Oxera

Assessment of retail pricing constraints

Response to submissions on consultation 12/27: ‘Next Generation Access (“NGA”): Proposed Remedies for NGA Markets’

Report prepared for Commission for Communications Regulation

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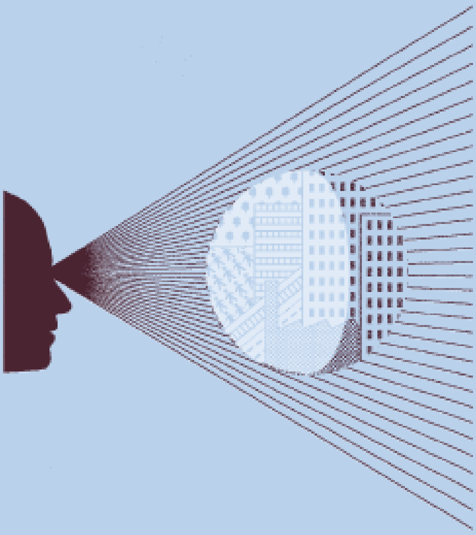

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1 Introduction

1.1 Objective and background

In the context of the Commission for Communications Regulation (ComReg) proposal to introduce an ex ante margin squeeze remedy on eircom's next generation access (NGA) products, this report analyses further the evidence on the retail pricing constraints facing eircom in areas where the company is planning to deploy NGA networks and services.

ComReg's consultation on remedies for NGA markets seeks to assess the appropriate form of regulatory obligations for wholesale NGA products in the markets of Wholesale Physical Network Infrastructure Access (WPNIA) and Wholesale Broadband Access (WBA) ('markets 4 and 5'), where eircom has been found to possess significant market power (SMP).[1] ComReg's proposed remedies include obligations on access; non-discrimination and transparency; and obligations on price controls of relevant wholesale access products. As part of this consultation process, Oxera assisted ComReg with a report assessing the need for, and appropriate form of, price regulation in the NGA context.[2]

In market 5, ComReg proposes that the form of price control for bitstream access products should be an obligation to comply with an ex ante margin squeeze test against retail and other relevant wholesale products. Oxera's report, reflected in ComReg's consultation, set out the advantages and disadvantages of cost-plus and retail-minus approaches to price regulation, including demand uncertainty that necessitates a sufficient degree of pricing flexibility, and unpredictability of unit cost. The most important factor affecting the choice between the two was found to be the degree of competition in the retail market. Retail minus (or a margin squeeze test) may be appropriate only if there are no concerns about the incumbent having the ability to sustain excessive retail prices.

The European Commission's NGA Recommendation is consistent with this finding and indicates that cost-oriented price controls should be used for wholesale bitstream access, but that other appropriate price controls could be used where sufficient competitive constraints exist in retail markets.[3] Indeed, retail pricing constraints are considered a prerequisite for an ex ante margin squeeze test price control, as established by the European Commission:

> Where *ex ante* price regulation is applied, wholesale bitstream access prices should be derived by means of cost-orientation. [national regulatory authorities] could use other appropriate price control methodologies including, e.g. retail-minus, **where there are sufficient competitive constraints on the downstream retail arm of the SMP operator**.[4] [emphasis added]

The Commission has recently endorsed the use of margin squeeze test in the regulation of NGA, provided that non-discrimination rules are rigorously implemented. Furthermore, it

[1] ComReg (2012), 'Next Generation Access ("NGA"): Proposed Remedies for Next Generation Access Markets - Response to Consultation, Further Consultation and draft decision', ComReg document 12/27, April 4th.
[2] Oxera (2012), 'eircom's next-generation access products: Pricing principles and methodologies', Consultation Report, March 2nd.
[3] European Commission (2010), 'Commission Recommendation of 20 September 2010 on regulated access to Next Generation Access Networks (NGA) (Text with EEA relevance) (2010/572/EU)', Recital 37, September 25th.
[4] European Commission (2010), 'Commission recommendation of 20 September 2010 on regulated access to Next Generation Access Networks (NGA)', September 25th.

responded positively to ComReg's notification and proposals to implement more rigorous regulatory regime to ensure non-discrimination, coupled with a margin squeeze test.[5]

Oxera's NGA report drew on market evidence of appreciable competitive pressure faced by eircom in the areas where UPC had rolled out its bidirectional cable network. As set out below, this area broadly matches the exchanges that are likely to be unbundled (as reflected in the LLU cost model), and where eircom therefore also faces retail- and wholesale-level competition from OAOs that have unbundled eircom's exchanges, at least to some extent. The constraint from unbundlers is relevant over the transition period, when eircom will provide access over the two access networks (legacy LLU and NGA).

Vodafone's submission to the consultation challenges the effectiveness of competitive constraints on eircom's wholesale and retail pricing.[6] It notes that there is no historical evidence to suggest that eircom's retail and, through indirect constraints, wholesale prices have been constrained by retail market competition from other operators thus far, and that, in Vodafone's view, there would be no constraint in the future.

1.2 What evidence is required?

A rigorous assessment of retail pricing constraints would draw on detailed data on consumers' responsiveness to changes in pricing and their likelihood of switching. Such an analysis is likely to be very data-intensive, for example requiring consumer surveys to be conducted. In this context, information on the historical behaviour of customers (where they have a choice, switching between services based on eircom's bitstream products and competitors' services) can provide an indication of whether consumers have been responding to competitors' offers and of eircom's likely future behaviour, given the change in the constraints in the NGA environment.

There is international evidence to suggest that retail-level competition could be sufficient to restrict an SMP operator's pricing to the extent that an ex ante margin squeeze test could suffice as a regulatory remedy (the appendix includes further examples).

- The retail-minus methodology for price controls in electronic communications markets has a broad level of support among European regulators, incumbents and entrants' associations.[7] There are several examples of retail-minus regulation being applied, in particular for bitstream access products (see the appendix).

- In the UK, Ofcom concluded that BT's NGA virtual unbundled local access (VULA) product was sufficiently constrained by current generation services and by competition from cable-based operators, and that a price control was not warranted.[8] Ofcom's approach was based on retail pricing constraints from cable (Virgin Media) as well as LLU operators (LLU-based competition is somewhat stronger in the UK than in Ireland, and is driven partly by the functional separation of BT):

  > The risks are likely to be mitigated by the presence of constraints from current generation broadband and from competition from other operators. A further constraint might be the availability of upstream passive products, such as [physical infrastructure access] and [sub-loop unbundling]. The availability of such products

[5] European Commission (2012), 'Commission Decision concerning Case IE/2012/1404, Wholesale physical network infrastructure access and Wholesale Broadband Access – Remedies in Ireland: Comments pursuant to Article 7(3) of Directive 2002/21/EC', December.
[6] Vodafone (2012), 'Vodafone Response to ComReg Document 12/27', consultation response, July 13th.
[7] Independent Regulators Group (2006), 'Summary of the Public consultation on draft IRG Principles of Implementation and Best Practice regarding the use and implementation of Retail Minus pricing as applied to electronic communication activities', January 13th.
[8] Ofcom (2010), 'Review of the wholesale local access market', consultation document, March 23rd.

> could mitigate the risk of anticompetitive outcomes by encouraging innovation in design and construction as well as product offers and pricing structures.[9]

Ofcom did not carry out detailed analysis of pricing constraints in its design of remedies; instead it relied on descriptive market data (eg, Virgin's broadband market share at the time was 16%), although the regulator had assessed substitutability when defining the relevant product markets, concluding that cable and DSL are in the same relevant retail market. Ofcom also applied a retail-minus price control to ATM-based wholesale bitstream access products in its market review in 2004.[10] More recently, Ofcom has introduced a form of ex ante margin squeeze test/retail-minus for BSkyB. In a decision, Ofcom stated how it considered retail-minus more appropriate than cost plus for a variety of reasons, including the unpredictability of, and implications of price regulation for, the underlying costs (content rights).[11]

– The Polish telecoms regulator, Prezes Urzêdu Komunikacji Elektronicznej (UKE), undertook a wholesale broadband market review in 2011 which included FTTH products that were part of proposed NGA deployment by Telekomunikacja Polska (TP). The market definition and assessment found that TP had SMP throughout Poland. The regulator did not impose cost-oriented remedies on the FTTH products, but instead applied access and non-discrimination measures and compliance with a margin squeeze test. The Commission argued that the remedies for FTTH were not compatible with EU law. These non-discrimination measures were based on agreements between the regulator and TP which included a price freeze on wholesale inputs. The Commission criticised the regulator's approach to incentivising investment as a form of regulatory forbearance, claiming that UKE did not identify competition problems in future NGA investments. It also stated that a lack of cost orientation would obscure investment costs and deter entry into the FTTH market. UKE did not cite retail pricing constraints in its justification, although it mentioned constraints in the broadband market more generally. For reference, while Poland's overall market share of cable-based broadband is comparable with Ireland (around 25%), this remained virtually unchanged in Poland between 2008 and 2012.[12]

– The Portuguese broadband market has relatively strong infrastructure-based competition, with cable-based platforms supplying approximately 40% of broadband lines nationally.[13] The Portuguese telecoms regulator, ANACOM, conducted a review of the wholesale broadband access (WBA) market in 2004, and found that Portugal Telecom (the incumbent) had significant market share in specific geographic areas.[14] The regulator applied a retail-minus price control in limited geographic areas as per the market definition. While the justification for a retail-minus control did not specifically highlight competitive constraints, the market analysis in the 2009 determination examined competitive constraints when concluding on the geographical segmentation of this market. It should be noted that the market analysis has been disputed in national courts and this is unresolved at present. The European Commission has also objected to the inclusion of cable platforms in the relevant market.[15]

[9] Ibid., para 7.255.
[10] Ofcom (2004), 'Review of the Wholesale Broadband Access Markets' explanatory statement', May 13th. The decision was recently over-ruled by the Competition Appeal Tribunal, although the Tribunal's findings related to the rationale of regulation in the first place, rather than the specific design of price regulation (and therefore Ofcom's analysis and design of the test are informative).
[11] Ofcom (2010), 'Pay TV Statement', March 31st.
[12] The European Commission Digital Agenda Scoreboard. Available at: http://ec.europa.eu/information_society/digital-agenda/scoreboard/download/index_en.htm.
[13] European Commission (2012), 'PORTUGAL 2011 Telecommunication Market and Regulatory Developments' report, June 18th
[14] ANACOM (2009), 'Markets for the supply of wholesale (physical) network infrastructure access at a fixed location and wholesale broadband access', decision document, January.
[15] European Commission (2004), 'Case PT/2004/0118: Wholesale broadband services in Portugal. Comments pursuant to Article 7(3) of Directive 2002/21/EC', Commission decision letter, December 22nd.

In general, the evidence in support of pricing constraints with regard to the choice of retail-minus price controls is not extensive in the international context. It tends to either rely on descriptive data regarding market developments or refer to evidence gathered in other related workstreams. Nevertheless, given the concern raised by Vodafone, and the fact that the choice between cost orientation and the margin squeeze test relies significantly on the degree of competition in the retail market, it is necessary to assess the competitive constraints present in the Irish market in further detail.

1.2.1 Report structure

The remainder of this report is structured as follows.

– Section 2 assesses retail market developments, based on up-to-date market data.

– Section 3 assesses eircom’s NGA pricing incentives going forward, taking into account differences between NGA and legacy products.

– The appendix contains reference material on the European Commission’s NGA guidelines, case studies of evidence required for retail constraints in other NRAs, and relevant Commission comments on regulatory decisions.

2 Market developments

ComReg's choice of a margin squeeze test over cost orientation stems from the notion that there are no significant concerns that the retail prices of eircom's NGA products could be excessive. An SMP decision should be forward-looking and therefore based on ComReg's expectations for market developments over the next three to five years. Historical data on market developments can provide an indication of the trends and competitive pressures faced by the SMP operator, which in turn need to be factored into the design of proportionate remedies.

This section presents details of the developments in the Irish marketplace over recent years. First, developments in eircom's offerings (in terms of prices and quality characteristics) are examined, followed by a review of customer switching and market share fluctuations inside UPC's footprint.

2.1 Product offering

Retail competition between eircom and its most significant rival, UPC, generally occurs between bundled offers of telephone calls, high-speed broadband access and television content—most switchers to UPC take a bundle deal/offer. For this reason, while it is not possible to compare retail offers on a strictly like-for-like basis, the analysis of pricing behaviour should recognise the competition between similar elements within competing bundles.

Oxera has been informed that eircom has not made reductions to the headline prices of its (non-NGA) bundled offers over the last three years. Rather, the strategy has been to increase the value of existing packages with a mixture of 'free' upgrades (ie, increases in broadband speed), time-limited promotions and customer-specific offers.[16] These may be targeted specifically at those customers who may be more likely to switch to an alternative platform. Where offers (such as a free upgrade) are conditional on a new contract, the strategy intends to lock in customers who could potentially churn to an alternative supplier for a further 12 months. Similar to eircom, UPC tends to increase the value of bundles with free upgrades for existing customers or limited-period discounts for new customers (this is discussed further below). The main alternative operator—Vodafone—also offers bundles of broadband and calls which ultimately rely on eircom for wholesale network inputs.[17] This limits OAOs' ability to add significant value; however, they are able to target their mobile customer base with specific discounts (which may sacrifice mobile revenue) and on-net calls.

Retail strategy—in particular that of eircom and UPC—appears to focus therefore on increasing the value of bundles, rather than appealing to a lower headline price. This may also reflect the fact that underlying broadband products (and the ability to provide add-ons such as TV) are not perfect substitutes in terms of quality, and thus bundled offers are tailored to compensate for these differences where possible. Figure 2.1 illustrates how eircom and UPC have upgraded their offers over time.

Figure 2.1 [✂]

Over time, eircom has reduced prices of certain wholesale access products outside of a periodic market review or charge control decision. For instance, the usage component for the

[16] Retail amendment data as supplied by ComReg.
[17] See http://www.vodafone.ie/df/homebroadband/.

Bitstream (Managed Backhaul) 8Mb product was reduced from €50 to €30 in July 2012.[18] [✂]

Further to the competition between eircom and UPC, eircom's NGA prices may be constrained by OAOs' offers. Importantly, the present consultation relates to a period over which eircom will run legacy wholesale products in parallel with NGA. As set out in Oxera's report annexed to the consultation, the underlying costs between legacy and NGA are linked, and given that the products are to some extent substitutable, legacy-level broadband offers and bundles are likely to constrain eircom's NGA pricing to some extent. This is particularly the case where operators have deployed their own active equipment and use LLU. While unbundling has been relatively limited in Ireland thus far, an important development in this respect is Sky's recent announcement that it will enter the Irish broadband and bundles market with a competitive retail offer.[19] BT Ireland—the most significant LLU operator in Ireland—will be providing the wholesale access service to Sky. This example illustrates that there can be further competition in the retail market through offers that are not reliant on eircom's active access services in market 5.

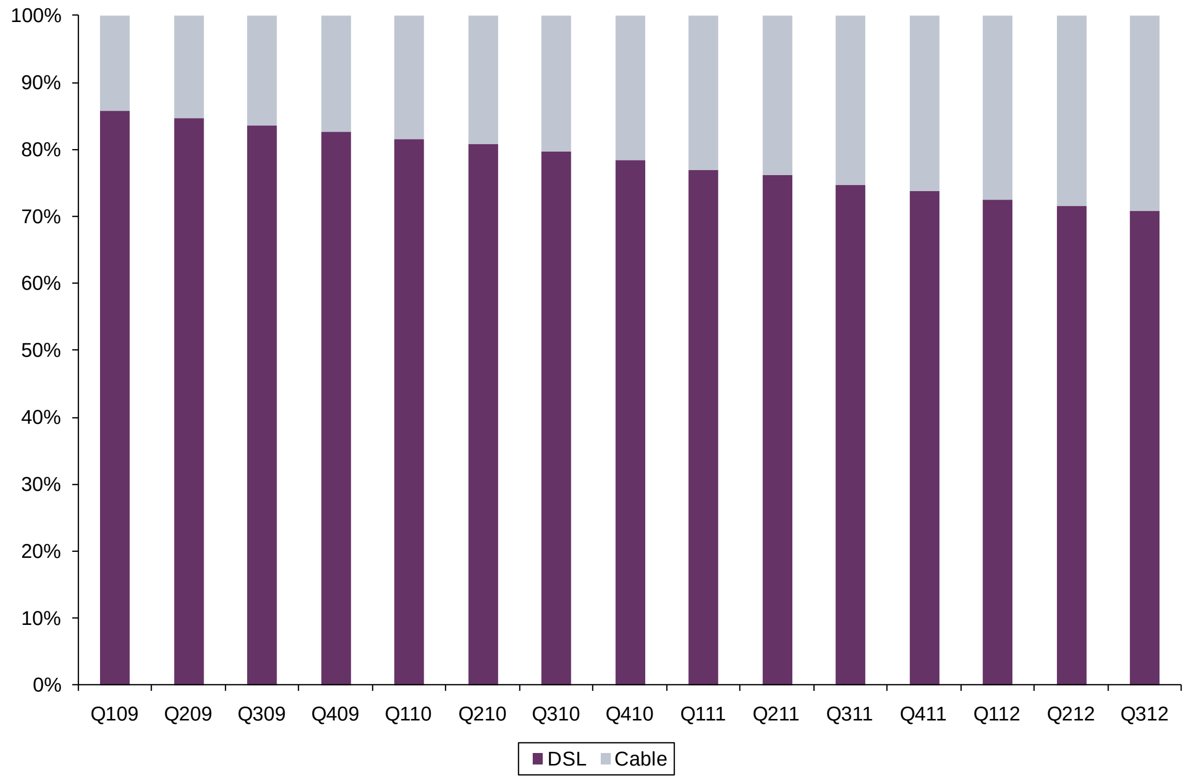
2.2 Customer switching and market share developments

Data on subscriber net additions provides insight into the dynamics of competition in the areas where UPC is active. While the publicly available aggregate-level numbers do not reflect competition in the sub-national markets, it is apparent that consumers are responding to UPC's relatively attractive product offering, putting pressure on both eircom and eircom's wholesale customers to provide competitive offerings to those who have the ability to access the UPC cable network.

Nationally, DSL is the dominant form of broadband access, with just over 70% of fixed-line (ie, excluding fixed wireless access) broadband subscriptions in 2012.[20] However, it is losing market share to other platforms, most notably cable. Year-on-year growth rates for cable are greater than 20%, and therefore the highest of all competing fixed-line broadband platforms.[21] Figure 2.2 illustrates the trend in market shares of the two main platforms on a national basis.

[18] The usage component reflects use of backhaul bandwidth. A flat fee of €50 (€30) applies for usage of up to an average of 100Kbps over a month. For usage of above an average of 100Kbps per month, a charge of €50 (€30) per average Mbps per month applies.
[19] Sky's announcement is available at: http://www.skyuser.co.uk/skyinfo/customers_to_enjoy_more_choice_and_better_value_as_sky_broadband.html.
[20] ComReg (2012), 'Quarterly Key Data Report—Data as of Q3 2012', market report, December 12th.
[21] Ibid. ComReg (2012), 'Quarterly Key Data Report—Data as of Q4 2011', market report, March 13th; and ComReg (2012), 'Quarterly Key Data Report—Data as of Q1 2012', market report, June 14th.

Figure 2.2 Fixed broadband shares by platform in Ireland (DSL, cable, %)



Source: ComReg (2012), 'Quarterly Key Data Report—Data as of Q3 2012', market report, December 12th, ComReg (2012), 'Quarterly Key Data Report—Data as of Q1 2012', market report, June 14th, ComReg (2012), 'Quarterly Key Data Report—Data as of Q4 2011', market report, March 13th, ComReg (2011), 'Quarterly Key Data Report—Data as of Q4 2010', market report, March 18th and ComReg (2010), 'Quarterly Key Data Report—Data as of Q4 2009', market report, March 18th,

At the retail level, eircom's fixed-line broadband market share decreased from above 47% in early 2011 to around 42% in 2012 Q32.[22] UPC increased its share from just under 21% in 2011 Q1 to over 27% in 2012 Q3, a greater increase than all other retail providers combined, including LLU unbundlers.[23]

As these figures are national, they mask the extent of the shifts in market shares occurring within the footprint of UPC's cable network. [✂]

[✂]

Figure 2.4 below illustrates that the decline in eircom's market share (and UPC's market share gain) is greater in urban areas than the national figures suggest. The pattern suggests that UPC is able to attract churning subscribers from eircom retail (and wholesale) products, as well new broadband subscribers, while eircom is losing subscribers in a growing market.

[✂]

Moreover, competition is not limited to stand-alone broadband. Voice and TV bundles are important drivers of switching, and UPC specifically tailors its packages to encourage customers to take double- or triple-play offers (see section 3.1). [✂]

[✂]

[22] See ComReg (2012), 'Quarterly Key Data Report—Data as of Q3 2012', market report, December 12th; ComReg (2012), 'Quarterly Key Data Report—Data as of Q1 2012 ', market report, June 14th; and ComReg (2011), 'Quarterly Key Data Report—Data as of Q1 2011 ', market report, June 21st.
[23] Ibid.

[✂]

3 eircom's pricing incentives for NGA products

The purpose of the pricing framework set out in ComReg's consultation is to provide stakeholders with a transparent set of principles to inform pricing decisions of both OAOs and eircom. ComReg's consultation defines a pricing framework for eircom's NGA products which are largely yet to be introduced to the market. As a consequence, historical market evidence should be interpreted with care—it provides insights on whether consumers are indeed responding to competitive offers in the market, but may not be informative about the dynamics of competition that would prevail when the firms compete with more comparable products.

3.1 Historical evidence on eircom's pricing behaviour

3.1.1 Could eircom have reduced its retail and wholesale pricing?

In contrast with eircom's and its expert's arguments suggesting a highly competitive broadband market within the UPC footprint, Vodafone has argued that competition from UPC has not influenced eircom's pricing decisions, stating that if it were a constraint:

> we would expect to see...at the very least, eircom reducing its wholesale products to their floor prices to give it the maximum headroom to compete with UPC at the retail level;...eircom reviewing its LLU prices (which are amongst the highest in Europe) to seek to identify efficiencies and savings, so that it has scope to further lower its retail prices to meet UPC's offering.[24]

As far as Oxera is aware, there is no evidence of sub-national pricing in either the retail or wholesale broadband markets in Ireland by eircom or any other supplier—apart from the niche NGA pilot launched by eircom. In this respect, eircom has historically not exploited the pricing flexibility it has had under the current regulatory constraints applying to non-NGA (ie, legacy) services. In response to ComReg's market review on WBA, eircom submitted:

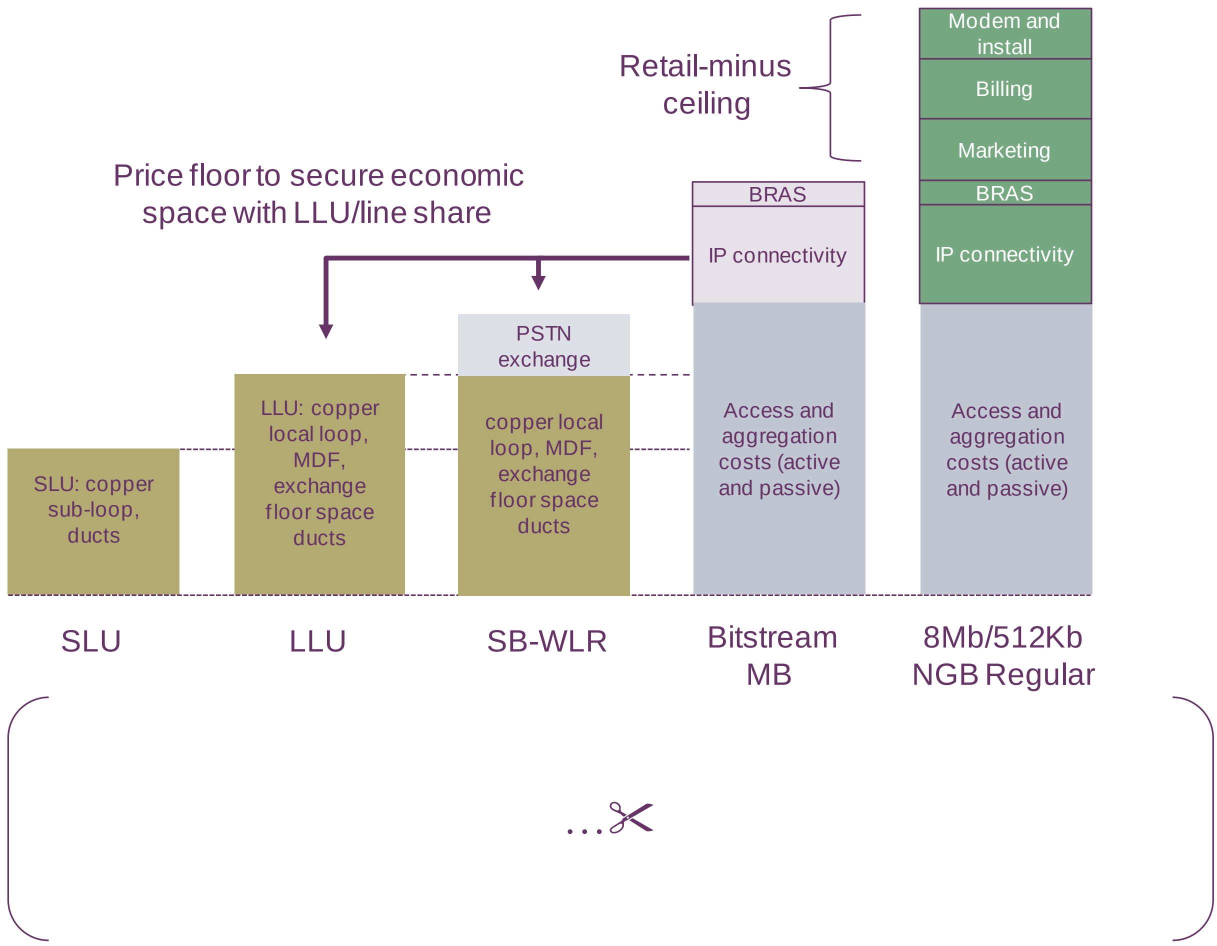
> that its retail-minus pricing obligations for WBA meant that it was not able to differentiate its retail price geographically because a reduction in the retail price in one area would trigger a reduction in the **national** WBA price [emphasis added][25]

ComReg has not in fact mandated nationally averaged wholesale prices, and the regulator has made this clear in its response to eircom, and by providing further clarity on the issue in the more recent decision on bitstream price floors.[26] Indeed, to provide eircom with pricing flexibility while ensuring a sufficient economic space between bitstream and LLU prices, ComReg has defined both floors and ceilings for eircom's current generation bitstream prices.

The floors and ceilings that apply for eircom's Bitstream Managed Backhaul product are detailed in Figure 3.1. The price floor includes a variable component which reflects backhaul capacity usage, as well as fixed components for port and backhaul costs. [✂] This illustrative example shows that with reasonable consumption patterns, there is some margin between the price floor and actual prices, which would suggest that there is sufficient economic space between managed products and LLU/line-share wholesale products. Moreover, it would seem that there is a degree of pricing flexibility for eircom's wholesale and retail products within these bounds.

[24] Vodafone (2012), 'Vodafone Response to ComReg Document 12/27', consultation response, July 13th.
[25] ComReg (2011), 'Market Review: Wholesale Broadband Access (Market 5)', document 11/49, para 4.127, July 8th.
[26] ComReg (2012), 'Wholesale Broadband Access: Further specification to the price control obligation and an amendment to the transparency obligation', document 12/32, April 5th.

Figure 3.1 Economic space between eircom retail and wholesale products



Source: ComReg (2012), 'Wholesale Broadband Access: Further specification to the price control obligation and an amendment to the transparency obligation', consultation document 12/32, April 5th; eircom (2012), 'eircom Reference Interconnect Offer Price List', price list, May 2nd; eircom (2012), 'eircom Access Reference Offer Price List', price list, May 2nd; eircom (2012), 'Bitstream Service Price List Version 7.14', price list, August 3rd; ComReg (2010), 'Amendment and Addition to Table 1 of ComReg Decision No. 01/06', information notice 10/25, 29th March; and the eircom website.

As noted in section 2, eircom has made changes to its retail product offering over time, but these have largely been changes to the composition of the bundled offer, rather than the headline price. Furthermore, the effective retail prices can differ considerably from the nominal prices, as the subscriptions are often bespoke and include, for example, temporary discounts. Table 3.1 shows that recently announced promotions mostly target existing bundle customers or customers who choose eircom's faster next generation broadband (NGB) products, rather than entry-level legacy customers.[27]

Table 3.1 [✂]

Notwithstanding the reactions at the retail level, it is apparent that eircom could have further reduced its retail prices without risk of breaching the existing price floor regulation. In light of this, Vodafone's observation has some merit in that there is no evidence to suggest that the historical retail competition (which has resulted in market share losses in certain areas) has fed into substantial price reductions in terms of headline prices of eircom's retail offers or wholesale pricing, either in general or in specific areas where eircom faces competitive pressure.

[27] NGB products are ADSL/ADSL2+ products which leverage eircom's next generation core network, as distinct from eircom's NGA products which rely on fibre or VDSL networks.

3.1.2 Possible reasons why eircom has not reduced legacy broadband prices

eircom has not as yet engaged in localised pricing or marketing in response to UPC's offers, despite its declining market share within UPC's footprint. While this may appear counterintuitive, there are a number of commercial explanations for such a strategy, which include the following.

– Competing against UPC's offerings on price with legacy-based products may have its limitations. Where the quality (in this case speed) differential is large, the price differential needed to attract back or retain customers may be so large as to render this approach uneconomic.

– Evidence gathered by ComReg (from eircom) suggests that price alone is not the only stated reason for switching from eircom to UPC, with a high proportion citing the TV and phone bundles as a reason. A price response in one component of the bundle, when other elements of the bundle may also be of lower quality (eg, access to fewer TV channels, less extensive content) may be sub-optimal.

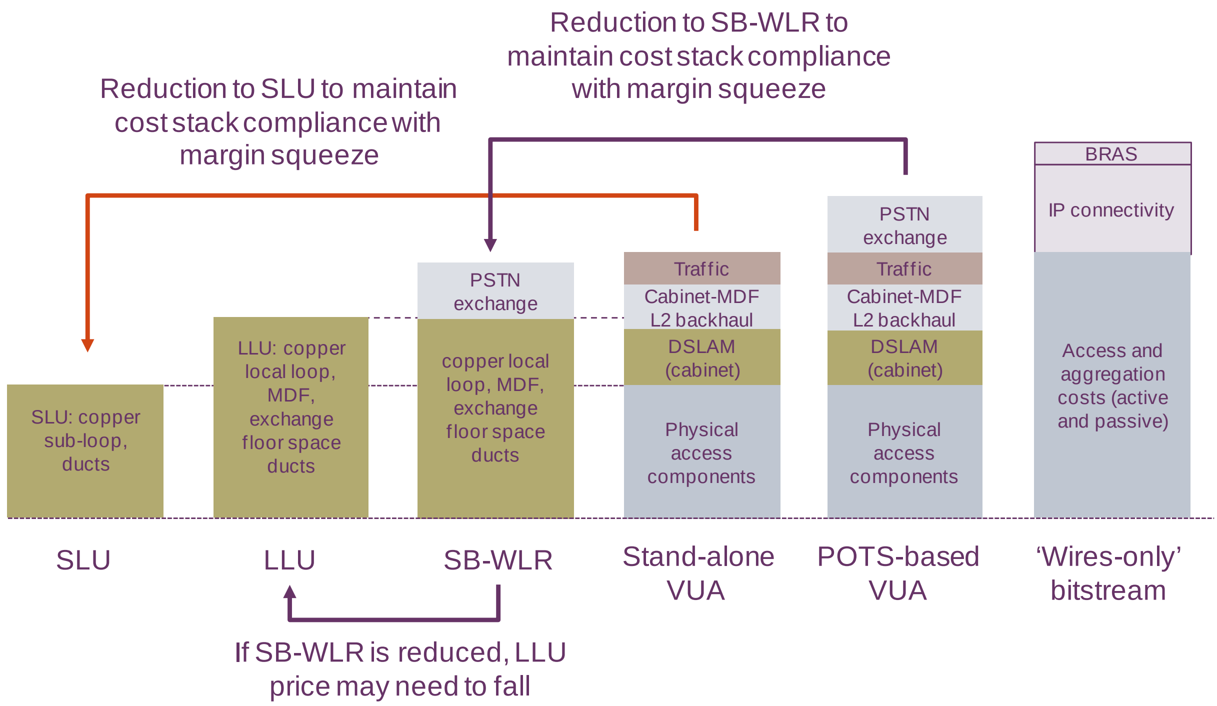
– In addition, to the extent that eircom actually believed that it would not be allowed to create a pricing structure with different prices in different locations (see above), a price response that would enable it to become competitive with UPC in the UPC footprint (and which would be in eircom's commercial interest to do if implemented in this area only) would not necessarily be in eircom's commercial interest if it believed that it would have to make similar retail and wholesale price reductions outside the UPC footprint. Outside the UPC footprint, retail and wholesale price reductions would not make eircom more competitive, and hence the incentives to cut prices are limited.

3.2 eircom's pricing going forward

Historical evidence on eircom's pricing may not, however, be informative about eircom's incentives and behaviour going forward, which is what matters for ComReg's forward-looking regulatory decision. Indeed, there is evidence to suggest that eircom will have the incentives to meet the retail competition from UPC within the NGA footprint.

NGA-based retail products will be available within the NGA footprint only, and will not have characteristics equivalent to legacy products elsewhere. The margin squeeze obligation may require eircom to make adjustments to other wholesale products within the NGA footprint. This could be consistent with existing cost-oriented price controls (eg, for SB-WLR) if the NGA platform enables these products to be delivered with lower unit costs. Figure 3.2 illustrates the relevant costs and wholesale access prices.

Figure 3.2 Economic space between eircom retail and wholesale NGA products: an illustration



Source: ComReg (2012), 'Wholesale Broadband Access: Further specification to the price control obligation and an amendment to the transparency obligation', consultation document 12/32, April 5th; eircom (2012), 'eircom Reference Interconnect Offer Price List', price list, May 2nd; eircom (2012), 'eircom Access Reference Offer Price List', price list, May 2nd; eircom (2012), 'NGA Indicative Pricing Proposal', presentation to NGA Forum, July 25th; and the eircom website: http://www.eircomwholesale.ie/Reference-Offers/Proposals/

The NGA footprint will largely overlap that of UPC. Hence retail and wholesale prices based on the different technology and topology deployed in the NGA network will not spill over significantly into areas where eircom does not face competition from UPC. The cost to eircom (in terms of potential lost revenue) of pricing NGA services competitively relative to UPC's offering is lower than it would be if such prices also had to be offered outside the UPC footprint.

As regards non-price dimensions, eircom's proposed NGA retail product will offer download speeds comparable to those available on UPC's network,[28] and eircom will be able to exceed the upload speed of UPC's current competing broadband bundles. This improved symmetry is a defining characteristic of NGA networks and is likely to improve the consumer experience for video calls, distributed cloud-based applications and social media. UPC's DOCSIS 3.0 network may be configured to meet or exceed the symmetry of the FTTC network in the future (but both platforms are ultimately constrained in their ability to deliver equal upload and download speeds).[29]

Where the technical capabilities are broadly similar, this may increase the incentives to compete on price. The market evidence presented in section 2 suggests that consumers find UPC's offers attractive and have switched from eircom's DSL platform to UPC's cable platform. This implies in turn that when competing with like-for-like products, eircom would not be able to retain its existing customers—let alone win back customers lost to UPC—by pricing considerably higher than UPC.

[28] The fastest package from eircom is available only where FTTH GPON is deployed.
[29] Cable- (and FTTH GPON-) based networks must share upstream bandwidth across neighbouring users. Both DSL- and cable-based networks must trade off upstream and downstream bandwidth. Point-to-point fibre-based networks can typically be configured for symmetrical service regardless of bandwidth.

While eircom's final retail prices for NGA products are yet to be determined, there is evidence to suggest that its forthcoming offerings would be priced in accordance with UPC's current offerings. Notably:

– for wholesale NGA products, eircom has indicated that its wholesale stand-alone VUA price, consistent with retail prices and the margin squeeze test, could be around €17.50 per month. Where the wholesale product includes telephone line rental, the indicative price is €21. [30] This announcement by eircom's wholesale division suggests that retail prices could be low enough to meet UPC's current offerings;

– eircom has already rolled out NGA in certain niche areas. The pricing of its current fibre products provides an indication of its likely pricing strategy going forward. eircom's fibre offerings are compared with UPC's products in Table 3.2. eircom's NGA retail products are priced above broadly comparable offers from UPC (the difference is smaller when one-off fees are taken into account). Considering the improved symmetry of the eircom offer, the higher outright bandwidth of the fibre product, unlimited on-net calls, and the free 'Hub' services provided as part of eircom's bundles, eircom's offers seem to be more competitive in the fibre broadband-bundle segment than eircom's legacy offers. For example, the monthly price of a bundle with 24Mbit/s download speed provided over eircom's legacy network is €60 per month—ie, €10 more than the price of a comparable (entry-level) fibre-based bundle.

Table 3.2 eircom NGA pilot and UPC's retail broadband bundles (voice and broadband)

	Entry level		Intermediate		Highest bandwidth	
	eircom[1]	UPC	eircom[1]	UPC	eircom[1]	UPC
Platform	FTTC	DOCSIS 3.0	FTTC	DOCSIS 3.0	FTTH GPON	DOCSIS 3.0
Download speed	25Mb	50Mb	50Mb	100Mb	150Mb	150Mb
Upload speed	8Mb	5Mb	20Mb	10Mb	30Mb	10Mb
Allowance	100GB	500GB	250GB	500GB	500GB	500GB
Peak	None	100min ANYTIME, anywhere in ROI + selected Intl Destinations	None	100min ANYTIME, anywhere in ROI + selected Intl Destinations	None	100min ANYTIME, anywhere in ROI + selected Intl Destinations
Off-peak	Unlimited on-net calls. 150 to Meteor, 150 to Intl.		Unlimited on-net calls. 150 to Meteor, 150 to Intl.		Unlimited on-net calls. 150 to Meteor, 150 to Intl.	
Price (€/month)	50.00	44.00	60.00	49.00	70.00	54.00
One-off (ie, install)	n/a	45.00	N/A	45.00	N/A	45.00
Discount (presented as average monthly discount over 12 months for consistency)	€2.5/month	€7/month, new customers only	€2.5/month	€8/month, new customers only	€2.5/month	€9/month, new customers only

Note: [1] SportsHub includes live coverage of some Premier League matches. All eircom bundles include MusicHub and StudyHub content.
Source: eircom and UPC retail websites (accessed September 19th 2012).

[30] See eircom website: http://www.eircomwholesale.ie/Reference-Offers/Proposals/

4 Conclusions

In reply to responses to ComReg's consultation 12/27, this report has presented further evidence and analysis of the competitive dynamics in the Irish broadband (and adjacent) markets. Oxera has complemented the analysis presented in its report that was annexed to ComReg's consultation, and has further examined the appropriateness of the margin squeeze test as opposed to the cost-orientation obligation, in particular. The principal conclusions of Oxera's additional analysis are presented below.

eircom has been losing market share to UPC where the cable operator has network footprint. UPC has been successful in acquiring customers who have previously used DSL broadband (purchased either from eircom or OAOs) as well as new customers without an existing broadband subscription. This trend, which is particularly strong among residential customers, has prevailed for some time and continues on an upward path. This implies that consumers are responding to UPC's offers, which are competitively priced and (before eircom's roll-out) superior in terms of the quality characteristics of speed and TV offering. The situation is not sustainable for eircom, which is why the company is defending its position by rolling out FTTC networks with the aim to launch retail services that compete more effectively.

Oxera does not challenge the factual evidence presented by Vodafone. In the past eircom has not generally reduced its retail prices or wholesale prices, when it could have done so without introducing a margin squeeze. However, Vodafone's *conclusions* derived from this observation may not be appropriate in that eircom's historical behaviour may not be reflective of its future pricing strategy.

– Historical evidence may not be fully informative about the dynamics of competition going forward. When competing with more like-for-like products, eircom could be expected to meet competition with UPC on price. Since consumers are responsive to competitive offers, in order to remain competitive in the NGA environment eircom would seem to have stronger incentives to match UPC's offerings on products that are broadly similar than on those that are dissimilar in terms of quality characteristics. eircom's current NGA (pilot) retail pricing and an indicative wholesale announcement on the upcoming pricing of VUA are consistent with this finding.

– It appears that regulatory factors may also have contributed to eircom's decision not to reduce its prices in areas where it faces more competition. Specifically, it appears to have believed that it would not be allowed to reduce its retail or wholesale charges in selected areas without introducing corresponding changes in other areas as well. Such a belief would result in significantly overestimating the costs of meeting the competition in selected areas. While ComReg provided eircom with clarity on this issue in 2011, eircom's statements indicate that it may have been a factor affecting eircom's pricing decisions until recently.

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There are therefore sound reasons to suggest that, in order for eircom to remain competitive, the margin squeeze remedy is appropriate in the context of its NGA products, given the retail pricing constraints that it appears to be facing with regard to these products.

While this report has focused on the evidence regarding a retail pricing constraint—which is the most important factor to consider—there are other factors to suggest that ComReg's proposal is appropriate in the current context. First, there is a degree of uncertainty about the costs and demand of NGA services (including eircom's TV offering), and hence reliably projecting unit costs over time may not be feasible. Second, ComReg's proposal relates to the next regulatory period, over which eircom will continue to provide copper-based LLU services in parallel with NGA products. As some OAOs have continued to invest in LLU, it seems reasonable to assume that eircom's NGA retail prices are, to some extent, constrained also by the legacy-level services.

Finally, it is noted that the margin squeeze test proposed in the Oxera report seeks to provide certainty and protection for entrants. ComReg's margin squeeze test is designed to take into account the fact that entrants do not benefit from economies of scale and scope to the extent that eircom does, which is consistent with ComReg's objective to promote competition, and which mitigates concerns that the relevant wholesale prices would be excessive relative to underlying costs.

A1 Summary of retail-minus price regimes in other EU countries

Further to the examples presented in section 1, retail-minus (or similar) regulation has been introduced in a number of countries. Historically, the remedy has been predominantly imposed in wholesale access products, namely wholesale line rental and WBA. Specifically, according to the Body of European Regulators for Electronic Communications (BEREC), in 2011 eight national regulators used retail-minus in the context of WBA.[31] This shows that such a remedy is not unprecedented and has been considered appropriate despite the fact that legacy-level WBA is arguably a more mature product than active NGA wholesale products, and the retail pricing constraints may not be any stronger in the non-NGA markets (as discussed in this report).

Austria

The broadband market in Austria has relatively strong infrastructure-based competition, with cable operators capturing over 31% of the residential market as at January 2012.[32] In 2010, the Austrian telecoms regulator imposed a retail-minus price control on the WBA market for business users.[33] The decision required the incumbent, Telekom Austria, to comply with a margin squeeze obligation with reference to unbundled local loops.

Finland

The Finnish regulator, FICORA, has never introduced explicit ex ante price regulation in market 5 (WBA), but instead has relied on access and non-discrimination obligations. In practice, this has meant that the regulator has intervened ex post if and when there have been concerns about discriminatory bitstream pricing. While FICORA's most recent market review was scrutinised by the European Commission, and there was a Phase II investigation about the matter, FICORA relaxed regulation of WBA further.[34] Specifically, the regulator decided to: (a) continue without imposing price controls; and (b) relax remedies from lower speeds (lower than 8Mbit/s). The European Commission had concerns that different treatment of lower-speed broadband access in the same product market might result in a distortion of competition—in particular, according to the European Commission, FICORA had not provided evidence on why lighter regulation would be justified and in line with the NGA Recommendation.

Hungary

In Hungary, infrastructure-based competition results in cable-based operators serving almost half of the broadband market as of January 2012.[35] Three telephony operators (Magyar Telekom, Invitel and UPC) operate local networks with strong market presence. Local operators with SMP provide bitstream access on a top-down long-run incremental cost methodology, while national bitstream prices are regulated with a retail-minus approach.[36]

[31] Body of European Regulators for Electronic Communications (2011), 'BEREC report: Regulatory accounting in practice', October 11th.
[32] European Commission (2012), 'AUSTRIA 2011 Telecommunication Market and Regulatory Developments' report, June 18th.
[33] Austrian Regulatory Authority for Broadcasting and Telecommunications (2010) 'Decision M/10-92', decision notice, November 15th.
[34] European Commission (2012), 'Commission decision concerning cases FI/2012/1328-1329: Markets for wholesale physical network infrastructure access at a fixed location and wholesale broadband access Opening of Phase II investigation pursuant to Article 7a of Directive 2002/21/EC as amended by Directive 2009/140/EC', June 18th.
[35] European Commission (2012), 'Hungary 2011 Telecommunication Market and Regulatory Developments' report, June 18th.
[36] Network Strategies (2011), 'Reviews of the standard terms determinations on Telecom's unbundled bitstream access service' report number 31011, May 20th.

Luxembourg

Luxembourg's broadband market is dominated by the fixed-line incumbent, P&T Luxembourg, which supplies over 70% of all fixed broadband lines.[37] Alternative operators supply around 20% of the DSL-based retail market, of which one-third is provided by bitstream and two-thirds is provided by LLU. The reference offer for broadband access, approved in 2011 by Institut Luxembourgeois de Régulation (ILR), the telecoms regulator, is based on a retail-minus methodology.[38]

[37] European Commission (2012), 'Luxembourg 2011 Telecommunication Market and Regulatory Developments' report, June 18th.

[38] See European Commission (2012), 'Luxembourg 2011 Telecommunication Market and Regulatory Developments' report, June 18th; and Network Strategies (2011), 'Reviews of the standard terms determinations on Telecom's unbundled bitstream access service' report number 31011, May 20th.

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