevant Decision Notices issued by the Commission for Communications Regulation and its predecessor the Office of the Director of Telecommunications Regulation'.

Q6 Do you agree with the proposed text for Case A above? If not please state your reasons and provide an alternative.

Q7 Do you agree with the proposed text for Case B above? If not please state your reasons and provide an alternative.

Q.8. Are there any other measures, which are within ComReg's powers, that should be considered in these circumstances?

3.7 Submission of Amendments

Text of Proposed Direction:

eircom is directed to amend its submissions for interconnect conveyance rates for 2002/03 and 2003/04 originally submitted on 7 November 2003 and 19 December 2003 in accordance with the above Directions and resubmit them, otherwise un-amended, within 7 working days of this direction. eircom is also directed to publish the amended rates in its RIO, unless otherwise directed by ComReg, within 10 working days of this Direction. Any amounts to be settled between operators as a result of these rate changes should be paid within 45 days of this Direction.

Q. 9 Should ComReg issue the above Direction in section 3.7 requesting revised submissions in relation to the calculation of the RIO rates for 2002/03 and 2003/04 amended for ComReg's proposed changes only? Is it sufficiently clear and unambiguous to permit implementation? If necessary, please provide suggested amendments to the text with reasons and detailed explanations for your answer.

4 Submitting Comments

The consultation period will run from 11 June 2004 to 25 June 2004, during which ComReg welcomes written comments on any of the issues raised in this paper.

In order to promote further openness and transparency, ComReg will publish the names of all respondents and make available for inspection responses to the consultation at its offices.

ComReg appreciates that the issues raised in this paper may require respondents to provide confidential information if their comments are to be meaningful. Respondents are requested to clearly identify confidential material and if possible to include it in a separate annex to their response. Such information will be treated as strictly confidential.

Appendix A – Consultation Questions

List of Questions

Appendix B – Statutory Powers and Provisions Giving Rise to Proposed Measures

The Directions contained in this Consultation and Draft Directions are issued under Regulations 8 and 17 of S.I. No. 305 of 2003 the European Communities (Electronic Communications Networks and Services) (Access) Regulations 2003 which transposes Directive 2002/19/EC of the European Parliament and the Council of 7 March 2002 on access to, and interconnection of, electronic communications networks and associated facilities ('the Access Regulations') for the purpose of further specifying requirements to be complied with relating to obligations imposed by and under the Access Regulations and having regard to Regulation 6 of the Access Regulations and sections 10 and 12 of the Communications Regulation Act, 2002.

The effective date of these Directions is their publication date.