



**Further Consultation**

**Further Input to Consultation Document No. 09/39 on Local Loop Unbundling ('LLU') and Sub Loop Unbundling ('SLU') Monthly Rental Charges**

<b>Document No:</b>	<b>09/62</b>
<b>Date:</b>	<b>27 July, 2009</b>

All responses to this consultation should be clearly marked:-  
"Reference: Submission re ComReg 09/62" as indicated above,  
and sent by post, facsimile, e-mail or on-line at [www.comreg.ie](http://www.comreg.ie)  
(current consultations), to arrive on or before 5.30 pm, 24 August  
2009 to:

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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

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## 1 Introduction

On 8 May 2009, the Commission for Communications Regulation ("ComReg") published Consultation Document No. 09/39<sup>1</sup> in which it detailed its preliminary proposals for revisions to the regulation of Local Loop Unbundling ("LLU") and Sub-Loop Unbundling ("SLU") pricing over the next 3 years in Ireland.

LLU and SLU allow entrants competing with Eircom access to the "last mile" into consumers' homes / businesses. Unlike some other types of regulated access, these products give other authorised operators ("OAOs") direct control over the hardware used to provide broadband services to consumers. This control over the hardware enhances the ability of OAOs to differentiate their services (for example, by offering higher speed broadband) thus helping to promote and increase consumer welfare and to ensure the long term sustainability of competition.

ComReg has taken careful account of the responses received to Consultation Document No. 09/39 and further information submitted in confidence from Eircom. ComReg would now like to offer respondents a further opportunity to provide input on four important parameters to the bottom-up, long run average incremental cost ("BU-LRAIC") model of Eircom's access network. ComReg believes that following further analysis of the responses it will shortly thereafter be in a position to publish a response to consultation and a final decision in relation to LLU pricing. The four areas being further consulted on are:

1. Working line threshold;
2. Evolution of working line volumes;
3. Long lines; and
4. Price trends.

The current price proposals, incorporating the preliminary views set out in Section 2, are broadly in line with those published in Section 5 of Consultation Document No. 09/39.

The following are indicative timelines intended to lead to the publication of ComReg's final decision:

Further consultation.	Responses due 24 August 2009.
Notify the European Commission.	31 August 2009.
Publish response to consultation and final decision.	16 October 2009.

<sup>1</sup> ComReg Document No. 09/39: Response to Consultation Document No. 08/56: Further Consultation on Local Loop Unbundling ("LLU") and Sub Loop Unbundling ("SLU") Monthly Rental Charges; published on 8 May 2009.

## 2 Further consultation

### 2.1 Working lines threshold

When constructing the BU-LRAIC model, ComReg considered that it was not appropriate to include in the LLU price, the full costs associated with exchanges that OAOs were highly unlikely to be able to unbundle during the period of the price control. The reasons for this were set out in Consultation Document No. 09/39.

This approach requires the model to distinguish between exchanges that are likely and are not likely to be unbundled on an economic basis. However, this can be challenging, given the range of economic influences on each exchange, and the different business strategies that OAOs may pursue. Consequently, ComReg adopted a highly conservative two-step approach to its assessment:

**Step 1:** Conservatively identify those exchanges that are least likely to be unbundled; and

**Step 2:** Apply a weighting to the LLU price such that even exchanges that are highly unlikely to be unbundled are reflected in the relevant cost base.

As recognised by regulators such as OFCOM<sup>2</sup> in the UK, there are significant economies of scale associated with the number of lines that a OAO expects to service when unbundling a given exchange. This means that the likelihood that a given exchange will be unbundled increases with the number of lines provided by that exchange. There are other factors that also influence the decision of OAOs to unbundle. However, ComReg considers that there is an impact of these economies of scale and practical difficulties that may emerge in trying to unbundle a large number of small exchanges in a short period of time. This therefore, provides a reasonable basis on which to distinguish between those exchanges that may, or may not be unbundled over the price control period. The addition of the probability weighting factor, is sufficiently significant to provide a reasonable basis on which to draw the distinction between those exchanges that may, or may not be unbundled during the period of the price control. An important consideration therefore, is where the boundary should approximately be drawn.

ComReg's starting point for assessing the boundary between those exchanges that it considers feasible for unbundling and those that it does not, was to examine the evidence currently available in the market in Ireland. The evidence demonstrates that, despite many years of a regulated access regime, OAOs do not currently unbundle exchanges with fewer than approximately 2,600 lines and that approximately 95% of those unbundled exchanges have more than 4,000 lines. Moreover, the available evidence also demonstrates the following:

- The number of exchanges subject to full LLU has remained static in recent years and the small exchange unbundled to date has approximately 2,600 lines. In a recent public announcement<sup>3</sup>, BT stated it would unbundle up to 58 additional exchanges to enable it to deliver up to 24Mbps broadband services to

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<sup>2</sup> <http://www.ofcom.org.uk/consult/condocs/wbamr07/wbamr07.pdf> See in particular paragraphs 3.277 – 3.287.

<sup>3</sup> [http://www.btireland.ie/pr\\_2009\\_07\\_22\\_vodafone.shtml](http://www.btireland.ie/pr_2009_07_22_vodafone.shtml)

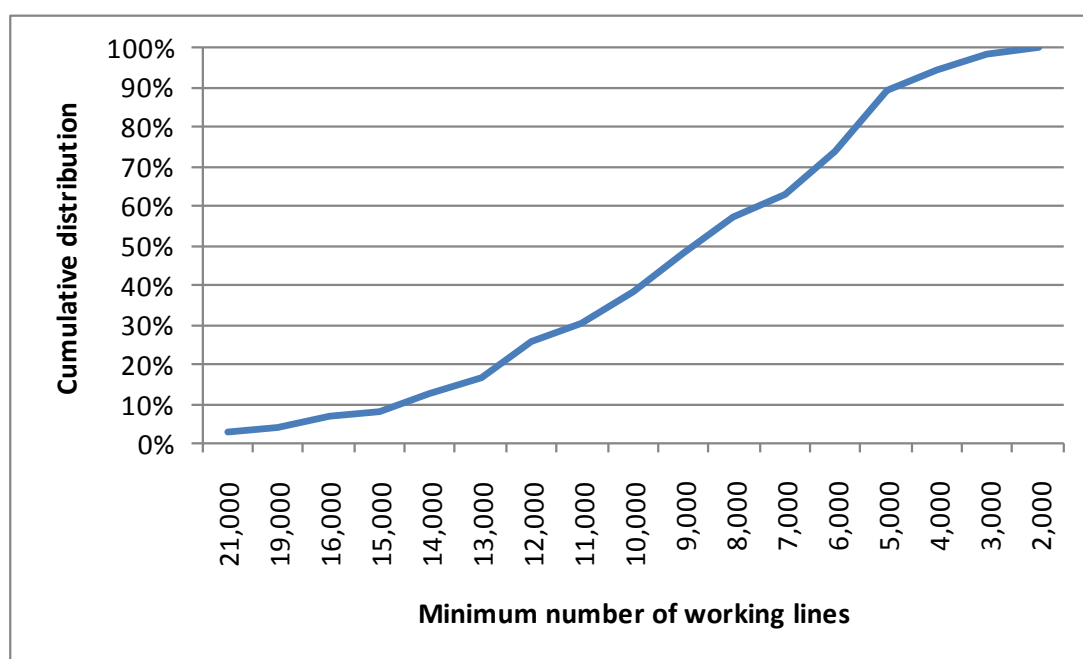
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approximately two thirds of Ireland's available broadband lines. BT has currently unbundled 22 exchanges. It is highly likely that the smaller exchanges may not have been upgraded for high speed next generation broadband. As the smaller exchanges have less lines, have a longer pay back period for the initial investment and are less likely to have been upgraded for high speed next generation broadband, it appears that OAOs are unlikely to unbundle exchanges significantly below the cut-off level of 2,500 over the three year price control period proposed by ComReg. While ComReg would envisage smaller exchanges i.e. those below 2,500 lines, being unbundled at some point in the future, OAOs are more likely to commit capital investment in stages and review the return on these investments before committing to smaller, low density exchanges where the returns may not be as great.

- Only 46% of exchanges with more than 2,500 lines are currently unbundled by OAOs. This suggests that these exchanges are likely to be more natural targets for OAOs, than smaller exchanges in the future.

The above points are illustrated by Figure 1 and Table 1 below.

**Figure 1: Cumulative distribution of unbundled exchanges by number of lines\***



\*Number of working lines rounded down to nearest thousand.

Source: ComReg calculations.

**Table 1: Unbundling activity**

Number of lines	Number of exchanges	Number currently unbundled	Proportion currently unbundled
≤1,600	1,012	0	0%
> 1,600	207	73	35%
> 2,500	157	73	46%

Source: ComReg calculations.

In Consultation Document No. 09/39<sup>4</sup>, ComReg expressed the preliminary view that 1,600 lines represented a highly conservative point<sup>5</sup> at which to draw the boundary between those exchanges that are considered viable for unbundling during the control period (large exchanges) and those that are not (small exchanges).

ComReg now believes that a threshold of exchanges containing at least 2,500 lines is appropriate because:

- In operator responses to Consultation Document No. 09/39, the majority of operators believed that a cut-off of 1,600 lines was inappropriately low. A number of the operators indicated that the cut-off point should be raised and suggestions included 2,500 lines, 3,000 lines and 5,000 lines;
- OAOs have not to date unbundled exchanges with fewer than approximately 2,600 lines;
- It ensures that OAOs are only expected to make an appropriate contribution to the costs of the exchanges that they unbundle; and
- It facilitates effective and fair competition between OAOs and Eircom.

For the avoidance of doubt, ComReg's preliminary view is that the proposed amendments to the working line threshold do not require adjustments to the 95:5 probability weightings

<sup>4</sup> Consultation Document No. 09/39, Q11: "Do you agree that exchanges with working lines in excess of 1,600 is a reasonable cut off for those exchanges that are unlikely to be economically viable for OAOs to unbundle in the timeframe of the proposed price control period? Please state the reasons for your response"[Emphasis added].

<sup>5</sup> In Consultation Document No. 09/39, ComReg stated that: "...in order to be conservative, ComReg proposes to allow for an element of costs associated with small exchanges (those with less than 1,600 lines), even though it considers it highly unlikely that a significant number of them could feasibly be unbundled within the proposed price control period".

for the reasons set out in Consultation Document No. 09/39. However, ComReg will keep this probability weighting under review.

**Q. 1. Do you agree that exchanges with working lines in excess of 2,500 is currently a reasonable threshold for those exchanges that are likely to be economically viable for OAOs to unbundle in the next three years? Please state the reasons for your response.**

**Q. 2. Given the current level of take-up of LLU in Ireland to date, the economies of scale referred to above, do you believe that, among other things, the current price of LLU plays a significant role when considering investing in LLU in the future? Please state the reasons for your response.**

## **2.2 Evolution of working line volumes**

In Consultation Document No. 09/39, ComReg recognised that, despite a long-term upward trend, the number of working lines is currently declining. ComReg expressed the view that this decline was a short-term phenomenon and that it would stabilise in 2010.

New data is now available which shows that the decline in working lines has been occurring at a faster rate than was previously anticipated. However, this decline is occurring in the context of rapid declines in economic output as, for instance, the gross domestic product ("GDP") fell by 8.5% in the year to March 2009. Employment rates show a 7.5% reduction to March 2009 in the number of people in employment over the preceding year and an increase of 103.7% in the number of people registered as unemployed (rising by 113,400, leaving a total of 222,800 people unemployed).<sup>6</sup>

Other reasons considered by ComReg for the decrease in working line volumes include the return of migrant workers to their respective countries, movement of customers from fixed line services to mobile and a reduction in the number of housing completions given the slowdown in the construction industry. However, ComReg consider that these particular factors are mainly one-off and are not expected to continue at the same dramatic pace as occurred in recent months.

While there is still uncertainty about the future economic outlook, current forecasts suggest that the economic position should begin to stabilise in 2010. For example, the ESRI reports that:

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<sup>6</sup> Central Statistics Office (2009), "Consumer Price Index, June 2009", 9 July 2009. Central Statistics Office (2009), "Quarterly National Household Survey". Quarter 1 2009, 25 June 2009.

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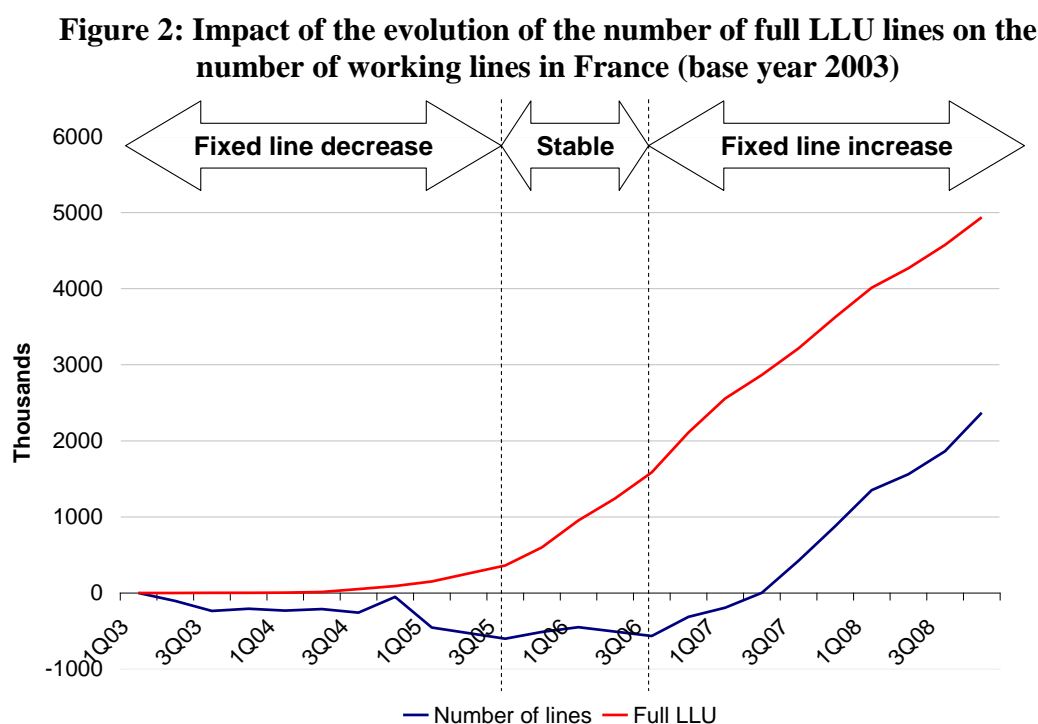
*'The contraction in the economy is expected to continue through this year and into next, with a very modest rate of growth now expected to emerge in mid-2010.'*<sup>7</sup>

In addition to this apparent stabilisation in economic output, ComReg considers that because the implementation of its pricing proposals should lead to an increase in demand for LLU (and stimulate competition in the provision of broadband services) this should act to reinforce stabilisation in the number of working lines.

While the focus of ComReg's analysis is on Ireland, it is also relevant to note that the above analysis is consistent with the experience of a number of other European countries. For example, the impact of broadband services on the number of working lines has recently been highlighted in a report by Arthur D Little/Exane<sup>8</sup> ("*Reviving the fixed line*", February 2009) where they make the following observation:

*"In several countries, the launch of triple-play has enabled the incumbent to considerably slow or even stop line losses. This is the case notably in Portugal, Austria and Sweden".*

In addition, the experience in France indicates that the strong development of full LLU first stopped the decrease in the number of working lines and then led to an *increase* in the number of working lines. This point is illustrated by Figure 2.



Source: ARCEP and France Telecom.

<sup>7</sup> Barrett, A. Kaerney, I. and Goggin, J. (2009), "Quarterly economic commentary." Summer 2009, Research Bulletin 09/2, p. 1.

<sup>8</sup> [http://www.adl.com/fileadmin/editorial/press/ADL\\_Reviving\\_the\\_fixed\\_line.pdf](http://www.adl.com/fileadmin/editorial/press/ADL_Reviving_the_fixed_line.pdf)



ComReg is therefore of the view that the current decline in working line volumes is a short-term phenomenon, driven partly by the current economic conditions and that it is likely to stabilise in 2010.

Taking some of these factors outlined above into account, ComReg proposes to re-calculate its forecast of working line volumes, taking into account the more rapid recent declines, but to retain its earlier assumption that volumes are likely to stabilise in 2010.

**Q. 3. Do you agree with ComReg's assessment that the recent declines (even though these declines have been faster than anticipated since the publication of Consultation Document No. 09/39) are largely a short-term phenomenon for the reasons set out above? Please state the reasons for your response.**

### **2.3 Long lines**

In Consultation Document No. 09/39, ComReg stated that the ability of OAOs to provide broadband is an essential prerequisite for their ability to unbundle lines. At the time Consultation Document No. 09/39 was published, the most up to date publicly available information indicated that it would not be feasible to provide broadband services on lines in excess of 5kms. Accordingly, ComReg applied a lower weight<sup>9</sup> to the costs associated with unbundling lines in excess of 5kms in proposing a LLU price.

In Consultation Document No. 09/39, ComReg did not have any direct evidence available to it to estimate the likelihood of OAOs unbundling long lines. ComReg therefore calculated an adjustment factor of 6.4, so that if long lines account for x% of total lines, then the associated costs should be given a weighting of x%/6.4 in the LLU pricing calculations.

However, Eircom has subsequently provided a confidential and detailed breakdown of long lines that can provide broadband and unbundled local metallic path ("ULMP") services, which suggests that a much higher proportion of long lines may be capable of supporting broadband services and hence, represent potential targets for OAOs. According to the information supplied by Eircom, the appropriate weight for long lines in the LLU cost allocation would rise from x%/6.4 to x%/1.54.

Prior to deciding whether or not to incorporate this updated data into the BU-LRAIC model, ComReg is seeking the views of interested parties, particularly OAOs, as to the importance of the available bandwidth in determining unbundling decisions and the minimum bandwidth that they would require to feasibly unbundle a line.

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<sup>9</sup> Details of the weights applied are contained in Consultation Document No. 09/39 in steps 2 and 3 of Section 5, paragraphs 5.12 to 5.29.

ComReg wishes to emphasise that its intention here is not to mandate the maximum or minimum speeds that OAOs should be making available to their customers, as such matters go beyond the scope of this consultation.

**Q. 4. What do you consider to be the appropriate minimum speed that should be available before you unbundle a particular line? In addition, please provide your definition of a broadband line over the fixed network.**

## 2.4 Price trends

In Consultation Document No. 09/39, ComReg set out its proposed two methodologies for calculating long-run price trends for the assets in the BU-LRAIC model: one for copper-based assets and one for the remainder of the assets. While ComReg remains of the view that the methodologies used for calculating the price forecasts within the BU-LRAIC model for LLU pricing are appropriate, ComReg has also considered the operator responses received in this regard.

In its response to Consultation Document No. 09/39, one operator, Vodafone proposed an alternative methodology for calculating the price forecast. According to Vodafone, ComReg should adjust the historic price trends by the difference in CPI rates, rather than adjusting them by the ratio as proposed by ComReg (in Section 4, paragraph 4.48 of Consultation Document No.09/39). Thus, according to Vodafone, ComReg should calculate price trends as follows:

$$\begin{aligned} \text{Average Price Trend 2008-12} &= \text{Average price trend 2000-2009} \\ &+ \\ &\text{Average labour inflation (or CPI) 2009-12} \\ &- \\ &\text{Average labour inflation (or CPI) 2000-09} \end{aligned}$$

ComReg would welcome any further comments that operators may have on the Vodafone proposed formula set out above. Subject to this, ComReg remains of the preliminary view that the methodology as set out in Consultation Document No. 09/39 is an appropriate one.

**Q. 5. Do you agree that the existing ComReg methodology for calculating price trends, as set out in section 4.48 of Consultation Document No. 09/39, remains appropriate in determining the final LLU charge? Please state the reasons for your response.**

In relation to price trends, ComReg would like to correct some specific typographical errors in paragraph 4.37 of Consultation Document No.09/39 which should have read:

*“One way of achieving this is through a tilted annuity formula because:*

*4.37.1 If prices are falling then the tilted annuity formula allows a **higher** depreciation charge in the early years of an asset's life and allows **lower** charges in later years, with the effect of making it relatively more expensive to invest in the short-term.*

*4.37.2 Similarly, if prices are rising then the tilted annuity formula allows **lower** depreciation charges in the early years and **higher** charges in the later years, making it relatively less expensive to invest in the short-term.”*

The substituted words are emphasised in bold above.

### **3 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 27 July 2009 to 24 August 2009, during which the Commission welcomes written comments on any of the issues raised in this paper.

Having analysed and considered the comments received, ComReg will review the issues raised from the Consultation Document and publish a report in the coming months on the consultation which will, inter alia summarise the responses to the consultation.

In order to promote further openness and transparency ComReg will publish all respondents' submissions 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.

#### **Please note:**

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 website 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: Consultation Questions

### List of Questions

- Q. 1. Do you agree that exchanges with working lines in excess of 2,500 is currently a reasonable threshold for those exchanges that are likely to be economically viable for OAOs to unbundle in the next three years? Please state the reasons for your response. .... 6
- Q. 2. Given the current level of take-up of LLU in Ireland to date, the economies of scale referred to above, do you believe that, among other things, the current price of LLU plays a significant role when considering investing in LLU in the future? Please state the reasons for your response. .... 6
- Q. 3. Do you agree with ComReg's assessment that the recent declines (even though these declines have been faster than anticipated since the publication of Consultation Document No. 09/39) are largely a short-term phenomenon for the reasons set out above? Please state the reasons for your response. .... 8
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