Commission for
Communications Regulation

Report on Consultation and Decision

Decision on the Costing of universal service obligations: Principles and Methodologies

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1 Introduction

1.1 The European Communities (Electronic Communications Networks and Services) (Universal Service and Users' Rights) Regulations 2003, ("the Regulations"), provide that universal service provider ("USP") may submit a request for funding for a claimed net cost of meeting the Universal Service Obligation ("USO") and that the Commission for Communications Regulation ("ComReg") is obliged to assess such a request.

1.2 This document outlines the response to the ComReg Consultation and Draft Decision *Costing of universal service obligations: Principles and Methodologies* (referred to here as "Consultation 11/15", "the Consultation" or "Draft Decisions Paper") which was published on 7 March 2011.[1] This Report to Consultation and Decision outlines the key principles and methodologies associated with the costing of the USO, and it provides guidance necessary to allow a USP submit an application for funding.[2]

1.3 Promoting competition, contributing to the development of the internal market and promoting the interests of users are ComReg's key objectives in relation to the regulation of electronic networks, services and associated facilities.[3]

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

1.5 ComReg has a role in promoting efficient levels of competition. Having regard to the Directive, universal service must be implemented in a way that minimises market distortions.[4] For example, Recital 3 of Directive 2002/22/EC of the European Parliament and the Council of 7 March 2002 on universal service and users' rights relating to electronic communications networks and services ("the Directive") provides that: *"….obligations will not be regarded as anti-competitive per se, provided they are administered in a transparent, non-discriminatory and competitively neutral manner and are not more burdensome than necessary for the kind of universal service defined by the member."*

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[1] The Draft Decisions Paper was published following consultation of ComReg document number 10/94 (the "Consultation Paper") which was published on 30 November 2010.

[2] However, should there be a material change in terms of the USO designation in the future, ComReg may be required to review these key principles and methodologies for appropriateness in light of a material change.

[3] Communications Regulation Act, 2002, as amended and Article 8 of Directive 2002/22/EC of the European Parliament and the Council of 7 March 2002 on universal service and users' rights relating to electronic communications networks and services.

[4] See Article 3 (2) of the Directive which provides that: *"Member States shall determine the most efficient and appropriate approach for ensuring the implementation of universal service, whilst respecting the principles of objectivity, transparency, non-discrimination and proportionality.* ***They shall seek to minimise market distortions****, in particular the provision of services at prices or subject to other terms and conditions which depart from normal commercial conditions, whilst safeguarding the public interest."*(Emphasis added)

1.6 In accordance with the Directive, ComReg's objective is to highlight the true total costs of USO. An over or under estimation or an incorrect calculation of the net cost by the USP concerned may distort competition. On the other hand, if a USP has an unfair burden, there is a risk that market developments and innovation could be endangered.[5] According to the European Commission, ensuring universal service may involve the provision of some services to some end-users at prices that depart from normal market conditions. However, compensating designated undertakings in such circumstances need not result in any distortion of competition, provided that they are compensated for the specific net cost involved, the net cost burden is recovered in a competitively neutral way.[6]

1.7 In making an assessment of the net cost of USO and the burden on a USP, it is incumbent on ComReg to take these general principles into account.

1.8 ComReg received six responses to the Consultation and the non-confidential responses received to the Consultation were published on 18 May 2011[7]. ComReg has taken full account of all of the responses in this document. In their response Alternative Operators in the Communications Market ("ALTO") stated that "*we support ComReg's Draft Decisions and we believe that the Draft Decision arrived at is the correct and proportionate response in all the circumstances*". BT Communications Ireland Ltd ("BT") stated that "*we are in general agreement with the approach taken by ComReg*" whilst Magnet Networks stated that "*the principles outlined in the Draft Decision are comprehensive… Overall this consultation and decision was thorough, enlightening and dealt with the issue in a clear and comprehensive manner*". Verizon Business stated that it "*supports ComReg's Draft Decisions and considers that they are a fair and reasonable and proportionate response in light of the issues considered*". Vodafone stated that it "*do(es) not have any fundamental objections to the draft conclusions reached by ComReg on its proposed approach*" and go on to state that "*these appear, in general, to be reasonable and objectively justified*". The main points made by respondents to the Consultation are addressed in full in the main body of this document. Other responses are addressed in Appendix A.

1.9 This document details how ComReg will seek to assess a USO funding application and the principles it will consider in establishing if there is an unfair burden associated with meeting the USO provision. Where ComReg has been in a position to specify the precise principles or methodologies that will be used, it has done so. It is not possible to do so absent an application for funding for practical reasons. By way of example, once the application is received from the USP and the modelling work begins with the assessment of the raw data, there may be circumstances where modifications are required to ensure that any limitations that are discovered are overcome. It is not possible at this time to forecast what modifications would be needed, but it is equally important to ensure that all stakeholders are aware of the possibility that ComReg will require some degree of flexibility going forward. However, any such modification will be pragmatic and consistent with the general principles and methodologies set out in this paper.

1.10 A Decision Instrument, formalising ComReg's Decisions is provided in Appendix D. In making the Decisions herein, ComReg has had due regard to the relevant policy directions

[5] Recital (25) of Directive 2002/22/EC.

[6] See the European Commission's Implementation of the Telecoms Regulatory Framework in the Member States: Reports 2006, 2007, 2008 and 2009.

[7] ComReg document number 11/38

issued to ComReg by the then Minister for Communications, Marine and Natural Resources in 2003 and 2004 and these can be read in detail in Appendix E.

1.11 The sections and appendices that make up this paper are set out in the following table.

Section	**Title and Topic**
Section 1	**Introduction** Discusses the scope and overall structure of this paper.
Section 2	**Executive Summary** Sets out at a high-level ComReg's overall approach.
Section 3	**Principles and methodologies for calculating the USO net costs and revenues (excluding benefits of the USO)** Sets out the costing methodology which will be used to calculate the net cost (pre any intangible benefits) and what categories of costs and revenues will be included and allocated in the calculation.
Section 4	**Principles and methodologies for calculating the benefits of the USO** Discusses the main benefits of the USO and discusses a number of identified potential approaches that it could adopt in valuing these.
Section 5	**Approach to the determination of unfair burden** Sets out ComReg's decisions regarding the concept of an unfair burden.
Section 6	**Treatment of confidential information** Discusses the treatment of confidential information.
Appendices	**Title and Topic**
Appendix A	**Review of Consultation Responses** Discusses ComReg's conclusions on additional views raised by respondents including: Regulatory Impact Assessment, respective USO funding, LLU, ECAS and End-to-End Valuation.
Appendix B	**The Legislative Provisions**
Appendix C	**Glossary of Terms** Defines terms and acronyms used in the paper.
Appendix D	**Decision Instrument**
Appendix E	**Ministerial Policy Directions**
Schedule 1	**Form of Directors' Certificate on USO Funding Application**

2 Executive Summary

Introduction

2.1 ComReg's objective in this document is to provide guidance that are to be used and to determine if such a net cost places an unfair burden on the USP. This document outlines guidelines in consideration of the responses to consultation, that has been received from a number of stakeholders during the last number of months with a view to providing as much transparency and certainty as possible.

2.2 The starting point for the assessment of a USO net cost is the Directive, and the Regulations.[8] They provide that for a calculation of a USO net cost: "…*the net cost of USO is to be calculated as the difference between the net cost for a designated undertaking of operating with the USO and operating without the USO.*" In addition,"…*Due attention is to be given to correctly assessing the costs that any designated undertaking would have chosen to avoid had there been no universal service obligation. The net cost calculation should assess the benefits, including intangible benefits, to the universal service operator.*"

2.3 Therefore, a key issue in estimating the USO net cost is the definition of avoidable cost. Diagram 1 (see pages 10-11) illustrates the process steps in relation to the key components of any estimation of the net cost of fulfilling a USO commitment. These are:

1. which costs and revenues are relevant;
2. on what basis to assess those costs;
3. the extent of any intangible benefits that the USP may generate from being the USP; and
4. how to assess whether any resulting net cost is material and may impose an unfair burden on the USP.

2.4 ComReg's view is that the above principles necessitate a methodological approach that estimates the Net Avoidable Costs (NAC),[9] identifying the costs that a USP would avoid and the revenues it would not earn if it had not faced a USO in a given year of application.

Principles and methodologies for calculating the USO net costs and revenues (excluding benefits of the USO) (Section 3)

2.5 ComReg proposes to assess the cost that the USO provision may place on the USP — by reference to the difference in actual costs that the USP, as a commercial operator, would have incurred had the USO be withdrawn for the year of an application for funding. The counterfactual (i.e. what costs the commercial operator would not have incurred had the USO never existed), is extremely complex, requires significant analysis and is open to ambiguity and subjectivity. However, where the USP can demonstrate to the satisfaction of ComReg that the USP, acting as a commercial operator, would never have served that area or customer if the USO had never existed — ComReg will consider this during the course of its assessment of the USO funding application.

2.6 Consistent with this overall approach, ComReg has concluded that the Historical Cost Accounting (i.e. the actual historic data reconcilable to the corresponding financial year

[8] Schedule 2, Part A of the Regulations

[9] NAC is a standard approach to the measurement of the USO in the telecoms sector across the EU and elsewhere.

audited separated accounts) suitably adjusted for efficiencies is the most appropriate costing methodology to assess the cost of the USO.

2.7 The time period over which the USO net costs are to be calculated is the time period of application (i.e. the corresponding financial year of the audited separated accounts). The net cost calculation will take into account the relevant depreciation levels (in that financial year) and make adjustments for potential efficiencies and avoidable costs, as appropriate.

2.8 The requirement that the net cost calculation takes into consideration efficiency is clearly contemplated in the Directive and the Regulations. Therefore, ComReg must ensure that the USP is not compensated for inefficient decisions in the past or costs incurred inefficiently. ComReg has identified a number of potential methodologies / approaches which may provide indicators of whether or not there are inefficiencies in historic costs. For the avoidance of doubt, it is only efficiently incurred costs which should be reflected in the net cost calculation.

2.9 In order to identify the "true" cost of the USO, the net cost calculation must take into account those costs that the USP would directly avoid without having the USO (i.e. the requirement to serve "uneconomic" customers). ComReg considers that it is important to distinguish those costs that the USP incurs as a commercial operator and those that it incurs in discharging its USO. The purpose of the net cost calculation is to accurately reflect the "true" cost of the USO[10].

2.10 The USP benefits from both tangible and intangible benefits as a result of the USO. Therefore, the net cost calculation must take into account these benefits that the USP would forego, for the given year of application, if the USO was not in place. The tangible benefits consist of the direct and indirect revenues that the USP derives from the USO. The intangible benefits consist of the gains (directly financial or otherwise) the USP derives from the USO (this is discussed further in paragraphs 2.13-2.16).

2.11 As well as provision of access at fixed locations and telephone services the USO provides for the provision of payphones, directory enquiry services, and directories and specific services for disabled users. Where these services can only be provided at a loss and where it would not have been provided by a commercial operator, ComReg considers it appropriate to include the associated avoidable costs and revenues in a net cost calculation.

2.12 Eircom is currently designated as the USP until June 2012 and may make applications for USO funding in respect of its financial periods 2009-2010, 2010-2011, and 2011-2012. Should the USP wish to apply for a USO fund it most do so no later than 9 months after the respective financial year end. However, for the current USP's financial year ended 31 June 2010 (some eleven months ago) the USP may apply for a fund but may do so no later than 6 months from the date of this decision.

Principles and methodologies for calculating the benefits of the USO (Section 4)

2.13 The USP benefits from serving both economic and "uneconomic" customers as a result of its USO and, as provided for by the Directive, the net cost calculation must be adjusted for such values.

2.14 ComReg has specifically identified four benefits which it will consider at a minimum when assessing the net cost calculation, namely: brand recognition, ubiquity, life-cycle and marketing.

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2.15 At this remove, in the absence of receiving an application, ComReg is unable to specify with certainty the specific methodologies which would provide an appropriate estimate in monetary terms of the value of these benefits. However, ComReg has identified a number of the potential approaches (implemented in overseas jurisdictions) that it could adopt.

2.16 For clarity, the direct benefits of the USO have been accounted for in the net cost calculation (see paragraph 2.10). In addition, where considered relevant, a segment of the value of intangible benefits may have been considered / incorporated in the commercial operator decision (i.e. the decision by the USP as a commercial operator that it would continue to serve certain loss-making customers or areas if the USO was removed), to the extent to which these have been demonstrated (to the satisfaction of ComReg) as being included in the net cost calculation. Accordingly, these should not be double-counted in a separate measurement of intangible benefits.

Approach to the determination of unfair burden (Section 5)

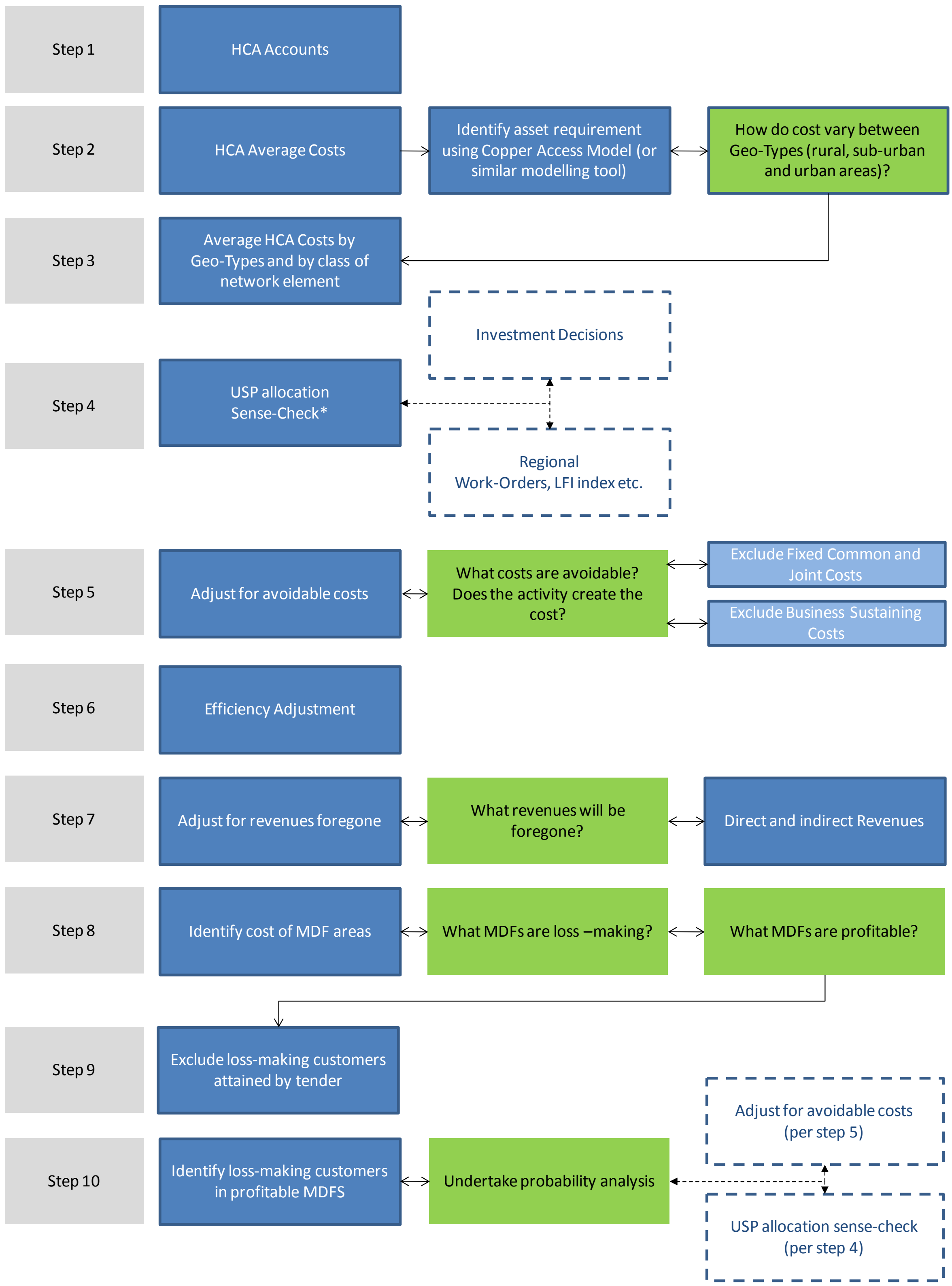
2.17 A determination of what constitutes an "unfair" burden is indispensable for determining whether, or not, a sharing mechanism should be established. A positive net cost does not automatically mean that the burden of a net cost is unfair or that it gives rise to a funding mechanism. ComReg will determine if there is an unfair burden, if there is a positive net cost of providing the USO, on a case by case basis.

2.18 If a positive net cost is relatively small, ComReg will conduct an "administrative cost" test (and hence whether or not the cost of establishing and implementing a sharing mechanism would be disproportionate to the net transfers to the USP). However, if a positive net cost is not relatively small, ComReg would also evaluate whether, or not, a positive net cost can be considered to be material having regard to an assessment of the USP's financial position and competitive conditions.

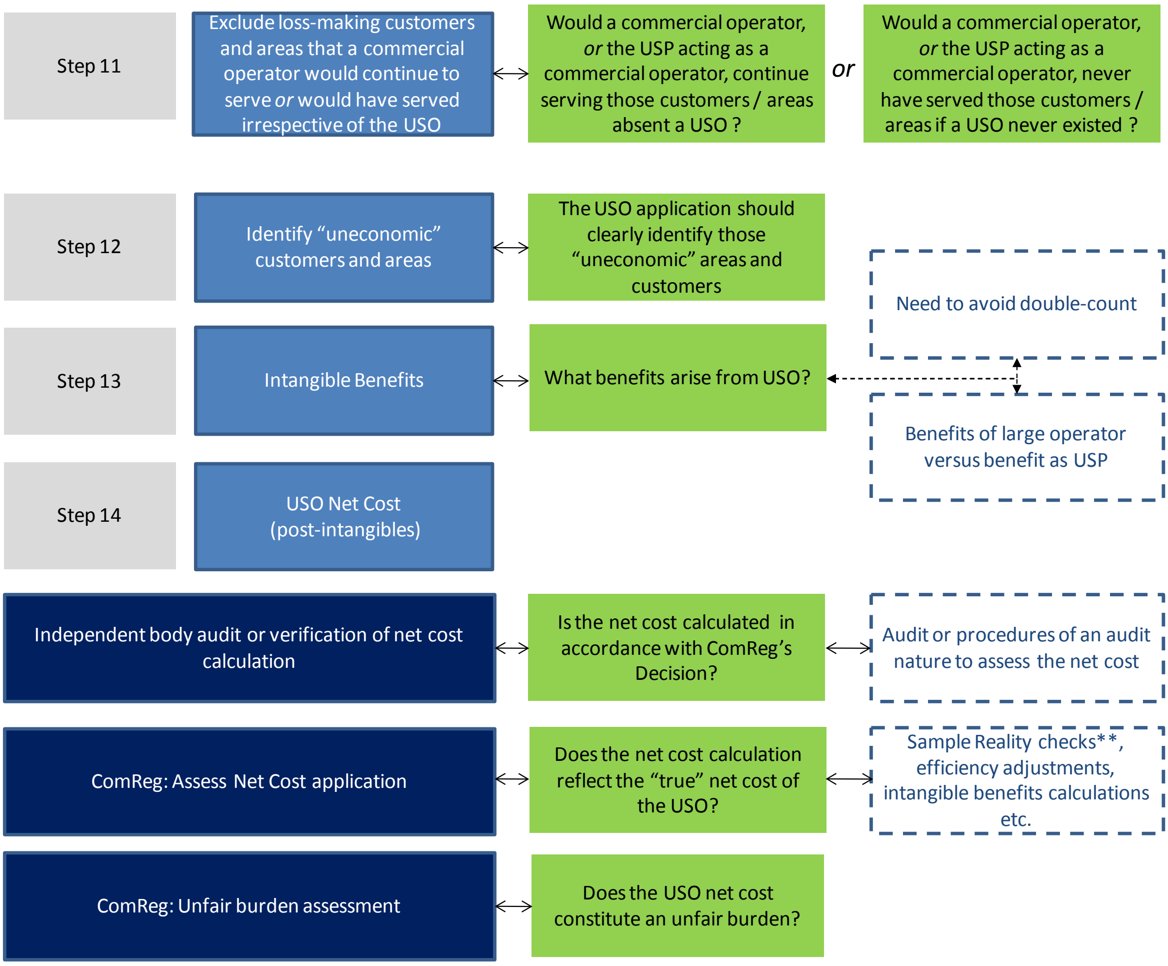
Treatment of confidential information (Section 6)

2.19 ComReg will adhere to its current guidelines regarding the treatment of confidential information and has decided not to use 'confidentiality rings' or similar tools. However, should exceptional cases arise, ComReg will consider alternative means on an "as needs" basis.

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



*See paragraphs 3.95 and 3.114.



**See paragraphs 3.98 and 3.116.

3 Principles and methodologies for calculating the USO net costs and revenues (excluding benefits of the USO)

Overview

3.1 This section sets out ComReg's decisions and guidance on the principles, methodologies, the form and information requirements that it will apply to the calculation of a net cost (including the identification and inclusion of associated revenues in that calculation) — if ComReg receives an application in respect of a USO.

3.2 This section is structured under the following headings:

- *Principles and methodologies: the costing methodology to be used:* ComReg's decision on the most appropriate costing methodology;
- *Principles and methodologies for avoidable costs*: ComReg's decisions on the appropriate avoidable costs;
- *Principles and methodologies for USO revenue calculations*: ComReg's decisions on how a USP's revenues are to be considered in determining the USO's net cost;
- *Principles and methodologies for efficiency adjustments*: ComReg's decisions on the efficiency adjustments that might be required in calculating the USO's net cost;
- *Principles and methodologies for cost identification and allocation:* ComReg's decisions on how net costs could be identified and calculated;
- *Principles and methodologies for cost identification and allocation: uneconomic payphones and other USO costs:* ComReg's decisions on how net costs could be identified and calculated for uneconomic payphones and other USO services;
- *Fit for purpose format:* ComReg's decisions on the minimum presentation and information requirements to be included by the USP in any application for USO funding; and
- *Timing of an application:* ComReg's decisions on the relevant timing should an application be made by the current USP in respect of: (a) the financial period 1 July 2009 to 30 June 2010; and (b) the relevant timing associated with any subsequent funding applications with respect to subsequent financial years.

Principles and methodologies: the costing methodology to be used

The Consultation issue

3.3 One of ComReg's regulatory functions is to ensure that the USO funding application presents a "true" net cost of serving uneconomic end-users or groups of end-users, and that the USP is not over or under-compensated. The appropriate costing methodology for calculating the net cost is not prescribed by law and the decision on which to use is, to a great extent, left to the discretion of a national regulatory authority ("NRA").

3.4 ComReg considered a number of widely known and understood costing methodologies as the basis for calculating the net cost of a USO. ComReg considered that the Historic Cost Accounting ("HCA") costing methodology, as opposed to either the Long Run Incremental Average Cost ("LRAIC") or the Current Cost Accounting ("CCA") methodologies, would more likely reflect the actual net cost of serving end-users, or groups of end-users, (i.e. uneconomic customers or uneconomic areas) where it is unlikely that an operator would invest in the short to medium term absent the USO.

3.5 ComReg's Draft Decision was that the HCA methodology, properly adjusted for efficiencies, and taking account of the costs that could have been avoided by the USP absent the USO, was the cost methodology that should be used to calculate the net cost of the USO.[11]

Summary of Respondents' views

3.6 Eircom made the only submission which specifically addressed this issue. Eircom believes the use of a forward-looking LRIC methodology is the most appropriate approach to calculate the net cost. Eircom believes that ComReg's reasoning on LRAIC is *"flawed"* and that the concept is much broader as: *"[i]ncremental costs reflect the cost to the operator – and to society as a whole – of engaging in the activity under review…Hence it reflects the resources that eircom has to give up in providing the USO services. In not providing these services, eircom would have avoided the corresponding incremental costs (or LRAIC per unit of service)."*[12]

3.7 Eircom accepts that the comparison of HCA and Modern Equivalent Asset ("MEA") with reference to under-ground and over-ground deployment may result in a more expensive roll-out cost. However, Eircom believes ComReg's analysis is incomplete, as the asset specified by the MEA methodology would provide for the asset (with the required capacity and functionality) which has the lowest discounted cost over future years to be used (i.e. if over-ground deployment meets this requirement then over-ground cables will be used in the net cost calculation etc.).

3.8 Eircom also suggested that: *"efficiency adjustments for HCA are highly unusual…It appears to eircom in this regard that the requirement under the Direction that funding reflect efficient costs is more consistent with a choice of LRIC."*[13]

ComReg's Conclusions

3.9 The appropriate costing methodology for calculating the net cost is not prescribed by EU or national legislation and is a matter in relation to which national regulatory authorities ("NRAs") have a considerable degree of discretion.

3.10 The question of which costing methodology is appropriate is a fundamental one. ComReg has considered this issue at great length and has paid careful attention to the views that respondents expressed on this issue.

3.11 Having done so, ComReg is now satisfied that the HCA approach (i.e. the actual historic data reconcilable to the corresponding financial year audited separated accounts appropriately adjusted for efficiencies and avoidable costs[14]) is the most appropriate costing methodology to be used in calculating the net cost of the USO.

3.12 The HCA approach is based on the actual costs incurred and it will more accurately reflect the "true" cost that the USP incurs as a result the USO. Furthermore, the HCA approach is based directly on the historical reported financial results for a given period and thus, it provides increased transparency in the net cost calculation.

[11] As the net cost calculation is based on a retrospective financial year, it is the cost which the USP could have avoided (including any relevant depreciation) in that financial year as if the USO obligation was removed at the start of that financial period. The principle of avoidable costs is discussed in paragraphs 3.20-3.45.

[12] Eircom Limited, "Response to ComReg's Consultation & Draft Decision No.11/15, Costing of Universal Service Obligations: Principles and Methodologies", 18 April 2011, pg. 4.

[13] Eircom, *supra* n 12, pg.4.

[14] As discussed in paragraphs 3.20-3.46.

3.13 ComReg disagrees with Eircom's statement that it is unusual to apply efficiency adjustment to actual costs. ComReg notes that in many overseas jurisdictions[15] where compensation mechanisms or price / revenue-paths are based on actual costs, that typically an efficiency adjustment is provided for — to prevent undue compensation or "gold-plating" of costs (i.e. the expectation is that due to the efficiency adjustment, over time the actual cost will be reflective of an efficient cost base and that end-users pay prices that correspond to appropriately discharged costs).

3.14 Without adjustment, the historical accounts could reflect inefficiencies, either as a result of sub-optimal network design or inefficient operational practices by the USP. The Regulations and Directive are clear that, regardless of the costing methodology implemented by the NRA, the approach used must either reflect efficiencies or be capable of adjustment for same.[16]

3.15 Furthermore, ComReg considers that appropriate efficiency adjustments,[17] will amongst other things, incentivise the USP in continuing to act efficiently as a profit maximising commercial operator. Not allowing for such adjustments runs the risk of the USP being compensated for decisions that were not cost efficient and signalling to the USP (wrongly) that it stands to be compensated for *any* costs incurred (efficient or otherwise). Therefore, the efficiency adjustment should ensure that the USP is not compensated today for inefficient decisions in the past, and provides a future incentive for costs to be efficiently incurred. If following the analysis of the financial data, the USP is found to be perfectly efficient then no such efficiency adjustment will be required. However, while a profit maximising operator has incentives to reduce costs to the most efficient level, one can not *a priori* assume that such efficiencies have been attained and indeed some international studies have shown that it is not generally the case that such efficiency levels are attained.[18]

3.16 ComReg has fully taken account of the views it received on this important issue. Following this, ComReg considers that its reasoning on the various costing methodologies, as set out in both the Consultation Paper and Draft Decisions Paper, remains sound.[19]

3.17 In particular, ComReg believes that the LRAIC methodology (and its variants i.e. LRIC) — which implements an MEA — may, in certain circumstances, result in a cost being included in the net cost calculation, which would not be reflective of the investment that has actually occurred in the network. For example, the LRAIC methodology may suggest that an under-ground network should be used, where in reality, an over-head network has been provided — which would inflate the cost that was actually incurred to roll-out the network (as acknowledged by Eircom). ComReg recognises that the MEA analysis may not necessarily result in an alternative technology or network design (to that actually in existence) being prescribed for certain parts of the network. However, in light of ComReg's previous experience in reconciling a LRAIC approach to the actual network, and the evident differences arising from these reconciliations, ComReg considers that the LRAIC approach (or its variants) would not be consistent with the regulatory objectives in

[15] For example, Ofcom (United Kingdom) and ComCom (New Zealand).

[16] Schedule 2 of the Regulations, states that: "National regulatory authorities are to consider all means to ensure appropriate incentives for undertakings (designated or not) to provide universal service obligations cost effectively" and supported by Recital 14 of the Directive which states that: "it is important that universal service obligations are fulfilled in the most efficient fashion so that users generally pay prices that correspond to efficient cost provision" [emphasis added].

[17] ComReg's Decision on potential efficiencies is set out in paragraphs 3.78-3.92.

[18] See http://stakeholders.ofcom.org.uk/binaries/consultations/charge/annexes/nera.pdf

[19] For further discussion see Consultation Paper 10/94 paragraphs 4.7-4.29 and Draft Decisions Paper 11/15 paragraphs 3.9-3.15.

the USO context. This is because the LRAIC approach runs the risk of over or under compensating the USP, based on a hypothetical deployment of assets. Furthermore, the MEA methodology may wrongly determine an area as being uneconomic — where this may specifically not be the case, due to the actual network design, asset profile or asset age evident in that area. Therefore, it is highly likely that the LRAIC methodology would not be representative of the “true” cost of the USO.

3.18 ComReg also considers that Eircom’s submission over-simplifies the LRAIC approach (and its variants) and the incremental costs which this methodology provides. Although ComReg agrees that a LRAIC approach would, by its definition, reflect incremental costs, it is also important to note that for such a methodology to be implemented correctly, the costs would need to be adjusted for efficiencies and technology. Therefore, the LRAIC approach would either super-impose modern technology based on a hypothetical green-field network (i.e. irrespective of the current network design) or super-impose network efficiencies that would be available *today* to an efficient operator. Therefore, while the LRAIC approach is incremental, the substance of the approach provides a hypothetical incremental cost of building a *new* network today. A LRAIC approach (and its variants) may properly be used for other regulatory purposes — depending on the regulatory objectives, but it is not the more appropriate methodology for calculating the net cost of the USO. Ultimately, the LRAIC approach (and its variants) runs the risk of over-compensating the USP for costs that have not actually been incurred by it, or indeed, under-compensating the USP where costs may have been incurred.

3.19 Similarly, as the CCA methodology is based on valuing the non-fully depreciated assets using current costs instead of historic costs, it will result in accounting holding gains and losses and adjustments to depreciation charges as a result of re-valuations. Therefore, the CCA methodology may either unfairly compensate the USP for asset revaluations which are notional, or penalise the USP by preventing it from recovering validly incurred historic (i.e. cash) costs. Furthermore, a complete re-valuation of the access network would require significant survey analysis and additional cost before it could be properly assessed — the current USP (Eircom) does not currently maintain records for current cost accounting purposes for the access network.

Decision No. 1.	**The HCA methodology, properly adjusted for efficiencies and taking account of the costs that could have been avoided by the USP without having the USO, is the cost methodology that must be used to calculate the net cost of the USO.**

Principles and methodologies for avoidable costs

The Consultation issue

3.20 Applying the principle of avoidable costs involves identifying those costs that the USP would directly avoid without having the USO (i.e. the requirement to serve "uneconomic" customers). In other words, it is necessary to identify and exclude, from the net cost calculation, those costs that the USP would continue to incur if the USO was removed (i.e. those costs that the USP as a commercial operator would continue to incur for commercial reasons). Therefore, the avoidable cost concept is a fundamental determinant of the net cost calculation.

3.21 In this paper, ComReg uses the term "uneconomic", in relation to specific end-users or areas, so as to identify those customers that the USP acting as a commercial operator would not serve if the USO was removed.

3.22 In order to fully establish whether costs would have been avoided, it is necessary to analyse and categorise the historic accounts. The cost categories[20] identified, which are not mutually exclusive, are:

- Direct costs;
- Indirect costs;
- Common costs;
- Joint costs;
- Fixed costs;
- Variable costs; and
- Incremental costs.

3.23 ComReg suggested that while an Activity-Based Costing ("ABC") technique may be useful to identify and analysis costs, it cautioned that ABC systems were not designed for the function of supporting a USO funding application and hence, care is required in manipulating and interpreting ABC-based data: *"…as the costs as allocated, may in fact not be considered avoidable, following a more detailed assessment."*[21]

3.24 ComReg considered that certain costs would continue to be incurred, irrespective of whether services to certain uneconomic areas or customers could be avoided. These costs are broadly categorised below:

1. Business Sustaining Costs: costs which are generated as a result of serving both economic and uneconomic areas / customers alike. These costs could not be avoided, either in part or in their entirety, if a particular set of customers, or customer area was discontinued. These costs could only be avoided if the operator withdrew all services from the market in its entirety.
2. Fixed common costs and joint costs: with respect to the provision of services over the access and core networks, these are not avoidable costs.

3.25 ComReg also considered that it would be inappropriate for the net cost calculation to include those customers which a commercial operator would continue to serve without

[20] For further information see: ComReg Document No. 08/10 Response to Consultation Document No. 09/75 and Final Direction and Decision: Accounting Separation and Cost Accounting Review of eircom Limited.

[21] ComReg Document No. 11/15, paragraph 3.33.

having the USO. ComReg reasoned that as the cost of serving such customers would not be avoided in the absence of the USO, these costs should not be included in the net cost calculation.

3.26 ComReg proposed the following Draft Decisions in relation to avoidable costs:

1. USO net costs will be calculated on the basis of “all” capital costs and “all” operating costs that could have been avoided, as if the provision of services to “uneconomic” customers by the operator was not required under a USO. It is only the portion of costs, both capital and operational expenditure, that can be directly attributed to the USO service (i.e. the service activity creates the cost) and which could have been avoided, which will be included in the net cost calculation; and

2. Fixed common costs and joint costs, with respect to the provision of services over the access and core networks, are not avoidable costs. They will not be included in the net cost calculation.

Summary of Respondents’ views

3.27 While Eircom agrees that only avoidable costs should be included in the net cost calculation, it considers that it is important that the term “avoidable costs” be defined in such a way as to include those costs that: *“could have been avoided if eircom had never had a USO.”*[22] Eircom also suggests four cost types and definitions which it believes are appropriate for consideration. Eircom agrees that fixed and joint costs should not be included in the net cost calculation.

3.28 Eircom also agrees in principle that Business Sustaining Costs are generally not relevant to the USO — provided that this category of costs is not defined too widely, citing that: *“[a]n element of the remuneration of a CEO might typically be linked to turnover, which, in the case of a USP, would be likely to vary depending on the presence or absence of a USO. Overheads are a function of the total activities of a company. To the extent that a sizeable part of these total activities are due to the USO this part would also have caused a part of the overheads and can be avoided.”* [23]

3.29 Eircom stated that: *“ComReg’s proposed Direction to the effect that the net cost calculation should exclude those customers which a commercial operator would continue to serve absent a USO is accordingly wrong.”*[24] Eircom believes that the avoidable costs concept should be based on the: *“factual situation, where eircom is under USO obligations, with a counterfactual, where eircom is not under any USO obligations, that is, a scenario where the USO has never been imposed.”* [25]

[22] Eircom, *supra* n 12, pg.6.

[23] ibid.

[24] ibid.

[25] ibid.

ComReg's Conclusions

3.30 The over-arching principle of avoidable costs is that: "…*the net cost of the universal service obligations is to be calculated as the difference between the net cost for a designated undertaking of operating with the universal service obligations and operating without the universal service obligations.*"[26] [emphasis added]. Schedule 2, Part A of the Regulations goes on to say that the net cost calculation is to be based upon: "…*those end-users or groups of end-users which would not be served by a commercial operator which did not have an obligation to provide universal service*"; and those customers which "…*can only be served at a loss or under cost conditions falling outside normal commercial standards.*" This is further emphasised by Schedule 2, Part B of the Regulations which states: "*[t]he recovery or financing of any net costs of universal service obligations requires designated undertakings with universal service obligations to be compensated for the services they provide under non-commercial conditions*" [emphasis added].

3.31 As recognised by the Directives and the Regulations, the over-arching principal is to arrive at a reasonably reliable, transparent and predictable assessment of the costs that are a direct consequence of the provision of the USO. Furthermore, as set out in Schedule 2 of the Regulations: "*[d]ue attention is to be given to correctly assessing the costs that any designated undertaking would have chosen to avoid had there been no universal service obligation.*" Therefore, due attention must be given to assessing what costs are truly avoidable in the context of the USO.

3.32 . Conceptually, and in accordance with the Regulations, the net cost of the USO can be viewed as the difference in the financial position of the USP in a given period when subject to the USO compared to its financial position in the counterfactual scenario in which it did not face the USO in that period.[27] In essence, ComReg's approach to estimating the NAC is a decremental approach — were the USP not to be subject to the USO, there may, for example, be customers that it would not serve. The net effect of this reduction in service would be reduced revenues and reduced costs.

3.33 In order to estimate the costs that the USP would avoid were the USO not to apply in a given period and the revenues it would not have earned, it is therefore necessary to identify the extent of the changes in USO that a commercially rational USP would make. This change represents the decrement in service that forms the difference between the factual and the counterfactual situation and which underpins the analysis of net costs.

3.34 In accordance with these principles, ComReg believes that its proposed approach (i.e. what would the USP acting as a commercial operator avoid if the USO obligation was removed in the given year of the USO funding application) would provide greater certainty, transparency, and that it would be more practical and reasonable to implement and analyse — based on today's information of what the costs and revenues have actually been in the year in question.

3.35 ComReg recognises that the USO net cost calculation must only include those costs directly attributable to USO services

3.36 ComReg considers that based on a customer life-time concept[28], the actions of the USP as commercial operator, if the USO was removed, requires close consideration. ComReg

[26] Schedule 2 of the Regulations.

[27] As discussed in paragraphs 3.14 and 3.78-3.92, this financial position must be adjusted for potential efficiencies as appropriate.

[28] As discussed in the Draft Decisions Paper, paragraphs 3.117-3.123.

believes that: *"…the decision to cease serving certain customers by a commercial operator is not based on a static assessment of costs and revenues. A single-year view does not, in isolation, give the commercial operator sufficient information to make the decision to stop serving that customer. In many industries…commercial operators make a conscious decision to serve currently unprofitable customers with low value, as they do not wish to forfeit potential future revenues or lose market share."*[29] Consequently, acting as a commercial operator, the USP may chose to bear the losses of certain customers.[30] This would mean that the net cost calculation would only include those costs that the USP, acting as a commercial operator, would choose to avoid, if the USO was removed. As such, this approach more accurately reflects the "true" cost of the USO (in any given financial year) and not the cost, or otherwise, of the USP as a commercial operator. Furthermore, it more accurately identifies those customers / areas that could be the subject of a USO tender in the future.

3.37 As discussed in paragraph 3.44, and consistent with the HCA approach based on actual costs incurred by the USP, the actual costs that the USP (acting as a commercial operator) could avoid for the given year of application and will include, as appropriate, any relevant depreciation for that financial year.[31] ComReg has concluded that not to allow depreciation to be included in the net cost calculation would be unreasonable, and that the proposed approach correctly captures the intent and purpose envisaged by the Directive, as the USP is compensated for the legal obligation to provide the service (in circumstances where an unfair burden is determined).[32]

3.38 ComReg considers that Eircom's suggestion (i.e. what the USP would avoid if the USO was never in existence) would:

(a) Increase the burden of proof required by the USP (i.e. the USP would have to reasonably demonstrate (through the form of a Net Present Value analysis or otherwise) that *for each* of those customers or areas that were connected *x* number of years ago, that acting as a commercial operator they would never have served those customers/areas); and

(b) Increase the subjectivity of what a commercial operator would have done (i.e. there would be significant difficulty and subjectivity regarding which customer or areas a profit maximising commercial operator, that has no USO, would or would not ever have served) and as a result, such a test may not only become unwieldy, but would reduce clarity and transparency of the net cost calculation verification process. For Eircom's approach to be analysed correctly, the USP would have to demonstrate that *at the time* of connection they would not have served that customer / area, based on assumptions that the USP would have used *at that time* i.e. it would be inappropriate to use the actual economic outcome to retrospectively influence the analysis. This exercise is inherently hypothetical because it concerns a world that never was. It could not be conducted without recourse to a range of subjective and debatable scenarios.

[29] ComReg Draft Decisions Paper, paragraph 3.117.

[30] The decision by a commercial operator to cease serving a customer is in effect a decision by the operator to forego any future potential revenue from that line. Therefore, the "hope" value that these lines may become profitable over time and the potential additional benefits of maintaining a line (e.g. the potential future location of additional houses / commercial premises may be in close proximity to the existing line and therefore the marginal cost of additional lines is reduced) is lost to the operator.

[31] For further detail on this issue, see Draft Decisions Paper, paragraphs 3.26-3.28.

[32] The principles and methodologies in relation to unfair burden are discussed in section 5.

3.39 ComReg considers that under Eircom's proposed approach (depending on the assumptions used) it *may* in theory be possible to demonstrate that a commercial operator would potentially have rolled-out its network in a similar fashion to the current network, and to demonstrate that it is only those customers in "extreme" circumstances and rural areas (where in certain circumstances it is possible that revenues may never equal cost) which a commercial operator might have chosen never to serve. ComReg considers that this approach, using *reasonable* assumptions, could in the final analysis, mirror the net cost of ComReg's proposed approach. However, as highlighted in paragraph 3.38, Eircom's approach may lack transparency and is open to ambiguity and subjectivity. For example, Eircom's approach may allow some "cherry-picking" over investments that, in hindsight, were loss-making for reasons not directly related to the USO provisions and therefore, unreliable.[33] However, where the USP can demonstrate, to the satisfaction of ComReg, that the USP as a commercial operator would never have served that area or customer if the USO had never existed — ComReg will consider this as part of its assessment of the USO funding application. For the avoidance of doubt, where the USP has demonstrated to the satisfaction of ComReg that it would never have served that customer or area had the USO never existed, it is only those actual costs which could have been avoided in the financial year of application (including any relevant depreciation) which will be considered in the net cost calculation.[34]

3.40 After full and careful consideration and having taken into account the submissions received during consultation, in relation to the cost categories put forward by Eircom, as noted in paragraph 3.9, ComReg maintains the view that avoidable costs are identified on a HCA basis. Furthermore, as set out in the Draft Decisions Paper and ComReg Decision No. D08/10,[35] ComReg considers that a direct cost does not mean an allocated cost, as this would not be categorised as a "direct" cost of serving those customers or those exchanges areas deemed uneconomic.

3.41 ComReg considers that for a cost to be deemed avoidable, it must be directly attributed to a given service. ComReg recognises that while some relevant overheads may not be directly apportioned in the HCA accounts, for example certain costs associated with exchange sites (if deemed uneconomic in their entirety), they are directly attributable to the uneconomic exchange — and should the USP identify that exchange as an area which without having the USO, it would no longer serve, then, for the purposes of the net cost calculation, it would be considered avoidable.

3.42 This means that the service activity creates the cost (be it an overhead or otherwise) and that those costs would not exist in part, or in their entirety, if the service was not required for "uneconomic" areas, or "uneconomic" customers. Accordingly, certain costs are not considered avoidable (i.e. a Business Sustaining Cost or a Fixed common cost / joint cost — with respect to the provision of services over the access and core networks) as they would be incurred irrespective of certain services being withdrawn from certain areas or customers. For example, economic customers may be served using the infrastructure which services uneconomic customers — in which case, those costs are common, or in the case

[33] ComReg believes having had regard to the Directive and the Regulations, that losses from loss-making services that are provided for reasons other than the USO would have to be deducted from this estimate.

[34] For further detail on this issue, see Draft Decisions Paper, paragraphs 3.26-3.28.

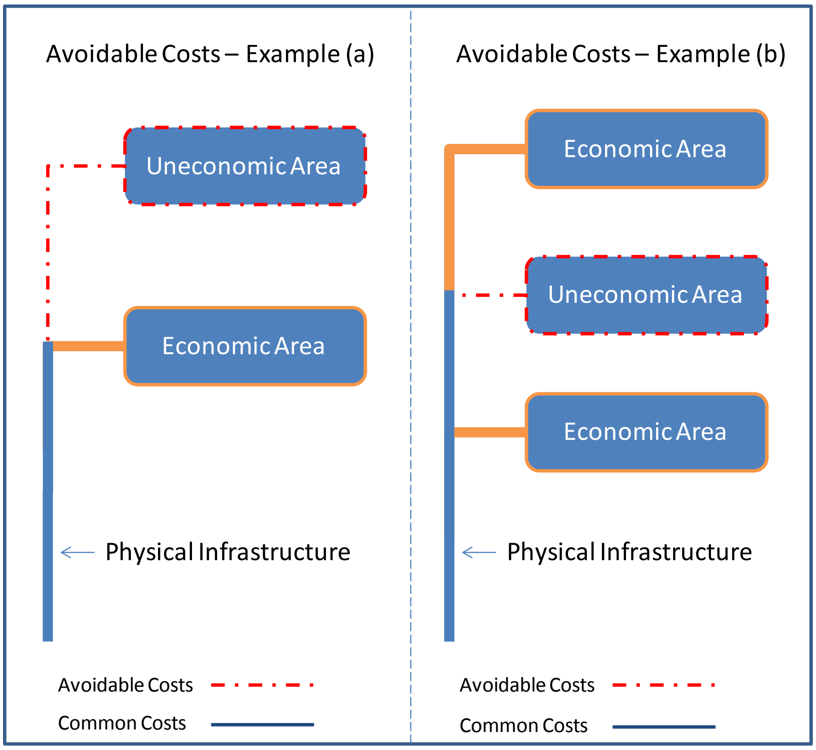
[35] As discussed in the Draft Decisions Paper, paragraph 3.32.

[36] As set out in the Draft Decisions Paper, pg.81.

of fixed costs (associated with the physical infrastructure) in part economic (as illustrated graphically below in Figure 1).

3.43 For the avoidance of doubt, in the case of ducts, trenches, cabinets etc., these are considered unavoidable, where there is any element which provides services to economic customers — as the cost would have be incurred irrespective of the continued connection or disconnection of "uneconomic" customers.

Figure 1: Identification of Avoidable Costs



3.44 Consistent with the principal of the HCA costing methodology, it is only the cost (including as appropriate any relevant capital cost, i.e. any relevant depreciation for that year) that the USP could avoid in that given financial year for which the USO funding application is made, which is included in the net cost calculation. ComReg considers that this will provide greater clarity and transparency to the net cost calculation. If a long-run view was implemented as suggested by Eircom, it is likely that it would cause increased complexity and potential over-compensation — as all costs (depending on the assumptions used) could be considered avoidable in the long-run.

3.45 While ComReg used CEO salary as potential example of Business Sustaining Costs, Eircom's example of a portion of CEO salaries potentially being avoidable is only partially consistent with the principles outlined in paragraph 3.42 (i.e. that those costs would not exist in part, or in their entirety, if the service was not required to uneconomic areas or uneconomic customers). Consistent with the principle of avoidable costs, it is only that portion of USO revenues that would be foregone by a commercial operator absent a USO that should be included in the net cost calculation — thus, the entire revenues generated from the USO would not be attributable to such contracts (i.e. the revenues associated with economic end-users would not be included in the net cost calculation). However, ComReg believes that, although a portion of overhead salaries may meet the avoidable cost requirement, it may create perverse incentives to allow such "costs", where they are material, to be included in the net cost calculation — as it may result in the alteration of these or future contracts, such that, the remuneration of such would favour weighting towards USO services.

3.46 ComReg considers that its Draft Decision 3.2 in isolation[36], adequately provides for the exclusion of fixed common and joint costs, where they are not avoidable due to their occurrence irrespective of the ability to disconnect certain customers (i.e. these costs would be incurred irrespective of the ability to disconnect certain customers, as they represent access and core network costs which provide service to economic customers and therefore would be unavoidable) and therefore the Draft Decision 3.3 that: *"Fixed common costs and joint costs, with respect to the provision of services over the access and core networks, are not avoidable costs. They will not be included in the net cost calculation."* is superfluous.

Decision No. 2.	**USO net costs shall be calculated on the basis of "all" capital costs and "all" operating costs that could be avoided on a HCA basis, as if the provision of services to uneconomic customers by a commercial operator was not required under a USO. It is only the portion of costs, both capital and operational expenditure for the given financial year, that can be directly attributed to the USO service (i.e. the service activity creates the cost) and which could have been avoided without the USO, which are included in the net cost calculation.**

[36] As set out in the Draft Decisions Paper, pg.81.

Principles and methodologies for USO revenue calculation

The Consultation issue

3.47 The USO generates tangible and intangible benefits for the USP. Both must be taken into account in determining the net cost of the USO (if any). ComReg noted that the USO tangible benefits (i.e. revenues) should be calculated on the basis of the direct and indirect revenues that a USP would forego as a result of ceasing to provide services to uneconomic customers.

3.48 The Draft Decisions Paper identified the direct and indirect revenues which the USP must take into account in the net cost calculation and detailed how such revenues should be attributed and allocated.

Summary of Respondents' views

3.49 While Eircom agreed with ComReg's Draft Decision on the application of the Reasonable Access Threshold ("RAT"), it noted that in certain circumstances, the period of allocation over at least four years may be excessive.

3.50 Eircom suggests that ComReg considers mobile revenues to be both direct and indirect in the Draft Decisions Paper. Furthermore, Eircom notes that the inclusion of the retail revenue from Meteor calls to uneconomic areas or customers may be an issue. Eircom suggests that: *"[i]dentifying this incremental retail revenue may be quite difficult unless an averaging approach is used. Identifying the incremental costs may also be challenging. (A number of matters will require consideration, including, how would Meteor / eMobile revenue have differed if a specific line or exchange was never provided, whether pre-pay revenues would have been smaller, and whether post-pay user would have changed)."*[37] Eircom also notes that the inclusion of Meteor revenue would increase the amount of allowable replacement calls.

3.51 Eircom also suggests that: *"an averaging approach may be necessary with other indirect revenues."*[38]

3.52 Eircom notes that while it sees: *"some merit in the two-stage process proposed by ComReg in relation to apportioning revenue between an economic customer and an uneconomic customer (be it voice or leased line)"*[39] that this may prove to be incapable of implementation, due to the sequence of iterations required. Eircom proposes instead that such revenues (where material) be apportioned equally (i.e. split 50:50 between the economic and uneconomic customers). Eircom also notes that, in certain circumstances, it is not possible to associate the revenue from an indirect service to a telephone line and proposes that in such cases, leased lines that cannot be associated with a line, should be averaged across all business lines in that exchange site.

3.53 Eircom notes that while: *"[c]all termination on the fixed network may be readily attributed to area or line. However, transit calls may be difficult to allocate to areas or lines."*[40] Eircom provides a number of transit call examples and, on the basis of the examples given, reasons that transit calls should be excluded from the USO net cost calculations.

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[37] Eircom, *supra* n 12, pg.8.

[38] ibid.

[39] ibid, pg.9.

[40] ibid, pg.10.

3.54 Eircom agrees with the concept of replacement calls, but suggests that: *"the issue of replacement calls must be considered in advance of arriving at a net cost figure, rather than after completing the net cost calculation."*[41] Eircom also suggests that the inclusion of replacement calls may make some areas that would have otherwise been uneconomic, economic.

ComReg's Conclusions

3.55 ComReg has carefully examined this issue and has taken into consideration the submissions it received in relation to it.

3.56 ComReg has now concluded that it is reasonable and appropriate that direct revenues include those revenues which are directly invoiced to a customer for the services provided directly by the USP.[42] ComReg has also concluded that the RAT must be apportioned equally over the expected life of the customer (assumed to be for a period of at least 4 years). However, in circumstances where a line is permanently disconnected, ComReg considers that it would be appropriate to attribute the unallocated RAT to the year of disconnection.

3.57 ComReg has concluded that indirect revenues would include those revenues which are not invoiced directly to a customer for the services provided by the USP, or to another authorised operator ("OAO") availing of the USP's wholesale services. The net cost calculation will take into account where there is an avoidable cost associated with generating revenue — resulting in effectively, net revenue (i.e. where there is a cost associated with, for example, premium rate numbers or mobiles, these will be taken into account).

3.58 For the purposes of clarity, mobile revenues generate both direct and indirect revenues.

1. Direct Revenues: Mobile calls can generate direct revenues by "uneconomic" customers calling mobile numbers (i.e. call origination revenues).
2. Indirect Revenues: Mobile customers may also call "uneconomic" customers and this can generate transit and call termination revenues for the USP.

3.59 Both types of revenues are created through the USP's fixed line network. Given that this is the case, ComReg is unable to understand how the USP would find it difficult to identify such revenues (with the exception of transit revenues — discussed in paragraph 3.62). Furthermore, consistent with the HCA approach, it is only those revenues that the USP would actually forego which are taken into account and therefore, the incremental approach as suggested by Eircom is not relevant.

3.60 ComReg recognises that in the case of indirect revenues, some level of estimation may be required. However, ComReg considers that this would only be acceptable when such revenue information is not reasonably available without estimation. Where estimation is used, the USO fund application must clearly document all assumptions and must be reconcilable to actual historic data to a reasonable degree of accuracy.

3.61 ComReg has concluded that the two-stage test for voice and leased lines, as described in paragraph 3.55-3.56 in the Draft Decisions Paper is appropriate. However, as this calculation is based on a modelled iterative process, at this stage, ComReg is unable to

[41] Eircom, *supra* n 12, pg.10.

[42] ComReg considers that this includes any telephone allowance (provided for by the Department of Social Protection) received by the USP as a result of the provision of USO services.

substantiate Eircom's concerns, but will consider the appropriateness of the proposed allocation should an application be made and not prove fully implementable.[43]

3.62 ComReg has concluded that it would not be appropriate to simply exclude transit revenues from the net cost calculation for the reasons suggested by Eircom. Transit revenues are relevant revenues that the USP would forego as a result of ceasing to provide services to uneconomic customers. Therefore, consistent with ComReg's view in paragraph 3.60, where such revenue information is not reasonably available, the USP will be required to provide an estimate of such revenues. Where estimation is used, the USO fund application must again, clearly document all assumptions and must be reconcilable to actual historic data to a reasonable degree of accuracy.

3.63 As discussed in the Draft Decisions Paper (paragraphs 3.57-3.58), a replacement call occurs when a disconnected customer continues to use the telephone of a relative, a friend, or one at work and in this way, continues to generate indirect revenues for the USP.

3.64 ComReg has reviewed its position in relation to replacement calls and considers that where the USP has a separate mobile network, acting as a commercial operator, it may consider that mobile revenues may increase as a result of disconnecting "uneconomic" areas or customers (i.e. that the corporate revenues of the USP as a commercial operator may increase). However, ComReg considers that this hypothetical scenario creates significant assumption difficulties (as acknowledged by Eircom). This analysis must take into account not only how consumption patterns would have changed if an "uneconomic" area was now disconnected, but also must take into account the competitive position of other mobile operators and the probability of losing revenue from these "uneconomic" customers entirely (i.e. there is no guarantee that those disconnected customers would use the USP's other products / services). Furthermore, this analysis must also take in the associated cost of serving these now mobile customers i.e. mobile termination rates, transit charges etc. and should therefore only include the net effect as a replacement call revenue. As part of any potential funding application, where the USP has included assumptions on mobile revenues (and associated costs) in the replacement calls calculation, all assumptions used must be clearly presented with supporting documentation (e.g. market analysis reports, required use of OAO mobile networks etc.)

3.65 The "uneconomic" customer or area must first be "hypothetically" disconnected for this revenue to be capable of being generated. Furthermore, replacement calls revenue is notional estimated revenue and, due to mobile substitution etc, is potentially immaterial. Therefore, ComReg considers that a commercial operator would be unlikely to base a commercial decision (i.e. to disconnect or not) on such substitute / replacement revenues. Accordingly, ComReg has concluded that replacement calls would only be included (as an adjustment) to indirect revenue after "uneconomic" areas or customers have been identified as commercially uneconomic.

[43] If the two-stage test cannot reasonably be implemented for voice or leased lines, ComReg will consider the merits of a 50:50 allocation between the economic and uneconomic customer / line.

Decision No. 3. **USO revenues shall be calculated on the basis of both the direct and indirect revenues that an operator would forego as a result of ceasing to provide services to uneconomic customers.**

Decision No. 4. **Direct revenues shall include those revenues which are directly invoiced to a customer for the services provided directly by the USP. They include:**

- **One-off connection charges: where the revenue should be allocated over the expected life of the customer. In circumstances where a line is permanently disconnected, the remaining unallocated one-off connection charges should be allocated to that year of disconnection;**
- **Revenues associated with access (e.g. line rental);**
- **Calls (e.g. local, national, mobile, international, directory enquiries ("DQ") and premium rate services); and**
- **Complementary services, such as, broadband services.**

Decision No. 5. **Direct revenues shall include those revenues from an OAO (who is indirectly providing the service to the customer) using the USP's wholesale services and include, amongst other things:**

- **Wholesale access (single billing wholesale line rental ("SB-WLR");**
- **Wholesale calls; and**
- **Complementary wholesale services, such as Bitstream and Local Loop Unbundling ("LLU") etc.**

Decision No. 6. **Indirect revenues shall include those revenues which are not directly invoiced to a customer for the services provided directly by the USP. They include:**

- **Wholesale interconnection revenues: fixed termination and transit services as a result of inbound calls from another fixed / mobile networks, where an OAO is invoiced for terminating and transiting a call on the USP network;**
- **Non-geographic numbers (e.g. 1800, 1850, 11811 and 1890 numbers);**
- **Economic USO customer calls to an uneconomic customer: firstly, the revenue of the economic customers' calls to uneconomic customers shall be allocated to the**

	uneconomic customer. If the uneconomic customer is now economic, as result of the allocation, then a second stage is required to ensure that this treatment does not make the previously economic customer into an uneconomic customer as a result. If as a result of this second stage the economic customer becomes uneconomic, then it is only that portion of revenue which the economic customer can spare without making themselves uneconomic that should be allocated; • **Leased Lines: where initially all revenues associated with the leased line are allocated to the uneconomic line. If the uneconomic point is now economic, as a result of the allocation, then a second stage is required to ensure that this treatment does not make the previously economic point into an uneconomic point as a result. If as a result of this second stage the economic point becomes uneconomic, then it is only that portion of revenue which the economic point can spare without making themselves uneconomic should be allocated; and** • **Replacement calls: where a net cost exists, replacement calls shall be estimated and added to the net cost calculation (but only in circumstances where “uneconomic” areas or customers have been firstly identified as commercially uneconomic).**
Decision No. 7.	**Where it is clearly demonstrated that due to a lack of information beyond the control of the USP, that it is not practicable for indirect revenues to be calculated in accordance with Decision No. 6, the USP may use an alternative approach, provided that it is properly supported with reasonable assumptions.**

Principles and methodologies for efficiency adjustments

The Consultation issue

3.66 As discussed in paragraph 3.14, the Regulations and the Directive envisage that the USO is efficiently delivered and that net cost of the USO is to be calculated having regard to efficiency.

3.67 ComReg suggested that the avoidable costs included in the net cost calculation should only relate to the USO service which a commercial operator would not ordinarily provide, and that it is reflective of the "true" efficient cost of meeting the USO i.e. capital costs associated with capital expenditure ("CAPEX"), operational expenditure ("OPEX") and overheads).

3.68 In paragraph 3.66 of the Draft Decisions Paper, ComReg considered that efficiency was not concerned whether the cost could *now* be delivered more efficiently, but whether the actual costs incurred *at the time* were discharged in the most efficient manner available. ComReg noted that in assessing the CAPEX and related OPEX incurred, it will need to decide whether the technology used appears reasonably efficient with regard to what was available and effective at the time, and whether any subsequent upgrades etc. also meet this criteria (i.e. whether it was cost effective that subsequent upgrades to the network were based on the pre-existing technology that was already in place at the time of upgrade). ComReg noted that it would assess at a high level the appropriateness of the technology used (e.g. would it have been more cost effective to use wireless technology) as part of its verification process, for those uneconomic areas and uneconomic customers identified. ComReg noted that a high capacity radio spectrum has been available to the USP for a number of years and may in certain circumstances have been a more efficient technology to implement. However, that the appropriateness, or otherwise, of alternative technologies would be considered on a case-by-case basis.

3.69 ComReg considered that the use of line faults could provide a reasonable and proportionate indicator of an efficient cost of maintenance of the actual network. The Draft Decisions Paper set out how ComReg proposed to implement this potential efficiency adjustment, for completeness this is repeated here: *"ComReg will take a sample of "uneconomic" areas and measure the LFI of those areas to determine if the levels of faults are causing a significant cost in those areas. If the LFI of a particular uneconomic area is high, a further efficiency adjustment may be necessary to reflect the poor condition of the network (which may be indicative of inefficient network investment over previous years). The annual efficient cost of such a network will be calculated on the basis of an LFI as set out in ComReg Decision No. D02/08 (or as amended), where the actual LFI is significantly above this."*[44]

3.70 The Draft Decisions Paper also considered the issue of "catch-up" investment and the potential implications for both CAPEX and OPEX, which may arise should a USP "sweat assets" i.e. continue to use assets beyond their useful lives. ComReg noted that the issue of "catch-up" investment for CAPEX was relatively straight-forward with one exception. This was that assets with short assets lives which should have been replaced earlier in the past, in which case they might by now be fully written-off (i.e. there would have been no depreciation charge in that year). ComReg proposed to review any application for USO funding with this in mind and reserved its discretion to disallow CAPEX on this basis. In relation to OPEX, where extra OPEX has been incurred as a consequence of past under-

[44] ComReg Draft Decisions Paper , paragraph 3.79.

investment, this would normally be disallowed, as OPEX should relate to an efficiently provisioned network.

3.71 ComReg's Draft Decision was that net cost calculation would only include those avoidable costs that were incurred in an efficient way. Therefore, historic costs may require adjustment to reflect the appropriate level of costs that an efficient operator would have incurred. The required level of efficiency adjustment would be informed by a number of data sources which may include, but not limited to, the use of:

- The review of supporting documentation available, such as: cost-benefit analysis reports; engineering reports; fault reports of geographical areas, and other documents in relation to the business case / investment decisions associated with the network roll-out and upgrade;
- An appropriately adjusted Line Fault Index ("LFI") target for the financial year in question;
- Independent survey report regarding the USP's efficiency;
- Overseas regulatory decisions providing relevant precedents and benchmarks; and
- The development of an independent cost model, where adequate and reliable accounting information is not available from the USP.

Summary of Respondents' views

3.72 Eircom agrees that the cost inputs to the net cost calculation should be efficiently incurred, but in their view there is little scope for efficiency adjustments on its actual costs and that it is unusual to undertake an efficiency adjustment on HCA accounts. Eircom suggests that: "*[w]hen historical capital costs are used…care must be taken not to confuse the efficiency gains that may be available when all assets are new with those that are available for historic assets. Furthermore, a rational profit-maximising operator has incentives to maximise efficiencies.*"[45]

3.73 Eircom says it has endeavoured to minimise costs through the use of wireless systems, including cellular services, but said that those: "*solutions are all sufficiently costly that they are rarely preferable to copper, except in extreme circumstances…and may have higher fault rates than copper solutions because the electronics are more prone to lightning damage and other failure modes.*"[46] Eircom says that customers served by alternative technologies are costly to serve and that absent a USO, they would only be served by higher prices, or not at all.

3.74 Eircom disagrees with the use of the LFI generally and the proposed use by ComReg of the LFI performance targets specifically for the purposes of the USO efficiency assessment regionally. Firstly, Eircom notes that a lower fault rate may not necessarily result in a lower total cost and that a profit maximising operator would choose to minimise total costs (while underground networks have a lower cost in dense urban areas and overhead networks have a lower cost in rural areas despite their higher fault rate). Secondly, Eircom

[45] Eircom, *supra* n 12, pg.11.

[46] ibid.

highlights that the LFI targets are based on a national average and that applying the LFI target to different geo-types is "unacceptable".

3.75 With regard to the issue of "catch-up" investments, Eircom says that: *"[t]here is no reason or basis for ComReg to suggest that eircom, as a profit-maximising private operator has not acted rationally investing in infrastructure as necessary, taking into accounts potential trade-offs between high Capex and low Opex, as opposed to lower Capex and somewhat higher Opex."*[47] Eircom considers that the better approach would be to disregard the issue: *"on the basis that the counter-acting effects would be likely to cancel each other out."*[48] Furthermore, Eircom suggests that if asset sweating must be avoided, that on the basis that those assets should have been replaced at the end of their useful lives, and where an asset has been fully depreciated, but is still being used for the purpose of its USO, a notional depreciation charge should be added to the USO funding submission to account for this.

3.76 BT submission notes that they welcome ComReg's proposed approach in relation to catch-up.

3.77 Eircom notes that in their view it is not appropriate that the methodologies and basis for efficiency adjustments can be open-ended and that it would be: *"counter to legal certainty and ComReg's obligation to review any funding obligation on a transparent and objective basis."*[49] Eircom also suggests that the source of the documentation for such an efficiency adjustment is unclear, and that it does not understand how an independent cost model could be used in the context of HCA.

ComReg's Conclusions

3.78 ComReg has considered this issue at length and taken into account the submissions it received. ComReg has concluded that it is reasonable and appropriate that the HCA costing methodology be adjusted for efficiencies, where appropriate.

3.79 The efficiency principle is clearly contemplated in the Regulations and the Directive. Its application should ensure that, amongst other things, the USP is not compensated for inefficient decisions in the past. The USP should not be compensated for inefficient costs.

3.80 Where costs have been demonstrated as *inefficient*, then a discrete analysis will be required to determine the "actual" efficient costs the operator would/should reasonably have incurred. For the avoidance of doubt, HCA costs appropriately adjusted for efficiencies will be those used in the net cost calculation of the USO.

3.81 As discussed in the Draft Decisions Paper, the efficiency adjustment is not based on whether or not the USO service could *now* be delivered more efficiently. Rather, ComReg will reasonably assess, at a high level, the appropriateness and efficiency of technology (including the efficiency from a cost perspective of implementing and maintenance of such technology) used at the time of instalment or upgrade when verifying the net cost calculation (i.e. for those uneconomic areas and uneconomic customers identified).

3.82 Eircom stated that: *"care must be taken not to confuse the efficiency gains that may be available when all assets are new with those that are available for historic assets."*[50] ComReg considers this point is only relevant for existing assets that have not exceeded their Economic Useful Life ("EUL"). Where operating costs are analysed and are found to

[47] Eircom, *supra* n 12, pg.13.

[48] ibid, pg.14.

[49] ibid.

[50] ibid, pg.11.

be excessive due to the sweating of assets (i.e. assets being used beyond their EUL), then it would be unreasonable to allow recovery of such high costs without consideration of the OPEX cost associated with a new asset.

3.83 Eircom stated that those customers being served by alternative technologies to copper would, in the absence of a USO, not be served at all or at a higher price. However, the net cost takes into account the revenues that the USP would forego in the absence of the USO, based on the actual prices charged in a given year of application, it specifically would not take into account any notional or hypothetical prices that the USP claims that it would have charged.

3.84 In relation to LFI and the relevant efficiency metric that should be used, ComReg has given further consideration to its original proposals. ComReg has also taken into account the views of respondents, in particular, the alternative approach suggested by Eircom. ComReg has now concluded that it is fair and reasonable to use the LFI as a methodology to assess the USP's efficiency. The use of an adjustment, based on a percentage of line faults, is intended to provide an indication of the level of costs that on a reasonable view, an efficient operator would incur on a regional basis to facilitate appropriate connection and not to impose new LFI targets on Eircom.

3.85 ComReg's Consultation Document No. 10/94 asked what would constitute an appropriate efficient level of line faults. ComReg reasoned in both the Consultation Paper and Draft Decisions Paper that while a line fault rate of 8% may be preferable it was considered not to be suitable based on the existing network. ComReg considered that a higher line fault rate than 8% would be more reasonable, and noted that a higher rate was provided for by the LFI targets imposed by ComReg Decision No. D02/08. For clarity, while the efficiency adjustment proposed by ComReg would utilise the LFI target rate, for that corresponding financial year, as provided by ComReg Decision No. D02/08 (or as amended), as the basis for the efficiency adjustment ("LFI efficiency rate"), both are distinct and provide a measurement tool for different means.

3.86 When applying the LFI efficiency rate to a geographic area allowances will be provided to take into account any adverse weather conditions — which may have resulted in a significantly high outlier of line fault rates in that area. Furthermore, allowing for topography differences (i.e. different geo-types, where due to the network design it may result in higher faults and higher fault repair cost), it is only where the actual line fault rate is significantly above the LFI efficiency rate are the potential circumstances where an efficiency adjustment may be necessary to reflect the poor condition of the network (which may be indicative of inefficient network investment over previous years). For example, a higher line fault rate may be evident in rural areas due to the deployment of an over-head network — which may be subject to adverse weather conditions and higher repair costs due to their geographic isolation. However, ComReg considers that it would inappropriate for a USO fund to *fully* compensate for such circumstances where the actual line fault rate is significantly higher than the LFI efficiency rate (which would be to the significant detriment of the provision of service (i.e. quality) to USO customers), without adequate reasoning from the USP to justify why these areas are significant outliers.

3.87 As noted in paragraph 3.14, without adjustment, the historical accounts could reflect inefficiencies, either as a result of sub-optimal network design or inefficient operational practices by the USP. Consequently, ComReg concludes that an efficiency adjustment on a regional basis can use the LFI target rate to generate appropriate indicators of potential inefficiencies and from this make efficiency adjustments as appropriate — so as to safe-guard against the USP being rewarded or over-compensated for past inefficient decisions.

3.88 ComReg has given further consideration to the issue of “catch-up”, with respect to the replacement of assets with short-asset lives and now considers that it is possibly not as straight-forward as originally suggested in the Draft Decisions Paper. ComReg considers that the cycle of replacement of such assets would be continuous over a period of time. Therefore, irrespective of when such assets were subsequently replaced, that for the purposes of the net cost calculation the appropriate capital charge (i.e. depreciation) should be included (i.e. in a given financial year, if the asset is replaced, an appropriate depreciation charge will be evident in the accounts for the duration of its EUL). In other words, if an asset should be replaced every 5 years and should have reasonably been replaced in 2003, but was actually replaced in 2009, the counter-factual would imply that the 2003 asset would require replacement again in 2008, and the respective depreciation charge would still be evident in say the 2009/2010 financial year (irrespective of the fact that the asset was only actually replaced in 2009). Furthermore, as assets which are used beyond their EUL will not be included in the historic accounts (i.e. as they are fully depreciated) they will not be allowable in the net cost calculation and therefore, will not provide undue compensation. ComReg has concluded that this proposed approach will provide greater transparency and reconciliation to the actual historic accounts. However, as noted in paragraph 3.70, where additional OPEX is incurred as a result of past under investment (irrespective of whether the asset has a short asset life or not), this may be disallowable and consequently, the efficiency adjustment provides a safeguard that the USP is not compensated for inefficient life-cycle management of assets.

3.89 ComReg disagrees with Eircom’s suggestion that where assets are used beyond their EUL, a notional depreciation charge should be added to the net cost calculation. As noted in paragraph 3.3, one of ComReg’s regulatory functions is to ensure that the net cost calculation does not over or under-compensate the USP — to allow a charge for an asset that is fully written-off, would allow additional recovery and would therefore over-compensate the USP.

3.90 With regard to the range of methodologies proposed by ComReg for a potential efficiency adjustment, it is not in fact possible without having sight of an application for USO funding, to clearly specify in full detail which methodologies will be used or capable of being used (i.e. the information sources for certain efficiency adjustments may not be available). However, where possible, ComReg has outlined how it proposes to determine indicators of potential efficiencies (e.g. analysing the USP’s reports on business case / investment decisions associated with the network roll-out and upgrade, implementing a line fault rate to areas of the network, reviewing and comparing the investment profile of the USP to fault and engineer reports etc.).

3.91 ComReg has specifically stated that any USO funding application will be reviewed for efficiencies. ComReg doesnot accept that the *“legal certainty”* referred to by Eircom entails that every circumstance should be catered for with exact precision in advance. This is simply not achievable at this remove and in the absence of an application (as acknowledged by Eircom’s submission). Where appropriate, ComReg will provide the USP with its reasoning and the basis for any required efficiency adjustment to the HCA accounts — ensuring *“ComReg’s obligation to review any funding application on a transparent and objective basis.”* It is open to ComReg to appoint an independent third-party to undertake an efficiency study of the USP. Any report or recommendation arising from such a study is likely to be based on a range of information and sources including: information provided by the USP and ComReg, statistical modelling *and regulatory decisions in other jurisdictions that address efficiency etc.*

3.92 *In the Draft Dec*isions, ComReg proposed the potential use of an independent cost model as one possible source to quantify an efficiency adjustment. ComReg wishes to clarify that the purpose of this exercise is not to replicate the net cost model provided by the USP, but to assess the level of efficiency adjustments incorpora*ted within the USP's model. Typically, such models would either utilise a top*-down or bottom-up approach and/or econometric techniques, such as a stochastic frontier analysis, to compare the actual entire network costs of the USP against an efficient sample (e.g. other European operators). ComReg reserves the regulatory discretion to undertake this exercise internally, as appropriate. ComReg has amended the drafting of this Decision to more accurately reflect its purpose and potential use.

Decision No. 8. **The avoidable costs included in the net cost calculation, shall be those costs reflecting the provision of the USO which a commercial operator would not ordinarily have provided, and which were incurred in the most efficient way. These costs shall relate to: (a) the avoidable capital costs associated with CAPEX i.e. depreciation; (b) OPEX; and (c) overheads for the appropriate financial year.**

Decision No. 9. **ComReg may use a number of methodologies to determine the appropriate level of costs that would have been incurred by an efficient operator, in order to determine the quantum of adjustments necessary to the USP's net cost calculation. These methodologies may include, but are not limited to, the use of:**

- **The review of supporting documentation available, such as: cost-benefit analysis reports; engineering reports; fault reports of geographical areas, and other documents in relation to the business case / investment decisions associated with the network roll-out and upgrade;**
- **A line fault efficiency rate: applying the national LFI target rate (corresponding to the financial year in question) at a regional level (and allowing for appropriately reasoned variances) ;**
- **Independent survey report regarding the USP's efficiency;**
- **Regulatory decisions from other jurisdictions that provide relevant precedents and benchmarks; and**
- **The development of a model to assess the appropriateness of the efficiency adjustment proposed by the USP.**

Principles and methodologies for cost identification and allocation

The Consultation issue

3.93 The Draft Decisions Paper noted that: *"The principal corner-stones of the net cost calculation are based on the premise that the costs of the USO services can be identified to end-users or groups of end-users, that these services are "loss-making", would not have been ordinarily served by a commercial operator, that these costs are incurred efficiently, and that these allocated costs could have been avoided if the USO provision to service these end-users or groups of end-users did not exist."*[51]

3.94 In determining the net cost of a USO obligation, ComReg believed it appropriate to consider the following:

- Whether costs can be accurately attributed to end-users or groups of end-users;
- Whether these end-user or groups of end-users are "loss-making" and would not have been ordinarily served by a commercial operator[52];
- Whether costs have been efficiently incurred; and
- Whether those allocated costs could have been avoided (i.e. that economic customers may be served using the infrastructure which was incurred for the provision of USO services to uneconomic — in which case, costs may become common, or in the case of fixed costs related to physical infrastructure in part economic).

3.95 ComReg considered that it would be reasonable to identify uneconomic areas at an MDF level. ComReg noted that while the preferred approach to the identification of such costs would be supported at an MDF level — the respective age profile of assets at this level may not always be readily available. ComReg suggested that an alternative, more pragmatic, approach would be to use a form of average depreciation by asset class with respect to the average cost and profile which would be representative of the MDF's geographic location. However, ComReg noted that it was the responsibility of the USP to ensure that such an allocation was not unrepresentative of the level of investment or cost of that MDF area. Consequently, ComReg proposed that the USP should undertake a number of "sense checks", based on its investment decisions and investment profile, to ensure that the allocation was truly representative of the cost profile of each MDF.

3.96 In relation to uneconomic customers in economic areas, ComReg considered it appropriate that customers be identified based on the universal account number ("UAN"). The Draft Decisions Paper also noted that it would be inappropriate to include those customers which were attained through a competitive commercial tender process — where they are deemed to be uneconomic.

3.97 Similar to the issues identified for uneconomic areas, while revenues can be identified to individual customers, costs cannot be determined with certainty. ComReg considered it appropriate that such customers be identified using a probability analysis — based on the same allocation approach for uneconomic areas. ComReg noted that where such a net cost is identified for uneconomic customers, the USP must ensure that it is representative of the actual costs such customers represent and (similar to the uneconomic areas sense-check)

[51] ComReg Document No. 11/15 paragraph 3.93.

[52] In other words, that acting as a commercial operator the USP would not serve these customers if the USO was removed.

suggested that the USP should undertake its own assessment to assure itself that the costs were representative of the "true" net cost.

3.98 In addition to the USP's "sense checks", ComReg as part of its verification process will undertake a number of "reality" checks, for uneconomic areas and uneconomic customers, to assess the appropriateness of the allocation. ComReg highlighted, if and where material discrepancies are found, that it has the discretion to require a full assessment for those exchange areas or customers deemed uneconomic (i.e. the USP would be required to identify all the assets at relevant exchanges to identifying the appropriate depreciation charge for that MDF and identify all relevant OPEX costs of the MDF); to apply a proportionate adjustment to the net cost calculation (pre-intangibles) *or* to reject the entire USO funding application (on the basis that the discrepancy is of a magnitude which would render the application not fit for purpose).

3.99 The Draft Decisions Paper outlined that while there are customers in every industry who will never become profitable in virtually all states of probability, that there is also fundamentally a quantum of customers or areas that a commercial operator would very likely never cut-off, despite their current loss making status. The decision by a commercial operator to continue serving loss making customers is based on the operator's commercial objectives and may include financial, reputational, strategic and operational reasons. ComReg reasoned that as these customers would continue to be served, absent a USO, by a commercial operator, they are not those "end-users" contemplated by the Regulations or Directive and therefore, they should not be included in the net cost calculation.

Summary of Respondents' views

3.100 Eircom submits that its USO obligation to charge uniform prices in all parts of the country is a cost, incurred by it, that has not been identified by ComReg as part of the USO net cost assessment. Eircom argues that this obligation creates a revenue shortfall (as they have to charge the same price for users with high cost and with low cost) which clearly imposes a net cost on Eircom. Accordingly, the calculation of the net cost of USO should take account of what, in its view, is the cost of geographic averaging.

3.101 Eircom agreed with the use of MDF to identify uneconomic areas.

3.102 Eircom generally agreed with: "*using its Copper Access Model to determine asset requirements by MDF area and to use then these assets requirements to allocate relevant depreciation charges (as reconcilable to the HCA and taking account of the principle of avoided cost).*"[53] However, Eircom noted that while: "*[t]he accounting records contain information on the total cost of assets by parent exchange and by MDF area…the use of the complete data set by MDF area would require significant processing to verify its accuracy and completeness.*" [54] Eircom suggests instead that the total depreciation profile of the parent exchange be used and the relevant allocation be apportioned to the respective MDFs (that it serves) based on the requirement of the Copper Access model. Furthermore, Eircom proposes that where a large parent exchange covers a large geographic variation (i.e. a parent exchange may have rural and urban MDFs), that Eircom will then utilise the detailed cost accounts at an MDF level to: "*assess the allocations and potentially adjust the allocations made using the Copper Access Model and the more aggregated data at the exchange level.*"[55]

[53] Eircom, *supra* n 12, pg.16.

[54] ibid, pg.16.

[55] ibid, pg.17.

3.103 Eircom states that: *"this approach would strike a good balance between requirement for detail and ease of implementation."*[56] Furthermore, Eircom notes that it considers it unreasonable and disproportionate that ComReg would be entitled to reject an application for funding on the *"basis of potential (unquantified) discrepancies from one "reality check" area."*[57]

3.104 Eircom suggests that ComReg provides no direct guidance for core network costs and suggests that these should be calculated using a top-down LRAIC approach, excluding: *"current cost accounting revaluations and excluding where relevant fixed common costs and joint costs and potentially "Business Sustaining Costs"."*[58] Eircom also suggests that further analysis of its accounts for each service may be required to determine the set of operating costs that may also be avoidable at different parts of the network.

3.105 Eircom noted that uneconomic customers in economic MDF areas can not be identified using the universal account number ("UAN").

3.106 Eircom agrees that a probability analysis is appropriate to calculate the cost of uneconomic customers in economic areas. However, it suggests that this analysis is complicated somewhat by the need to measure the relevant avoidable cost on a customer basis. Eircom suggests that consistent with LRAIC, that it is the incremental costs that the USP could have avoided in the long run, if it had never served that customer, which should be calculated.

3.107 Eircom suggests that to calculate the avoidable cost of the access network, that the Copper Access Model be used and the difference in cost with and without certain customers would identify the avoidable cost.

3.108 Eircom also suggests that it is unclear what a "tender" is intended to mean. It also suggests that: *"at the level of principle, it cannot be assumed that just because the USO makes a tender, serving the customer concerned is an avoidable cost. Such an analysis ignores that the regulatory context in which the USO is met."*[59] Eircom also notes that: *"the situation with "voluntary tenders" is that very often the network costs are unavoidable: the choice facing eircom is to bid for the retail revenue, or have to have an OAO serve the customer using eircom's wholesale services. If eircom did not bid, only the retail costs and bid costs would be unavoidable."*[60] Eircom says it is incorrect to suggest that Eircom would potentially reduce tendering bids to attain customers, as it would not be in its commercial interests to do so. Eircom suggests that by excluding customers gained through tender it would not be in its interest to compete for such customers and thus, reduce competition — as it would recover: *"at least a portion of the loss arising between the wholesale revenue and the avoidable cost through funding, which it would not if it had won the bid"*[61]. Eircom considers that: *"ComReg's proposed approach, which results in including certain customers where there is a positive contribution, and excluding them with a net cost is not consistent."*[62] However, Eircom suggests that if ComReg is to maintain its position that a clear and precise definition of the term "tender" is required.

[56] Eircom, *supra* n 12, pg.17.

[57] ibid, pg.18.

[58] ibid, pg.17.

[59] ibid, pg.19.

[60] ibid.

[61] ibid.

[62] ibid, pg.20.

3.109 In relation to the issue of "ghost estates", Eircom welcomes ComReg's proposed position, but suggests that all costs associated with these "customers" should be included in the net cost calculation. Eircom notes that the usual practice in relation to new housing estates is to enter into an agreement with the local developer to provide the labour, ducting and joint box infrastructure for an agreed fee.

ComReg's Conclusions

3.110 As noted in paragraph 3.83, the net cost calculation only takes into account the actual revenues the USP would forego if the provision of services to uneconomic customers / areas was not required. The uniform price(s) is given for the period of application and therefore will be implicit in the revenues foregone in the net cost calculation. ComReg considers that it would be inappropriate to include in the net cost calculation the hypothetical prices the USP considers that it could or may have charged. However, in circumstances where a net cost is determined, ComReg recognises that this net cost may represent a direct impact on the financial burden of a USP — based on the USP's ability to bear such costs through uniform pricing and the impact of competition in economic areas year-on-year. As such, if a USO net cost is established then the impact of uniform pricing (if any) would be considered as part of the unfair burden assessment.[63]

3.111 Having regard to its initial views and having fully taken into account the views it received during consultation, ComReg has now concluded that it is reasonable and appropriate to require that uneconomic areas be identified at the MDF level (i.e. based on network structure) where avoidable costs are greater than total revenues foregone.

3.112 This approach is consistent with the principle of avoidable costs; where the ability to avoid costs is largely determined by the capability to remove parts of the network that the USP, as a commercial operator, would have chosen not to continue to serve in the absence of the USO.

3.113 As noted in the Draft Decisions Paper, in order to calculate the net cost (taking account of the principle of avoidable costs) the USP should ideally be able to identify all the assets at the relevant exchanges (taking account of the relevant depreciation charge with respect to the assets' age) and relevant OPEX cost for each exchange and comparing the sum of these actual avoidable costs to the revenue (both direct and indirect) of that exchange.

3.114 However, ComReg recognises that this level of data is not typically available to large utility companies and indeed, Eircom notes that its accounting systems are unable to provide such detailed information. While Eircom's proposed approach, as set out in paragraph 3.102, is similar to the approach described in ComReg's Draft Decision, there is a key difference: ComReg's methodology specified that while an appropriate version of an average HCA approach (i.e. one which takes account of different geo-types and different depreciation profiles for different classes of assets) is allowed, ComReg also noted that: *"[i]n making this allocation, the USP should draw on, and be prepared to substantiate with, its investment profile / decision making, works-orders etc., so as to ensure that the allocation is appropriate (e.g. the allocation of the average depreciation charge should be reflective of the USP's investment profile in the exchange area and not seek to allocate large average depreciation charges to areas that are nearly fully depreciated or fully-written-off)."*[64] Eircom's proposed approach with respect to parental exchanges whose MDFs have the same geo-types may compensate / reward the USP for investing in

[63] This issue is discussed further in paragraphs 5.30 - 5.31.

[64] ComReg, Draft Decisions Paper, paragraph 3.110.

economic MDF areas at the expense of the uneconomic MDF areas present in the parent exchange. Accordingly, ComReg considers that Eircom's proposed approach, without this "sense check", would not take into account where investment actually occurred. Therefore, this approach could allocate a depreciation charge to an area which would not be reflective of the region-specific investment profile which ComReg considers inappropriate (i.e. Eircom's submission that its approach would ease implementation, would not provide in ComReg's view the required detail to ensure the appropriateness of the allocation and may as a result be meaningless). Taking into account the above, ComReg remains of the view that the proposed methodology, as set out in the Draft Decisions Paper, is appropriate.[65]

3.115 Regulation 11 (7) of the Regulations provides that: *"accuracy of the accounts or other information or both, serving as the basis of the net cost of an obligation shall be audited or verified, as appropriate"* and Schedule 1 Part A of the Regulations provides that: *"[t]he responsibility for verifying the net cost lies with the national regulatory authority."* Therefore, ComReg reserves the right to undertake its own verification process and to test sample areas.

3.116 ComReg concludes that if one sample area was found to be materially different, then it would be reasonable to require either a full assessment of the uneconomic exchange area, or to apply a proportionate adjustment to the net cost calculation. However, in circumstances where a number of reality checks show material discrepancies, ComReg must retain the discretion to reject the entire application — if it considers that neither a full assessment of those areas, nor a proportionate adjustment would be equitable, given the materiality of the discrepancies. Accordingly, ComReg concludes that it is reasonable and appropriate that where material discrepancies are found following "reality checks" by ComReg, itmay:

(a) require a full assessment of uneconomic exchange areas;

(b) apply a proportionate adjustment to the net cost calculation (pre-intangibles); or
(c) reject the entire funding application (if discrepancies are of a magnitude which on a reasonable view, would render the application not fit for purpose).

3.117 With respect to core network costs, consistent with the HCA costing methodology, it is only the actual costs which are avoidable which should be taken into account in the net cost calculation. ComReg considers that the LRAIC approach suggested by Eircom, is inappropriate — as it may not be reflective of the actual costs incurred by the USP in that financial year. ComReg considers that the core network costs calculation should be consistent with the principle of avoidable costs and therefore, should not include any costs which the USP would not have avoided if it did not have the USO (see paragraphs 3.20-3.26 and 3.28-3.45).

3.118 As noted in paragraph 3.94, for a cost to be considered avoidable, it must be accurately attributed to end-users or groups of end-users. Uneconomic customers in economic areas must be identifiable from a net cost perspective to be allowable. Therefore, ComReg proposes that it is appropriate that such customers be identified based on a UAN, or by other reasonable means which the USP can demonstrate (to the satisfaction of ComReg) has the same identification meaning as required by the Regulations of *"specific end-users"*.

3.119 In relation to eircom's use of a probability analysis to calculate the cost of uneconomic customers in economic areas, ComReg considers that in order to prevent the over or under-

[65] ComReg, Draft Decisions Paper, paragraphs 3.110.

compensation of costs (i.e. costs which would not be reflective of the actual costs such customers present (if any)) the identification and allocation of these specific USO net costs must be at least consistent with the allowed approach outlined in paragraph 3.95 — in relation to uneconomic exchange level or area USO net costs. As part of the USP's funding application, the onus is on the USP to provide sufficient detail to ComReg to justify any circumstances where the USP considers the customer uneconomic. For this purpose, the parameters and assumptions used in the probability analysis must, at a minimum, be clearly documented and duly reasoned.

3.120 In addition, ComReg, as part of its assessment process, reserves the right to further interrogate any rationale provided by the USP in relation to the assumptions and reasoning underpinning either the identification of "uneconomic" areas or the probability analysis to identify "uneconomic" customers. ComReg will undertake its own assessment, as appropriate, to ensure the net costs associated with uneconomic exchange and/or customer levels, if any, are both reasonable and appropriate. For the purposes of clarity, ComReg has concluded that it would be appropriate to refer to this in Decision No.15.

3.121 ComReg continues to believe that for these elements care must be taken to avoid the double-counting of revenues and costs. ComReg considers that all uneconomic areas identified must be removed from the calculation of uneconomic customers in economic areas in order to avoid double-counting.

3.122 ComReg considers that Eircom's proposed approach to calculate the avoidable cost without certain customers using the Copper Access Model is incorrect. While the use of the Copper Access Model may provide a useful tool in identifying those assets which may or may not be required in the absence of "uneconomic" areas/customers, as the model is based on a MEA approach the costs will not be representative of the actual costs incurred for those parts of the network (as discussed in paragraph 3.17). As such, ComReg considers that while the Copper Access Model may be useful in identifying the number of assets (i.e. poles, cables etc.) that might be avoidable, the USP must interrogate / analysis its actual network investment profile of those areas to ascertain the true avoidable cost. This analysis must take into consideration the respective age profile of those assets and where an asset is fully written-off there is no avoidable capital charges. As discussed in paragraph 3.44, with respect to physical infrastructure it is only the respective depreciation charge for that given financial year which is considered avoidable.

3.123 Commercial tenders for telecommunications services are often conducted when a project is considered sufficiently large that the project owner (e.g. a local developer) believes there may be commercial incentives in doing so. For the purposes of clarity, the "tenders" to which ComReg is referring to are those commercial agreements that have been agreed following a competitive tendering process (e.g. where the developer of a business park seeks tenders for the most economically advantageous services for different telecommunications services). Such competitive tender processes are by their nature voluntary and there is no obligation on the USP to involve itself in such a process.[66]

3.124 ComReg considers that there is an important distinction between "uneconomic" customers acquired by tender and "uneconomic" customers the USP acquires because of the USO. While a commercial operator may wish to avoid "uneconomic" customers, for the duration of the commercial tender contract, they cannot do so — due to the legal contractual requirement (resulting from the competitive tender) to serve those customers. ComReg

[66] When referring to tenders, ComReg is specifically, and only, referring to those tenders which provide services which are identical to the services provided by the USO (i.e. absent a commercial tender process the USP would have provided those services under a USO).

recognises that a commercial operator may choose to avoid such customers at the end of their respective commercial contractual obligations and, if, at that time (i.e. in the financial year in which the commercial obligation ends) those customers would not be otherwise retained by a commercial operator, then it would be appropriate that they are considered as "uneconomic" USO customers and included in the net cost calculation for that given financial period.

3.125 With respect to Eircom's suggestion that should such "customers" not be allowed in the net cost calculation that it would decrease competition, ComReg considers that the fact that there is competition for such contracts (i.e. customers) highlights the inappropriateness of such customers being considered USO customers — the clear purpose of the USO is that it should only represent those end-users or groups of end-users for which there is no competition. Furthermore, ComReg considers that its position will provide a safeguard for competition, as it protects against any potential unfair tendering advantage the USP may otherwise have (i.e. the USP knowing that they would be compensated irrespective of their profitability could potentially decrease their tendering bids to attain these customers). ComReg proposes to expand the wording in the Decision to illustrate the meaning of the term "tender."

3.126 ComReg considers that it is consistent that profitable "tender" contracts be included to determine the economic viability of areas. To exclude those customers would mean that an area could potentially become uneconomic (where it would not be the case if they were included) and if the USP determines it would avoid that area absent a USO, such profitable contracts would also be foregone. ComReg considers it appropriate that profitable tender contracts are included in the net cost calculation to determine the "true" avoidable cost of the USO (i.e. there may be fixed common or joint costs that are unavoidable as a result of the contractual obligation to continue to serve those customers for the duration of the tender). Consistent with ComReg's view of "uneconomic" tenders, once the contractual legal obligation ends (i.e. the duration of the tender agreement) to serve these profitable customers, the USP acting as a commercial operator would have the discretion to continue to serve those areas (if these customers or areas would no longer be served by a commercial operator then they would fall within the remit of the USO).

3.127 As noted in paragraph 3.44, it is only those costs actually incurred by the USP that could have been avoided which should be included. Therefore, in relation to housing estates where local developers receive payment from the USP in relation to any remedial work, it is appropriate that such costs be included in the net cost calculation. In circumstances where no payment is made, because costs are not incurred by the USP, these should not be evident in the historic accounts and therefore, this issue should not be relevant.

Decision No. 10	**The net cost calculation shall not include those customers who were originally considered "uneconomic" but who have now become profitable. The net cost calculation also does not include those customers attained as a direct result of a competitive tendering process (who are deemed "uneconomic").**
Decision No. 11	**Uneconomic areas shall be identified at an MDF level.**
Decision No. 12	**An average depreciation charge for each class of network element (based on an average cost and asset age) shall be developed by geo-types (e.g. urban, sub-urban, rural etc.). The**

	USP may allocate the relevant depreciation charge (as reconcilable to the HCA accounts and taking account of the principle of avoidable costs) for each exchange area based on the asset requirements as determined by the Copper Access Model (as updated or similar modelling tool). The calculation must be sufficiently granular to allocate costs only to those network elements actually used by users who are potentially uneconomic. In making this allocation, the USP should draw on, and be prepared to substantiate its investment profile / decision making, works-orders etc., so as to ensure that the allocation is appropriate (i.e. the USP should satisfy itself that in making an allocation to an MDF area, it has not allocated costs which are not reflective of the USP's investment profile in that MDF area).
Decision No. 13	**Uneconomic customers in economic areas shall be identified based on universal account numbers ("UANs"). However, if ComReg is satisfied, because of a lack of information beyond the control of the USP, that it is not practicable to identify uneconomic customers by UAN, the USP must demonstrate that the use of an alternative approach has the equivalent effect of identifying those customers.**
Decision No. 14	**The USP may calculate uneconomic customers in economic areas using a probability analysis. However, the identification and allocation of these costs must be consistent with ComReg's decision outlined in Decision No. 12.** **The parameters and assumptions used in the probability analysis must be clearly documented and duly reasoned as to the circumstances why the USP considers the customer uneconomic.**
Decision No. 15	**During the course of ComReg's assessment of a USO funding application, a number of sample "reality" checks will be undertaken. If material discrepancies are found, ComReg may: require a full assessment for those exchange areas claimed to be uneconomic or include uneconomic customers; apply a proportionate adjustment to the net cost calculation (pre-intangibles); *or* reject the entire USO funding application (on the basis that the discrepancy is of a magnitude which would render the application not fit for purpose).** **ComReg as part of its assessment process, will reserve the right to further interrogate any rationale provided by the USP in relation to uneconomic areas and uneconomic customers and to undertake its own assessment regarding the appropriateness of these net costs.**

Principles and methodologies for cost identification and allocation: uneconomic payphones and other USO costs

The Consultation issue

3.128 The USO consists of the provision of a defined set of services to end-users at an affordable price. As well as provision of access at fixed locations and telephone services (as discussed above) these services include: the provision of payphones, directory enquiry services, and directories[67] ("Directories") and specific services for disabled users. Where these services can only be provided at a loss and where it would not have been provided by a commercial operator, ComReg considered it appropriate to include the associated avoidable costs and revenues in a net cost calculation.

Summary of Respondents' views

3.129 Eircom made the only submission which considered specifically uneconomic payphones and other USO costs in their response.

3.130 Eircom noted that payphones are provided in two general contexts. The first is a commercial business case, where Eircom bids for the right to do so. Eircom notes that as these payphones are not accessible by the general public at all times (i.e. due to their location in airports, shopping centres etc.) that even if these payphone are unprofitable, they would not be included in the USO. The second, Eircom note is provided purely as a result of the USO. Eircom highlight that they have sought to systematically reduce the number of payphones that are provided, however, they note that: "*the economics of payphone removal should not be confused with the provision of or existence of uneconomic payphones. Where an existing payphone is marginally uneconomic, the net saving may not justify the cost of removal.*"[68]

3.131 Eircom notes that they consider ComReg's approach to calculate the net cost of Directories as reasonable. However, Eircom suggests as its: *"universal service obligations in relation to directories do not give rise to a net cost."*[69] they will not be included in the 2009/10 funding application

ComReg's Conclusions

3.132 ComReg considers (as acknowledged by Eircom) that as some payphones (irrespective of profitability) are typically not accessible to the general public at all times and therefore, they are outside the scope of the USO. With respect to loss making payphones, ComReg proposes to assess these costs — by reference to the difference in actual costs that the USP as a commercial operator would have incurred had the USO be withdrawn for the year of an application for funding. Therefore, where a payphone is only marginally loss making, a commercial operator, using financial and other decision making tools, would assess whether they would chose to maintain those payphones or not. Where a commercial operator would not maintain those payphones, ComReg considers that it is appropriate that these avoidable costs be included in the net cost calculation. However, ComReg considers

[67] The USP must provide end-users with a comprehensive printed directory of subscribers, free-of-charge, and updated at least once a year. In addition, the USP must keep a record in the national directory database ("the NDD") of all subscribers of publicly available telephone services in the State (including those with fixed, personal and mobile numbers who have not refused to be included in that record) and must allow access to any information contained in such a record to any such other undertaking, or any person, in accordance with such terms and conditions to be approved by ComReg.

[68] Eircom, *supra* n 12, pg.21.

[69] ibid, pg.23.

that where the number of payphones in an area is deemed to be excessive (i.e. in excess of the number of payphones required to provide the USO regional coverage), then it would be inappropriate for such payphones to be included in the net cost calculation. The number of payphones in an area may be inefficient and ComReg considers that it would be inappropriate for the USP to be compensated for uneconomical deployment of payphones. Therefore, where (and if) the number of uneconomic payphones is considered excessive and unreasonable, ComReg will adjust the net cost calculation to reflect appropriate payphone coverage (in areas where they are mandatory).[70]

3.133 ComReg maintains its position on the calculation of net cost of Directories. However, ComReg considers that irrespective of profitability of Directories they must be included in the net cost calculation. If as Eircom suggest it is demonstrated that it does not create a net cost, then it will not be included in the net cost calculation. However, the quantum of the profitability, or otherwise, must be included as part of the USO funding application so that it can be incorporate either in the net cost calculation (in circumstances where this service is loss-making) or assessed as part of the unfair burden (in circumstances where this service is profitable).

3.134 ComReg did not receive any submissions on the net cost for the provision of specific USO services for disabled users. However, ComReg considers that its position as set out in the Draft Decisions Paper remains appropriate.

Decision No. 16	**In respect of mandatory public payphone provision, the net cost calculation shall be based on the total avoidable cost, minus the total revenues foregone. Furthermore, for each public payphone that is connected to a single exchange site, the access cost for a payphone will be the same access cost as that of any line at the exchange site on which it is connected. The avoidable access costs shall be calculated as an estimate per line at the exchange site to which the public payphone is connected. If the number of uneconomic payphones is considered excessive and unreasonable, ComReg may adjust the net cost calculation to reflect appropriate payphone coverage (in areas where they are mandatory).**
Decision No. 17	**For Directories, the net cost calculation shall use the total avoidable cost, minus total revenues of this service.**
Decision No. 18	**The net cost for the provision of specific USO services for disabled users, shall be calculated using the total avoidable cost minus the associated total revenues foregone. The avoidable cost shall include the cost associated with the provision of USO special services over the standard minimum level of service (e.g. minicom relay services, free directory enquiries, etc) and specialised equipment (e.g. restricted vision phones, inductive couplers, etc) minus the total revenue which is incremental to the total revenue associated with the standard minimum level of service to disabled users (which is appropriate to all operators).**

[70] However, where the USP can demonstrate to the satisfaction of ComReg that the USP as a commercial operator would never have provided those loss-making payphones if the USO had never existed — ComReg will consider this as part of its assessment of the USO funding application.

Format of applications for USO funding requests by USPs

The Consultation issue

3.135 A request for USO funding must accord with the Regulations, the Directive, and the decisions made by ComReg as a result of this consultation process. The Draft Decisions Paper set out a number of requirements regarding the form and quality of information necessary to be included in a USO funding application, in order for it to be fit for purpose.

Summary of Respondents' views

3.136 Eircom considered that the application should contain a 10 year investment profile as unreasonable and disproportionate.

3.137 Eircom propose that it is unreasonable to require that the Directors declaration statement regarding the application should be based on a "true and fair view".

3.138 Eircom notes that the granularity of the data required to support an application may not always be available due to data warehousing procedures which aggregates records year-on-year. Eircom suggest that should an application be made for 2009/10 the level of data available would not be as detailed as that currently available for a 2010/11 application.

3.139 Eircom does not believe that it is appropriate to require that an application be made using specific software.

ComReg's Conclusions

3.140 As noted in paragraph 3.114, the level of granularity regarding the geographic investment profile of the USP may not readily be available. Therefore, ComReg has reviewed its position requiring a funding application to require an investment profile (between CAPEX and OPEX and differentiating between installations and upgrades). However, as part of ComReg's verification process and in undertaking its "reality checks", ComReg may require a reasonable estimate from the USP (post-application) regarding its historic investment profile in MDF areas — where there is a significant net cost and which ComReg believes may have been subject to the sweating of assets, or represent areas where ComReg believes there may have been a lack of investment in the past. Consequently, ComReg has deleted its Draft Decisions requiring such specific investment profile information by the USP on application.

3.141 ComReg notes that both the Regulations and Directive are silent on the level of "audit" the net cost application should be subject. Regulation 11 (7) specifies that the: *"accuracy of the accounts or other information or both, serving as the basis of the net cost of an obligation shall be <u>audited or verified, as appropriate</u>, by the Regulator or by a body independent of the undertaking concerned and approved by the Regulator""* [emphasis added]. ComReg considers that the term "*as appropriate*" provides for a range of procedures of an audit nature and would provide for a spectrum of opinions and comfort.[71] As the Director's certificate sign-off is directly based on the level of "audit" the third party undertakes, ComReg proposes that it would appear reasonable that the Director's certificate wording would reflect this.

3.142 In addition, ComReg notes that Schedule 1 Part A of the Regulations provides that: *"[t]he responsibility for verifying the net cost lies with the national regulatory authority."*

[71] For example, ComReg may require that the USP's auditors undertake specific "*Agreed Upon Procedures*". These "*Agreed Upon Procedures*" would be a limited scope assignment, as agreed between a qualified independent body, the USP and ComReg, with the objective of reporting on factual findings. The same level of audit assurance is not expressed in an "*Agreed Upon Procedures*" engagement when compared to a "*Fairly Presents in Accordance with*" opinion. Instead, users of the report assess for themselves the procedures and findings reported by the qualified independent body and draw their own conclusions from its work.

Accordingly, ComReg may undertake its own assessment on receipt of a USO funding application, which may include, but not limited to, further testing, sample-checks, analysis and assessment. Therefore, ComReg considers that while the level of work undertaken by the independent third-party to determine their "opinion" or report of the USO net cost calculation, may provide some degree of comfort, it will only form part of ComReg's overall assessment.

3.143 Regarding Eircom's data warehousing procedures to aggregate data year-on-year, ComReg is unable to ascertain at this stage, absent an independent third-party "audit" and application, whether this aggregation will render the assessment of the "true" net cost of uneconomic areas and uneconomic customers in economic areas meaningless. ComReg does not consider it unreasonable that the relevant data to support a USO funding application is retained by any USP. Without prejudice to a potential USO funding application for 2009/10, ComReg considers that where the materiality of such aggregation is unknown, it may render such an application not fit for purpose. It is the responsibility of the USP to ensure sufficient data is retained to support any USO funding application and ComReg strongly suggests that Eircom review its current data warehousing procedures.

3.144 ComReg has given further consideration to the issue of the required software that would be appropriate in making a USO funding application. ComReg will permit the use of alternative software provided it is reasonably capable of access and review (i.e. the software package / licence must be affordable and readily available).

3.145 ComReg has reflected on its Draft Decision that: *"An independent declaration shall be signed off by the Board of Directors of the USP and it must accompany the application. (The required declaration is included in Schedule 1). Financial information shall be provided with an appropriate audit opinion or verification report, where the Auditor*[72] *(as approved by ComReg) has in no way assisted with the preparation of the USO funding application, <u>or provided advice or opinions (other than in relation to audit reports) on the methodologies or processes used in preparation of same</u>."*[emphasis added] ComReg considers that the underlined portion of this Draft Decision may unintentionally conflict the Auditor in its interaction with the USP as part of it audit / verification procedures. As such, ComReg has amended the Decision to make allowances for this necessary interaction.

Decision No. 19	USO funding applications shall be consistent and in accordance with this Decision and Decision Instrument**.**
Decision No. 20	**USO funding applications shall be fit for purpose.**
Decision No. 21	**USO funding applications shall be based on annual information which coincides with the USP's financial year.**
Decision No. 22	**A declaration shall be signed off by the Board of Directors of the USP and it must accompany the application. (The required declaration is included in Schedule 1). Financial information shall be provided with an appropriate audit opinion or appropriate report, where the Auditor[73] (as approved by**

[72] Where an Auditor can refer to a person, corporation sole, a body corporate, and an unincorporated body.

[73] Where an Auditor can refer to a person, corporation sole, a body corporate, and an unincorporated body.

	ComReg) has in no way assisted with the preparation of the USO funding application.
Decision No. 23	**USO funding applications shall be supported by calculations in an MS Excel, or MS Access format, or alternative software which is reasonably capable of proper access and review.**
Decision No. 24	**Any models submitted in support of a USO funding application shall be transparent: there must be limited hard-coded cells (where cells are hard-coded a supporting reference document of such numbers must be provided and be capable of being reconciled and audited) and all numbers must be set out so that there is an audit trail present. The models submitted shall be set out in a clear and transparent manner, showing the separate calculations for each component (e.g. uneconomic areas, uneconomic customers, the provision of public pay telephones and specific services for disabled users). The calculations supplied must clearly set out the capital costs, operating costs, overheads, etc (including General and Administration — ("G&A") costs) and the methods adopted for the allocation of costs which are not directly related to the provision of the USO. Where uneconomic lines/areas are identified, the works orders associated with those areas for the year of assessment must be available upon request by the Auditor as supporting documentation for the USO application.**
Decision No. 25	**Applications shall, with reference to the supporting model, clearly identify (by MDF or by geographic location as appropriate), with adequate reasoning and cogent evidence to justify that, those customers or groups of customers (i.e. area), that in the absence of the USO, the provision of the service would *either* not continue to be provided or would never have been provided, to that customer or groups of customers (i.e. area) by a commercial operator, *or* by the USP acting as a commercial operator. The USP must provide its commercial reasoning, including the respective parameters used in justifying its decision, including, but not limited to:** • **The current loss-making status of those customers or areas;** • **The local density of those customers or areas;** • **The respective distances from exchange for uneconomic customers;** • **The network infrastructure / technology used to serve those customers or areas; and** • **Any other pertinent information the USP has used to influence its decision making process.** **Furthermore, applications must not include those customers attained through a competitive tendering process, or those**

customers which have now become economic, but who were previously considered uneconomic.

Decision No. 26 **There may be a requirement to make certain key data / workings publicly available and the USO funding application is deemed to be made by the USP on this understanding.**

Decision No. 27 **With respect to the provision of public payphones which are "uneconomic", sufficient detail shall be provided on their geographic location and proximity of other public payphones operated by the USP (irrespective of their profitability).**

Decision No. 28 **The model provided shall be supported by comprehensive documentation, clearly setting out and explaining all inputs (both financial and otherwise), efficiency adjustments applied, engineering rules applied, cost allocation methodologies employed, depreciation methodologies applied and assumptions made.**

Decision No. 29 **Sampling may be used for certain aspects of the modelling of net cost, for example the assumptions driving the size of replacement calls. Where sampling is used, samples must be sufficiently representative of the population being sampled. Where applicable, any application of a sampling methodology by the USP must accord with ComReg Decision D07/10.**[74]

Decision No. 30 **USP funding applications shall, where applicable, accord with ComReg Decision No. D07/10 in relation to accounting separation.**

Decision No. 31 **The calculation of the benefits of the USO shall be completed by an external expert, independent of the USP. These calculations must clearly set out: the respective methodologies; assumptions and supporting documentation used at deriving the benefits of the USO.**

These calculations must provide: (a) the benefit (in monetary terms) that the USP derives as a commercial operator; (b) the benefit (in monetary terms) that the USP derives as a result of the USO; and (c) a reconciliation with reasoning to explain the incremental difference between (a) and (b).

Timing of applications for USO funding request by USPs

The Consultation issue

3.146 The Regulations do not specify when a USP must submit a request for funding. ComReg Document No. 07/39 decided that, in the event that the USP wished to make a request for USO funding, any such request should be submitted on an annual basis, within one month

[74] ComReg Decision D07/10, Document 10/67. Response to Consultation Document No. 09/75 and Final Direction and Decision: Accounting Separation and Cost Accounting Review of eircom Limited, published 31 August 2010.

of the publication of relevant audited separated accounts, but no later than six months following the end of the USP's financial period.

3.147 ComReg's Draft Decision provided timelines with respect to (a) a request for USO funding by Eircom in respect of its financial period 1 July 2009 to 30 June 2010; and (b) any subsequent requests for USO funding by the USP.

Summary of Respondents' views

3.148 Eircom's submission did not raise any issues in relation to the timelines for a request for funding for financial period 1 July 2009 to 30 June 2010. However, Eircom noted that due to a number of regulatory obligation deliverables that fall due in and around December each year, that it would present significant difficulties for any potential subsequent funding applications to be delivered on time. Eircom proposes that the deadline for subsequent applications be set at the end of March each year (i.e. 9 months after the respective year end).

3.149 Eircom submits that it has considerable concerns about projecting a net cost 6 months prior to that financial year end. Instead, Eircom proposes that it would be reasonable for industry to base their expectations on the quantum of a potential fund on the outcome of the previous year's assessment.

ComReg's Conclusions

3.150 ComReg recognises that the current USP has a number of regulatory obligations which fall due year-on-year in and around December (which is currently 6 months after the financial year end) and that reasonable accommodation should be made for the current USP in this regard.[75] Therefore, ComReg considers it reasonable that subsequent applications for USO funding be accepted no later than 9 months of the current financial year end.

3.151 ComReg accepts Eircom's concerns and considers that it would be reasonable, in circumstances where a fund has previously been determined in the preceding financial year, and where undertakings are obliged to contribute to such a USO fund, that they could base their respective accruals (for their corresponding financial year) on the previously determined USO fund (if any). However, undertakings must be prudent when making their accrual, the respective size of the fund (if any) could change year-on-year depending on the actual historic cost for that financial year (appropriately adjusted for efficiencies) and the assessment of the unfair burden (if any) — which will include an assessment of impact of competition on the USP's ability to cross-subsidies uneconomic customers and areas.

[75] For example, ComReg Decision D07/10 provides that Eircom, as the current USP, is required to provide Statutory Accounts by 31 October year-on-year, HCA Separated Accounts by 30 November year-on-year, CCA Separated Accounts by 31 December year-on-year and Additional Financial Statements and Additional Financial Information by 31 January year-on-year.

Decision No. 32.	**Eircom, the current USP, may submit a request for USO funding to ComReg in respect of its financial period 1 July 2009 to 30 June 2010. If Eircom intends to submit such a request to ComReg, it shall do so no earlier than 1 month, and no later than 6 months following the date of this Decision. ComReg may extend this deadline, but only where it considers that there are exceptional reasons for doing so.**
Decision No. 33.	**Subsequent requests for USO funding by a USP(s) may be submitted to ComReg in respect of a relevant financial year. If a USP intends to submit such a request to ComReg, the USP(s) shall do so no later than 9 months following the end of the financial year in respect of which the request is intended to be made. ComReg may extend this deadline, but only where it considers that there are exceptional reasons for doing so.**
Decision No. 34.	**ComReg Document No. 07/39 dated 2 July 2007 and entitled *“The Provision of the Universal Service: Request for Funding by Eircom”*, is hereby revoked in its entirety.**

4 Principles and methodologies for calculating the benefits of the USO

Overview

4.1 This section sets out ComReg's decisions and guidance on identifying the different intangible benefits the USP gains from its USO and the methodologies that may be applied in quantifying their value.

4.2 This section is structured under the following headings:

- *Benefits resulting from the universal service provision:* The intangible benefits of a USO that ComReg will consider, at a minimum, when assessing a USO funding application; and
- *Methodologies and data requirements for calculating benefits*: Guidance on the various methodologies available to ComReg to assess the value of the benefits of a USO.

Benefits resulting from the universal service provision

The Consultation issue

4.3 As noted in paragraph 3.47, the USP benefits from both tangible (i.e. revenue) and intangible benefits (i.e. indirect benefits) as a result of the USO. Recital 20 of the Directive specifies that: *"[t]aking into account intangible benefits means an estimate in monetary terms, of the indirect benefits that an undertaking derives by virtue of its position as a provider of universal service, should be deducted from the direct net cost of universal service obligations."* As such, the net cost calculation must be adjusted for any intangible benefits the USP derives from the USO.

4.4 Neither the Regulations nor the Directive prescribe a methodology for identifying, or attributing values to intangible benefits. The European Commission *(Com 96-608*)[76] identified four main benefits of the USO, namely: brand recognition, ubiquity, life-cycle, and marketing. ComReg requested stakeholders' views on whether these key categories of market benefits were appropriate. The majority of stakeholders' submissions confirmed that they were.

4.5 ComReg recognised that the benefits accruing to a USP may be approached in various ways and that there can be some overlap between the categories of benefits. Consequently, ComReg noted that care must be taken to avoid the double-counting of benefits and that it was important to distinguish between the benefits resulting directly from the USO to those attributable to the USP being a large operator.

4.6 ComReg proposed the following draft decisions in relation to the identification of intangible benefits:

1. The net cost calculation must assess the benefits, including intangible benefits, to the USP. ComReg will consider, at a minimum, the following benefits (as a result of the USO) for a USO net cost calculation:
    - Brand Recognition.
    - Ubiquity.

[76] Communication from the Commission on "Assessment Criteria for National Schemes for the Costing and Financing of Universal Service in telecommunications and Guidelines for the Member States on Operation of such Schemes", 27 Nov 1996.

- Life-cycle.
- Marketing.

2. For the identification of the benefits, ComReg said it would observe the following key principles:

- The benefits represent effects on a USP of providing the USO which have not been accounted for in the direct costing methodology (any benefits that are directly identifiable to specific revenue streams, including indirect and replacement calls revenues are excluded, since they have been covered by the direct net cost calculation).
- Avoid the double-counting of any direct or indirect benefits.
- The benefits are those accruing to the USP, as a consequence of being the designated USP (any benefit arising from the fact that the USP is a large player in the market is to be excluded from the calculations).

Summary of Respondents' views

4.7 Eircom made the only submission to the Draft Decisions Paper which specifically addressed this issue. However, during the course of the consultation, with the exception of Eircom, all submissions were largely in agreement to the existence of intangible benefits and that the categories identified by ComReg in the Consultation Paper accurately captured these.

4.8 Eircom noted that: *"[t]he brand recognition benefit is the benefit that the USP derives from being seen to provide service to uneconomic areas and customers."*[77]

4.9 Eircom also suggests that in their view the quotes that: *"brand loyalty may reduce the advertising and marketing costs"*[78] in relation to brand recognition and *"logo display and public payphones and WiFi hotspots"*[79] in relation to marketing, indicate the potential level of overlap and uncertainty in relation to Brand Recognition and Marketing.

4.10 With respect to ubiquity, Eircom submits that: *"[i]t is important to note that the benefit is only derived from those customers that the USP serves solely as a result of the USO. If the USP would have served the customers in the absence of the obligation, then the benefit is simply a result of being a large national carrier. This means that it is only customers moving from uneconomic areas to economic areas that can provide a ubiquity benefit."*[80] Eircom also suggests that due to wholesaling arrangements it is the seller of the service who benefits from ubiquity and not the provider of the infrastructure or USP *per se*. Eircom recommends that the benefit of ubiquity should be excluded from the USO calculation.

4.11 Eircom notes that the issue of life-cycle benefits is quite a complex issue. Eircom suggests that if ComReg intends to consider life-cycle effects, it must do so consistently (i.e. recognise that economic customers may also become uneconomic). Eircom stated that it agreed with the approach outlined by ComReg in paragraph 4.55 of the Draft Decisions Paper, stating that the: *"USO life-cycle benefit "is likely to be insignificant and, therefore,*

[77] Eircom, supra n 12, pg.28.

[78] ibid.

[79] ibid.

[80] ibid.

could be excluded from the valuation of the benefits", is both reasonable and pragmatic."[81]

4.12 In relation to marketing, Eircom highlighted that as all revenue associated with payphones are accounted for in the tangible net cost calculation that there is no *"additional "intangible" benefits"*[82] in their view.

ComReg's Position

4.13 ComReg remains of the view that there are a number of intangible benefits the USP derives from the USO and that those benefits identified in the Draft Decisions Paper remain potentially the most important. Each of these benefits is discussed in turn below.

Brand Recognition

4.14 Brand recognition is not merely based on the USP's insignia (although this may facilitate instant public recognition), but also derives in principle from the USP's corporate reputation and goodwill (i.e. how it is perceived to operate its day-to-day business activities). Consequently, brand recognition is often closely associated with brand loyalty, which allows the USP to gain and retain more customers than it would in the absence of the USO.

4.15 ComReg considers that Eircom's suggestion that brand recognition is merely as a result of being seen to provide services to uneconomic areas and customers is incorrect. ComReg believes that brand recognition derives from serving both economic and uneconomic areas alike as a result of the USO. Brand recognition is based on the premise that the USP's brand creates amongst others a perception amongst the general public (both actual and potential customers and irrespective of their "profitability" status) of the USP as a corporate entity. Brand recognition may be of particular benefit in economic urban areas where there may be increased consumer choice. However, due to consumer brand loyalty or affiliation with the USP's brand they may not switch to a competitor's service offering. As discussed in the Consultation Paper, brand recognition is often the largest benefit identified by other NRAs when assessing the market benefits of the USO. However, ComReg notes that care must be given to correctly identify the proportion of this benefit which is a result of the USO and hence properly attributable to the USP, as opposed to branding benefits associated with being a large and well established commercial operator..

4.16 With respect to Eircom's submission that there is potential overlap between brand recognition and marketing, as acknowledged in the Draft Decisions Paper, care must be given to ensure there is no double-counting of benefits. Furthermore, as noted by ComReg in relation to brand recognition and marketing: *"to the extent that this* [marketing] *benefit is taken into account in any valuation of brand recognition, it would not be accounted for separately as a potential benefit."*[83] For the purposes of clarity, ComReg considers that as a result of brand recognition the USP may be able to reduce their <u>general marketing costs</u> as a whole (i.e. the USP may be able to reduce their marketing spend as customers are more likely to remain with the USP despite competition). In relation to Marketing spend, ComReg's example is referring to the USP's ability to reduce <u>specific marketing costs</u> due to the presence or positioning of the USP's payphones and WiFi areas. As such, while they both influence marketing spend the reason why they do so are very different and as such must be measured and accounted for separately in intangible benefits. However, ComReg

[81] Eircom, supra n 12, pg.29.

[82] ibid, pg.22.

[83] ComReg Draft Decisions Paper, paragraph 4.13.

recognises that care must be given to avoid the double-counting of such benefits and any calculation based on marketing spend will be cognisant of such.

Ubiquity

4.17 As the USP has a national presence as a result of the USO, this benefit derives from the basis that a proportion of customers who move from uneconomic areas are likely to remain customers of the USP — despite moving into an area which has alternative providers.

4.18 After due consideration of this issue, ComReg considers that Eircom's suggestion that it is only customers moving from uneconomic areas to economic that provide the benefit would seem reasonable and appropriate. ComReg considers that the movement of customers from economic areas to uneconomic areas is not a benefit to the USP but a direct result and purpose of the USO (i.e. those profitable customers would not have been served save for the fact that the USP has a legal obligation (i.e. USO) to serve those "uneconomic" areas).

4.19 ComReg acknowledge that, in part, it is the brand of the retailer of the service and not the wholesaler who benefits from ubiquity. In the circumstances where, the USP does not hold a direct retail relationship with the end-user, as set out in [Decision No. 5] the net cost calculation will take into account the wholesale revenues received from the OAOs and not their corresponding retail costs or revenues. Therefore, ComReg considers that it remains appropriate for the Ubiquity benefit to be included and calculated as part of the net cost assessment and that such calculation take into consideration the ubiquity benefit of the USP from a wholesale and retail perspective (as appropriate).

Life-Cycle

4.20 This benefit is achieved on the basis that a proportion of lines which are currently uneconomic (whether in uneconomic areas or serving uneconomic customers) may eventually become profitable in the future. As noted in the Draft Decisions Paper, there are a number reasons that may impact the future profitability of an uneconomic customer, including:

- The difference in revenues and costs for these particular set of USO customers – it is probable that this difference is sufficiently large; loss making subscribers today would not be expected to become profitable over time.
- The proportion of such subscribers who the USP would keep – factors might alter the likelihood that customers would continue to be served by the USP. These factors include: latency and loyalty effects; when an area could become economic (if ever); and the range of service providers that a customer might have (through, for example, pre-selection capabilities).
- Macroeconomic expectations.
- Competitive expectations.
- Technology and product expectations.

4.21 While ComReg accept that profitable customers may become unprofitable over time, consistent with HCA and avoidable costs — it is only those customers that a commercial operator would chose to avoid if the USP was removed that are included in the net cost calculation. Therefore, following this logic the net effect of including those profitable customers — which a commercial operator would chose not to serve would reduce the net cost of the USO (i.e. their revenue would be greater than cost per the historic accounts).

4.22 Eircom appears to have misinterpreted ComReg's reasoning to exclude the life-cycle effects from the intangible benefits calculation. As discussed in paragraph 3.36, the net cost calculation will already have been adjusted, in part for life-cycle effects, for those customers that the USP, acting as a commercial operator, would continue to serve. Accordingly, ComReg suggested that as those "uneconomic" customers (included in the net cost calculation) would not be otherwise served by a commercial operator, they are likely to represent those customers that are never likely to become positive (i.e. profitable) in all states of the world and therefore, their value is likely to insignificant. Consequently, ComReg reasoned the life-cycle benefits calculation could be excluded from the intangible benefits calculation. However, ComReg considers that it remains appropriate that life-cycle benefits are acknowledged as an intangible benefit, the fact that their benefit is in part included in the net cost calculation (i.e. the commercial operator decision to continue serving loss-making customers) and not separately calculated as an intangible benefit is irrelevant.

Marketing

4.23 The marketing intangible benefit incorporates the different types of benefits which may arise from being the USP; for example, potential commercial benefits relating to usage data and benefits from advertising, in particular, on public payphones.

4.24 ComReg considers that there is a significant advantage for the USP in having access to customer database and expenditure profile associated with USO customers (economic or otherwise), which the USP as a commercial operator would not otherwise have access to. While data protection laws prevent the USP from selling this data, the USP can utilise this data themselves directly to identify promotional activities, which may increase the profitability of both economic and uneconomic customers. Consistent with ComReg's reasoning on brand recognition (see paragraph 4.15), this marketing benefit is derived from serving both economic and uneconomic customers as a result of the USO.

4.25 In relation to Eircom's submission that all revenues associated with advertising on public payphones are accounted for in the tangible net cost calculation, ComReg considers that while Eircom is correct, the purpose of this calculation is not to measure the direct tangible revenues which the USP derives. The purpose of this intangible benefit is to calculate and take into account the benefit the USP gains from being able to display its own logo and other forms of self-promotion (i.e. advertise its own brand and products) on public payphones etc. and the relevant cost savings attained by not requiring additional advertising as a result.

Decision No. 35	**The net cost calculation must assess the benefits, including intangible benefits, to the USP. ComReg will consider, at a minimum, the following benefits (as a result of the USO) for a USO net cost calculation:** • **Brand Recognition.** • **Ubiquity.** • **Life-cycle.** • **Marketing.**
Decision No. 36	**For the identification of the benefits, ComReg will observe the following key principles:**

- **The benefits represent effects on a USP of providing the USO which have not been accounted for in the direct costing methodology (for example, any benefits that are directly identifiable to specific revenue streams, including indirect and replacement calls revenues are excluded having been covered by the direct net cost calculation).**
- **Avoid the double counting of any benefits.**
- **The benefits are those accruing to the USP, as a consequence of being the designated USP (any benefit arising from the fact that the USP is a large player in the market is to be excluded from the calculations).**

Methodologies and data requirements for calculating benefits

The Consultation issue

4.26 ComReg discussed a range of methodologies for estimating the value of the various intangible benefits the USP attains from the USO in the Consultation Paper and Draft Decisions Paper. ComReg recognised that the definition and estimation of the benefits accruing to a USP may be approached in various ways, and through a range of alternative methodologies. ComReg noted that there was a heterogeneous approach in other jurisdictions to the evaluation of the benefits of the USO.

4.27 Furthermore, as certain information requirements to undertake specific calculations (to estimate the value of these intangible benefits) may not be available, ComReg proposed, that absent an application and the types of supporting information that would be available, that it would be appropriate, at this stage, to focus on the principles of the various approaches that may be available to ComReg. The Draft Decisions Paper also highlighted that ComReg's overall approach in estimating these benefits would, as appropriate, be based on a combination of methodologies and data sources.

4.28 ComReg noted that the USP will most likely be the main source of data when determining the benefits of the universal service (e.g. surveys). However, in the absence of receiving an application for USO funding from the USP, the type and quality of data that the USP is able to provide, and the manner in which they will be presented by the USP, are not currently known. ComReg acknowledged that care must be taken when using any methodology which relies solely on USP supplied data. ComReg also noted that it could commission appropriate independent experts to explore the measurement of the benefits.

Summary of Respondents' views

4.29 Eircom suggests that in their view the magnitude of brand recognition only requires estimation following the verification that such a benefit exists. Eircom proposes that statistical analysis may provide a means to establishing whether such a brand recognition benefit exists.

4.30 As noted in paragraph 4.10, Eircom considers that the ubiquity benefit should not be included in the intangible benefits calculation. Furthermore, Eircom considers that the proportion of consumers who would not be aware of alternative suppliers in the telecommunications industry is likely to be small.

4.31 As noted in paragraph 4.11, Eircom considers that it is both reasonable and pragmatic to exclude the life-cycle benefits from the valuation of intangible benefits. Eircom also notes that: *"due to the uncertainty with which forecasts can be obtained, any resulting life cycle benefit calculation will introduce considerable uncertainty into the calculations, and any outcome will lie within a large margin of error."*[84]

4.32 In relation to marketing, Eircom's submission notes that they consider ComReg's approach to base the calculation of the marketing benefit using the Ofcom methodology as set out in the Draft Decisions Paper.[85]

[84] Eircom, supra n 12, pg.29.

[85] Eircom in its submission noted that they agreed with the Oftel approach in the Draft Decisions Paper. For clarity, Oftel was superseded as the British telecommunications regulator by Ofcom (The Office of Communications) in 2003.

ComReg's Position

4.33 As set out in Decision No. 31, the calculation of the benefits of the USO to be provided by a USP must be completed by an independent external expert. These calculations must be included as part of a USO funding application and must clearly set out: (a) the benefit (in monetary terms) that the USP derives as a commercial operator; (b) the benefit (in monetary terms) that the USP derives as a result of the USO; and (c) a reconciliation with reasoning to explain the incremental difference between (a) and (b).

4.34 The direct benefits of the USO have been accounted for in the net cost calculation (see paragraphs 3.55-3.65). In addition, where considered relevant, a segment of the value of intangible benefits may have been considered / incorporated in the commercial operator decision (i.e. the decision by the USP as a commercial operator that it would continue to serve certain loss-making customers or areas if the USO was removed), to the extent to which these have been demonstrated (to the satisfaction of ComReg) as being included in the net cost calculation. Accordingly, these should not be double-counted in a separate measurement of intangible benefits.

4.35 In relation to the measurement of intangible benefits arising from the USO, ComReg requires accurate and up-to-date data. As noted in paragraph 4.26, ComReg cannot determine with certainty, at this stage, which methodologies would be computable due to the uncertainty of the availability of supporting information. However, pending the receipt of the first USO funding application, ComReg will actively continue to evolve and refine a number of potential methodologies and data sources as outlined in the Draft Decisions Paper (i.e. that ComReg would commission appropriate independent experts to explore the measurement of the benefits). ComReg will require the current USP's estimates and reasoning regarding the availability or otherwise of information for those methodologies. However, at this remove, ComReg considers that it remains appropriate, to outline the various approaches that could be used to ascertain the quantum of the various intangible benefits. In this regard, ComReg will observe the key principles set out above (Decision No. 35 and Decision No. 36.)

4.36 If ComReg publishes a draft determination on whether it considers that the USP bears a net cost which represents an unfair burden arising from the USO, it will consult with stakeholders on this. At that stage, stakeholders will have the opportunity to submit their views on the approach used by ComReg to value the intangible benefits.

4.37 The principles of the various approaches so far proposed by ComReg were outlined in the Draft Decisions Paper and for completeness, are repeated below.

Brand recognition

4.38 ComReg's view is that it is relevant to evaluate brand recognition based on the provision of USO services. As brand recognition is likely to be the largest benefit arising from the USO in Ireland, ComReg will need to ensure any proposal is rigorous and provides a reliable estimate of the value of the benefit.

4.39 ComReg expects that the USP will be a key source of data (e.g. surveys) when determining a value for this category of benefit. However, to assess the benefit of brand recognition various approaches could be followed:

- Estimating brand recognition through valuation multiples implicit in a USP's transaction price.
- Identification of cash flows generated by brand recognition, corporate reputation and goodwill.

- Depreciated replacement cost (DCR) approach.
- Primary research/survey data.
- Regression techniques.

4.40 Therefore, ComReg may use one or a combination of approaches to determine a potential range of brand value. For example, by comparing research/survey data to a valuation approach to ensure a robust estimate. An additional approach would be to adopt a marketing spend approach.

4.41 Eircom’s submission that it must first be established that such a brand benefit exists before the magnitude can be established is somewhat circular. ComReg considers that it is only in the measurement of the benefit which will provide the correct determination whether such a benefit exists.

Ubiquity

4.42 As noted in paragraph 4.19, ComReg maintains the view that it is appropriate for ubiquity to be included in intangible benefits calculation.

4.43 As discussed in paragraphs 4.17-4.19, ComReg considers that the ubiquity benefit can be differentiated according to which types of areas may be involved when customers and/or households are moving. Therefore, the analysis of migration flows would, at a minimum, consider:

- The percentage of customers moving from uneconomic to economic areas; and
- The percentage of profitable customers moving into uneconomic areas.

4.44 One approach to evaluate ubiquity is to compare the proportion of customers that move to an economic area and retain the USP relative to the market share of the USP. Another method could assess the number of households that would have chosen an alternative operator, had they been aware of the alternatives.

4.45 In relation to Eircom’s submission that in their view the number of people who would not be aware of alternative telecommunications providers to be small, ComReg considers that the correct survey data will correctly determine to what extent this is accurate or not.

4.46 ComReg expects that the USO would be one source of data to evaluating this benefit. However, there are a range of potential other data sources, including, publically available data, such as, the Central Statistics Office. In addition to its own assessment process, ComReg would view the appropriateness of the methodologies and data sources used by the USP to assess the value of this benefit as part of its funding application.

Life-cycle

4.47 The customer life-time value concept is considered, in part, in the net cost calculation (see paragraph 3.36). Coupled with the fact that, as the value of these “uneconomic” customers or areas is likely to be insignificant ComReg considers that it is reasonable that this benefit can be excluded from the valuation of the intangible benefits.

Marketing

4.48 In the Consultation Paper, ComReg proposed using a similar approach to that used by Ofcom to determine the marketing benefit. The Ofcom approach took two potential elements into account when assessing the marketing benefit of each uneconomic payphone. Firstly, Ofcom considers corporate branding or logo display to be a form of advertising benefit. Secondly, Ofcom considers that the value of income from advertisements on kiosks should be included in the profitability of a payphone (which are provided as a result of the USO). Ofcom assumed only 50% of uneconomic payphones were suitable for advertising because of location and vandalism.

4.49 Using a similar approach to that of Ofcom would entail determining the income from advertisements on uneconomic public payphones, and using this to estimate the benefit gained from the logo display and any advertising on such public payphones. However, estimating the marketing benefit for uneconomic payphones involves establishing the number of uneconomic payphones which have an advertising value. ComReg would need to determine which of the uneconomic payphones were suitable for inclusion in the calculation. In addition to its own assessment process, ComReg would view the appropriateness of the methodologies and data sources used by the USP to assess the value of this benefit as part of its funding application.

Decision No. 37	**The methodologies to assess the value of the benefits that will actually be used cannot be prescribed in advance of receiving an application for USO funding from the USP.** **Pending the receipt of the first USO funding application, ComReg will actively continue to evolve and refine a number of potential methodologies for the purposes of valuing the benefits of the USO.** **ComReg reserves the right to implement alternative methodologies and data sources to verify the appropriateness of the value of the benefits resulting from the USO.** **During the course of the USO funding application assessment, ComReg will review the valuation of the benefits provided by the USP.**

5 Approach to a determination of an unfair burden

Overview

5.1 A determination of what constitutes an "unfair" burden is one of the principle elements of the process of determining whether, or not, a sharing mechanism should be established. An unfair burden arising from a net cost would have to be demonstrated before a sharing mechanism could be established. However, the concept of unfair burden is not defined in the Directive or the Regulations. This section contains ComReg's guidance and decisions on how it will determine the existence or not of an unfair burden.

Principles in relation to unfair burden

The Consultation issue

5.2 It was ComReg's preliminary view that for there to be an unfair burden, three cumulative conditions must be met:

1. There must be a verifiable direct net cost.

2. The benefits of the USO must not outweigh the net cost.

3. The positive net cost is (a) material compared to administrative costs of a sharing mechanism; and (b) causes a significant competitive disadvantage for the USP.

5.3 In the Consultation Paper and Draft Decision Paper, ComReg set out that, on the basis of the "audited" costs of the USO, it would determine whether USO financing was not required or unjustified. In general, the analysis of a potential unfair burden is conducted once there is a net cost of USO, taking into account intangible benefits (also referred to as a positive net cost). Whether a burden is unfair, depends not only on there being a positive net cost, but also on whether this impedes the USP from competing fairly with the rest of the industry. Therefore, a positive USO net cost does not *a priori* constitute an unfair burden on the USP. ComReg suggested that, in principle, there is an unfair burden when a USO results in a positive net cost for a USP, that is not relatively small compared to the administrative costs of a sharing mechanism, and, when it significantly modifies market equilibrium and leads to deterioration in a USP's market position.

Summary of Respondents' views

5.4 There was general support for ComReg's approach to determine the existence or not of an unfair burden. Most respondents considered that the approach is reasonable and objectively justified. While Eircom supports conditions (1) and (2) above, it continues to believe that condition (3) is inappropriate, for the reasons set out in its response to Consultation 10/94 and, as further detailed in the relevant sub-sections below on administrative costs, the USP's financial position and competitive conditions.

ComReg's Conclusions

5.5 Recent EU case law[86] confirms that the Directive gives ComReg (and other NRAs) discretion in determining what constitutes an unfair burden.

5.6 ComReg will determine if there is an unfair burden, if there is a positive net cost of providing the USO on a case by case basis.[87]

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[86] *Commission v Belgium,* paragraph 44 and 50, Case C-222/08.

5.7 It is ComReg's view, consistent with the EU recent case law, that a positive net cost does not automatically mean that the burden of a net cost is unfair, or that it automatically gives rise to the need for USO funding.[88]

5.8 Assessing whether the burden of a net cost is in fact *unfair* is an indispensible part of the analysis. In the Consultation Paper and Draft Decision Paper, ComReg explained that there while there may be a positive USO net cost for the USP, the USO or a net cost associated with it is not *a priori* an unfair burden. One case may be where the positive net cost is relatively small, such that the cost of establishing a sharing mechanism would be disproportionate to the net transfers towards the USP. In addition, once the net cost is known (and if it is considered to be material pursuant to administrative costs of a sharing mechanism), ComReg would (again consistent with recent EU case law) then evaluate whether this positive net cost is considered to impede the USP from competing fairly with the rest of the industry. The next section discusses these issues in further detail.

Decision No. 38	**For there to be an unfair burden on a USP, 3 cumulative conditions must be met:** *1.* **There must be a verifiable and verified direct net cost** *2.* **The benefits of the USO must not outweigh the net cost (i.e. there is a positive net cost)** *3.* **This positive net cost is (a) material compared to administrative costs of a sharing mechanism, and (b) causes a significant competitive disadvantage for a USP**

[87] Regulation 11 (3) of the Regulations provides that: "The Regulator shall, on the basis of such information, including information supplied pursuant to paragraph (2), as it considers sufficient to enable a determination under this paragraph to be made, determine whether an obligation referred to in paragraph (1) may represent an unfair burden on the undertaking concerned."

[88] *Commission v Belgium,* paragraph 42, Case C-222/08.

Thresholds and criteria to determine unfair burden

The Consultation issue

5.9 ComReg proposed three stages of analysis to assess the existence or not of an unfair burden on a USP. These are:

1. If the positive net cost is relatively small, assess whether or not the cost of establishing a sharing mechanism would be disproportionate to the net transfers to a USP.
2. If the positive net cost is not relatively small, assess whether or not this net cost materially undermines a USP's profitability and/or ability to earn a fair rate of return on its capital employed.
3. If the positive net cost undermines a USP's profitability, assess whether or not such a net cost materially impacts a USP's ability to compete on equal terms with competitors going forward.

Administrative costs

The Consultation issue

5.10 ComReg proposed if a positive net cost is relatively small, to assess this net cost, compared to the potential administrative costs of establishing and implementing a sharing mechanism. ComReg suggested that the administrative costs would include operational costs. Administrative costs might also include establishment costs of a USO fund. However, this would depend on the type of funding mechanism to be established. ComReg was of the view that it would also be relevant to compare the administrative costs to the percentage contributions made by the USP and other operators to a sharing mechanism, if any.

Summary of Respondents' views

5.11 Eircom agreed with the first element under condition (3), that the positive net cost should be (a) "*material compared with the administrative cost of the sharing mechanism.*" However, it did not agree that its entitlement to compensation may in any circumstances be subject to the net positive costs not being "relatively small", in particular, where it is not clear how it is to be determined that the net positive cost is relatively small. Accordingly, Eircom submits that the wording used in paragraph 5.10 of the Draft Decision Paper should also be used in the Decision, namely that the positive cost is material compared to the administrative costs of a sharing mechanism.

ComReg's Conclusions

5.12 In the Consultation Paper and Draft Decisions Paper, ComReg set out the reasons for its view that three cumulative conditions must be met for an unfair burden on a USP to exist. If it is established that a positive net cost exists (and hence conditions (1) and (2) above are met), clearly, condition (3) will be assessed on the basis of two criteria: (a) material compared to administrative costs of a sharing mechanism, and (b) causes a significant competitive disadvantage for a USP. In this regard, three stages of analysis will apply to decide the existence or not of unfair burden.

5.13 If a positive net cost is relatively small, ComReg plans to conduct an "administrative cost" test (and hence whether or not the cost of establishing and implementing a sharing mechanism would be disproportionate to the net transfers to the USP). ComReg's view is that an overall assessment of whether or not a positive net cost outweighs the administrative costs, would be consistent with regulatory best-practice principles of proportionality and practicality. In that regard, it is also relevant to compare the administrative costs to the percentage contributions made by the USP and other operators to any sharing mechanism.

5.14 However, if a positive net cost is not relatively small, ComReg would also evaluate whether, or not, a positive net cost can be considered to be material in view of the USP's financial position and competitive conditions. ComReg considers that, consistent with the EU case law, it would be objective and appropriate to apply this criterion (reflected in condition 3 above) to decide on the existence of an unfair burden on a USP.

5.15 Accordingly, in relation to the administrative costs assessment, ComReg has decided that:

Decision No. 39	**Administrative Costs:** **If the positive net cost is relatively small, ComReg will determine, on the basis of audited costs of the USO, whether USO financing is or is not justified, taking into account the administrative costs of establishing and operating a sharing mechanism (compared to the positive net cost of the USO) and taking into account whether these costs are disproportionate to any net transfers to a USP.**

The USP's financial position and competitive conditions

The Consultation issue

5.16 In the Consultation Paper and Draft Decisions Paper, ComReg proposed, if the positive net cost is not relatively small, to assess first the USP's financial position. ComReg highlighted that if there is a significant positive net cost, it is probable that a cross-subsidy would be required, meaning that this may represent a call on a USP's profits. The objective of that evaluation would be for ComReg to be reasonably certain that the USO is not affecting the profitability of a USP in the prevailing market circumstances. Therefore, ComReg considered it objective and appropriate to apply criteria to determine the possibility of an unfair burden to some measure of revenues and profits/profitability (and, hence, whether or not this net cost significantly affects a USP's profitability and/or ability to earn a fair rate of return on its capital employed).

5.17 In the Draft Decisions Paper,[89] ComReg set out its view that it would not be reasonable or appropriate to take account of the USP's level of indebtedness in examining the question of an unfair burden. In summary, the USP's level of indebtedness is not driven by the USO in particular, or necessarily at all.

5.18 In addition, ComReg proposed that, if the positive net cost is likely to significantly affect a USP's profitability, it would also then evaluate whether or not a net cost materially impacts a USP's ability to compete, dynamically, with its competitors.

5.19 ComReg noted paragraph 49 of *Base & Others v Ministerraad*, where the ECJ ruled that a burden is unfair if it: *"….is excessive in view of the undertaking's ability to bear it,*

[89] See section 5, paragraphs 5.32 to 5.39.

account being taken of all the undertaking's own characteristics, in particular the quality of its equipment, its economic and financial situation and its market share."

5.20 ComReg highlighted that while an appreciation of a USP's profitability and efficiency was relevant to determine its ability to fund a USO today (a static approach), it may not be sufficient to decide the existence of an unfair burden. For example, if the USP has a positive net cost, and it is financially viable, the USP may nonetheless be impeded in its ability to fairly compete in the market. The possibility of a net cost arises, partly because the USO's ability to internally finance (cross-subsidise) the uneconomic part of the USO, may decrease as competition intensifies in the economic areas (and as the USP loses customers). In addition to the USP's financial position, its market share and economic position are also relevant in relation to its ability to bear a USO.

5.21 Accordingly, ComReg believed that it may also be relevant and necessary to take into account the competitive position of the USP in the market. ComReg considered that a holistic analysis using static and dynamic criteria, would better indicate the extent to which a positive net cost, if any, can be borne by a USP.

Summary of Respondents' views

5.22 Eircom does not agree with ComReg's proposed approach to its assessment of whether an unfair burden exists. It continues to be of the view that the case of *Base & Others v Ministerraad* is no authority for ComReg's proposed method for assessing the USP's ability to bear the burden of the USO in light of the USP's "own characteristics."

5.23 Eircom submits that *Base & Others v Ministerraad* makes clear the "financial situation" of the company is relevant to determine the issue of unfair burden, given the existence of a positive net cost. According to Eircom, it is difficult to reconcile ComReg's proposal that the USP's level of indebtedness is not directly relevant to a calculation of USO net costs to this. They consider that a heavily indebted company is much more likely to suffer an unfair burden for a particular net USO cost than is a company that is debt free. Eircom also submits that the WACC must be taken into account and, hence, there is also a need to identify net book value of assets.

5.24 In relation to market share, Eircom commented that:

- Undue reliance is placed by ComReg on the USP's market share as reflective of its market power.
- Only SMP regulation, not the financing of USO, can be relied upon by a regulatory authority in addressing market power issues.
- ComReg's analysis in the Draft Decisions Paper at paragraph 5.30 and paragraph 5.41 in particular may have been justified prior to liberalisation of the markets. However, 13 years on, in the presence of regulation at wholesale markets on a nationwide basis, it appears to Eircom that these factors will be reflected in the existence of a net cost (as mentioned indeed at paragraph 5.30).
- The liberalisation of the markets combined with SMP regulation means that cross-subsidies of the sort referred to by ComReg are no longer possible and it is this which gives rise to the net cost of USO.

5.25 According to Eircom, a snapshot of its profitability today will tell ComReg nothing about whether self funding the USO is sustainable into the future. What needs to be looked at (among other things) is how market share has changed over time.

ComReg's Conclusions

5.26 An assessment of the materiality of a significant positive net cost (and hence unfairness of the burden) is a necessary stage of the analysis.[90] Having carefully taken into account respondents' views, on the basis of its reasons outlined in the Consultation paper and Draft Decisions Paper and, in view of recent case law, ComReg believes it is reasonable to conclude that it is relevant and necessary to assess any significant positive net cost relative to the USP's financial position, and the competitive position of the USP in the market.

5.27 The impact of a USO can, in principle, undermine the profitability of a USP or endanger its financial viability. It is relevant and necessary, therefore, to take into account whether or not a positive net cost significantly affects a USP's profitability and/or ability to earn a fair rate of return on its capital employed in the prevailing market circumstances. This analysis would take account of a USP's ability to bear a positive net cost (i.e. a USP's ability to fund a USO today through cross-subsidy revenues). *Base & Others v Ministerraad* expressly refers to the USP's financial position as a characteristic to take account of in relation to an unfair burden. For the reasons it has already set out in the Draft Decisions Paper,[91] ComReg believes that it would not be reasonable or appropriate to take account of the USP's level of indebtedness. Notwithstanding this, any examination of this issue would need to be supported by detailed analysis of a USP's financial accounts.

5.28 Profitability can indicate a USP's ability to bear a USO in the short term. However, a static view of a USP's revenues and profitability may only provide a weak indicator of a USP's ability to continue paying cross-subsidy revenues into the future. ComReg's approach is to complement a profitability assessment with a competitive distortions assessment, as appropriate. ComReg notes Eircom's view that: "*a snapshot of its profitability today will tell ComReg nothing about whether self funding the USO is sustainable into the future.*" Therefore, a profitability analysis may be complemented by a competitive distortions assessment, as appropriate.

5.29 It is considered appropriate to relate the definition of unfair burden to the dynamic impact that the USO may have on the USP. As discussed at paragraph 3.110, ComReg recognises the relationship between uniform pricing, net cost, and the impact of competition. ComReg first envisages a static approach to estimating the net cost of the USO. However, if a positive net cost is established, then the static net cost calculation will be supplemented by a more global assessment, as appropriate. This assessment will consider whether or not the wider USO affects (and hence a positive net cost) significantly modify market equilibrium and deteriorate a USP's market position.

5.30 In the Consultation Paper, ComReg outlined that an assessment of how the range of USO rules, other electronic communications rules, pricing policies, and evolving competition, affect each other — at least in so far as they impact on the issue of universal service — is relevant to the ultimate question of whether the burden of a net cost is actually unfair. In this regard, an assessment of a number of dynamic and somewhat interdependent criteria can also inform the USP's ability to sustain a USO positive net cost. For example,

1. **Market share:** is relevant in a USO context in order to understand whether the degree of competition faced by a USP in access markets, in particular, is such that its ability to bear the USO is undermined and, therefore, whether there is an

[90] The Consultation paper and Draft Decisions Paper emphasised that a positive net cost does not assume that there is also an unfair burden: a loss making situation may be a burden, but it is not necessarily an unfair one.

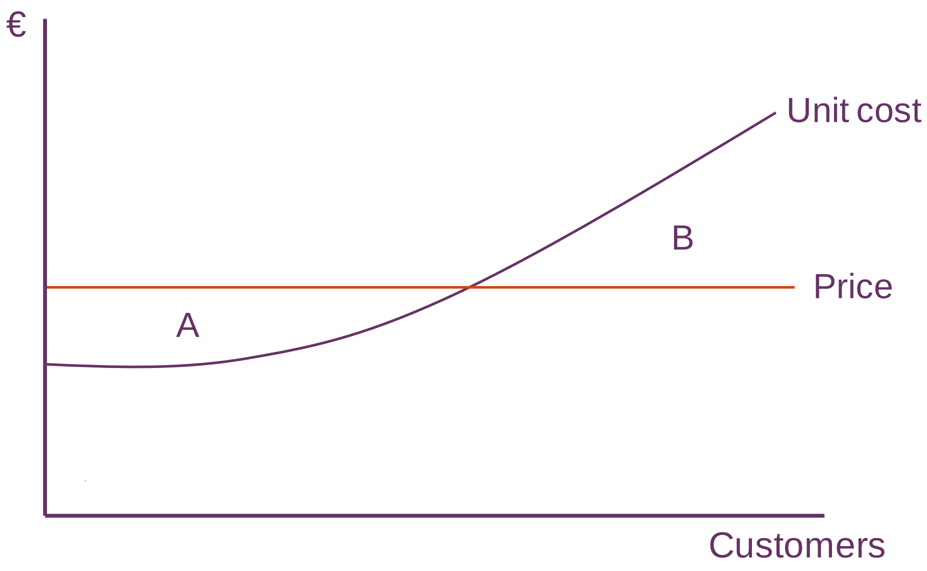
[91] ComReg, Draft Decisions Paper, paragraphs 5.33-5.36.

unfair burden. *Base & Others v Ministerraad* expressly refers to the USP's market share as a characteristic to take account of in relation to an unfair burden. ComReg notes Eircom's view that: "*What they need to look at (among other things) is how market share has changed over time*."

2. **Price uniformity**: across Ireland could, in theory, lead to "cherry picking" by rivals and a scenario where unit costs rise and the universal service cannot continue to be borne by a USP alone. If a USP is facing competition in the most profitable segments of the market, its ability to cross-subsidise USO customers may be undermined, in principle, and this could eventually lead to a USP being unable to bear any positive USO net cost. For example, if competition is sufficiently widespread to suggest cherry picking. For illustrative purposes, two scenarios are considered below.

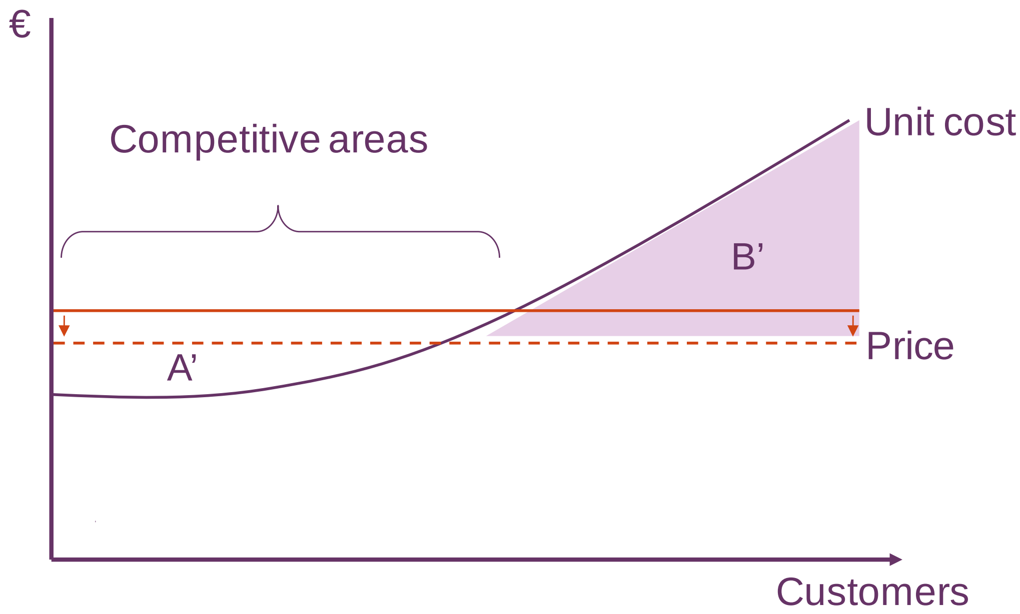
In the first, the USP faces no competition, but an obligation to price uniformly at a level at which it earns normal profits. This is depicted in Figure 2 below, highlighting that the super-normal profits the USP earns on low cost customers (area A) are equal to the losses it incurs on higher-cost customers (area B). As the USP faces no competition in this example, the obligation under the USO can not impede the USP's ability to compete for low cost customers.

Figure 2 Uniform pricing absent competition



In the second scenario, there is competition for the lower cost customers. In the face of such competition, and the expectation of being able to recover a portion of the net cost of the USO, the USP's profit-maximising price would be expected to be lower than in the absence of competition, as depicted in Figure 3.

Figure 3 Uniform pricing in the face of competition



The USP's uniform price would be expected to fall in order to seek to retain low-cost customers in those areas where it faces competition. If uniform prices are lowered, this may result in some customers that were previously profitable becoming unprofitable (i.e. potentially increasing loss-making customers in total). Indeed, the loss on those customers (in area B') originally loss-making may become greater. It is also probable that competitors are likely to win some of the remaining customers in area A' so that the USP does not retain all of that area.

The combination of these effects is relevant to consider when assessing a USP's financial position and competitive distortions. These effects may represent an unfair burden that impedes the USP's ability to fairly compete in the market with the rest of the industry. However, this will need to be assessed carefully, as it is by no means inevitable or axiomatic that uniform pricing in the face of competition will damage the USP's competitive position.[92]

3. **Price interaction**: In the Consultation Paper, ComReg highlighted that an examination of whether a USO represents an unfair burden may also need to take account of the interaction with, for example, the retail price control. ComReg noted that the line rental pricing has been calculated on the basis of providing an efficient network. A conservative price cap may sustain a cross-subsidy: for example, losses on uneconomic local loops are offset by pricing above a competitive level for local loops for other areas. In addition, it is relevant to consider the potential for a (partial) double recovery of USO net cost. Taking into account pricing obligations (wholesale and retail) on a USP can inform its ability to bear the USO. Such an analysis is not interdependent of market share and the market position of the USP.

5.31 For these reasons, ComReg is of the view that the overall approach outlined to determine the existence or not of an unfair burden is perfectly consistent with *Base & Others v*

[92] ComReg notes that Eircom is not bound to provide national uniform pricing of its broadband services, but chooses to do so, presumably for sound commercial reasons.

Ministerraad, and indicates that some attention at least, must be paid to the competitive situation on the market, as appropriate.

5.32 At paragraph 45 of *Base & Others v Ministerraad*, the ECJ confirms that NRAs have significant discretion in relation to a determination of unfair burden: *"…it falls to the national regulatory authority to lay down general and objective criteria which make it possible to determine the thresholds beyond which …a burden may be regarded as unfair."* Accordingly, for the above reasons, ComReg has sought to present general and objective criteria, taking account of the potential circumstances faced by the USP and its rivals, the relevant EU approaches, economic theory and best regulatory practice. The specified criteria will be used to establish how the unfairness threshold would be met.

Decision No. 40	**If the positive net cost is not relatively small, ComReg will assess whether or not this net cost significantly affects a USP's profitability and/or ability to earn a fair rate of return on its capital employed; and**

Decision No. 41	**If the positive net cost significantly affects a USP's profitability, ComReg will assess whether or not such a net cost materially impacts a USP's ability to compete on equal terms with competitors going forward.**

Decision No. 42	**ComReg will use the following criteria, statically and dynamically, to determine whether or not a net cost burden is actually unfair:** *1.* **Changes in profitability, including an understanding of where a USP generates most of its profits over time.** *2.* **Changes in accounting profits and related financial measures e.g. earnings before interest, tax, depreciation and amortisation ("EBITDA") analysis.** *3.* **Changes in direct USO net cost, if any, over time.** *4.* **Estimates of average level of cross-subsidy between classes of more or less separately accounted for services, and changes in these over time.** *5.* **Changes in prices over time.** *6.* **Changes in market share and/or changes in related markets.** *7.* **Market entry barriers.**

6 Treatment of confidential information

The Consultation issue

6.1 ComReg's policy with respect to the treatment of confidential or commercially sensitive information is set out in ComReg 05/24. ComReg is of the view that the USO Regulations place a premium on accuracy of records, transparency and submission of detail and that this affects confidentiality claims also.

6.2 Clearly there is a requirement to have all the necessary supporting documentation made available to ComReg to allow it to establish the principles and methodologies for assessing the possibility of an unfair burden on a USP. There is also the recognition that all of the interested and affected stakeholders will require access to information and data that may or may not have been confidentially supplied to ComReg or sought by ComReg.

6.3 ComReg does have a legal obligation to recognise and maintain the confidentiality of information that it receives from stakeholders when such information is designated by them as confidential or commercially sensitive. At the same time there is a duty to provide as much transparency as possible to affected stakeholders whilst also recognising the stakeholder's right to reply in accordance with fair procedures and the need for ComReg to provide intelligible reasons for the views formed.

Summary of Respondents' views

6.4 Eircom stated that it welcomed*: "the fact that ComReg does not intend to proceed with its original proposal for a "confidentiality ring" and that it believes that "a departure from established precedent is warranted or necessary."*

ComReg's Conclusions

6.5 ComReg has previously published guidelines on the treatment of confidential information, and believes that these adequately address the requirements of USO funding applications. However, there may be exceptional cases where ComReg may need to depart from its guidelines and where it should consider the merits and practicalities of establishing confidentiality rings. ComReg will consider these on an "as needs" basis.

Decision No. 43	**With respect to the treatment of confidential information, ComReg will maintain the current published guidelines. However, if exceptional cases should arise, ComReg will consider alternative means on an "as needs" basis.**

Appendix A – Review of Consultation Responses

A.1 As outlined in the paragraph 1.8, the views of respondents that ComReg consider to be material are dealt with within each respective section. Other views are dealt with in this appendix.

Regulatory Impact Assessment

Respondents' Views

A.2 In the Consultation, ComReg outlined that it had not intended to perform a Regulatory Impact Assessment ("RIA") on the principles and methodologies associated with the costing of the USO. In its responses Eircom stated that it: "*does not accept ComReg's neglect of a RIA*" and "*treating an RIA as a discretionary add-on at the end of a Decision process is not acceptable*." Vodafone in its response stated that it: "*strongly disagrees with ComReg's decision not to undertake a RIA prior to making its current draft decisions*." None of the other respondents provided any statement regarding this approach.

ComReg's Conclusions

A.3 By way of response, ComReg refers to its position as stated in Appendix B of the Consultation: that in the absence of receiving a valid submission from the USP and in the absence of undertaking a review of same to assess if the net cost of meeting the USO, if any, constitutes an unfair burden, it is not possible to perform an impact assessment at this time. Furthermore, ComReg is not imposing any obligations on any undertaking by virtue of this document and performing a RIA in the absence of any such obligation is not required. ComReg also has not consulted upon the mechanism, should there be one established, by which the relevant undertakings would be obliged to contribute and what the quantum and timing of such contributions would be. It is only when a determination with respect to an unfair burden assessment and/or a relevant sharing mechanism is taken that a RIA will be completed. All relevant stakeholders will at this time be in a position to respond to any draft decision in line with the normal consultation procedures.

Retrospective USO Funding Application

Respondents' Views

A.4 During the course of the consultation leading to this Decision, both O2 and Vodafone argued that any USO fund could not be retrospective in nature. They suggested that any application for USO funding could only be in respect of years that post-dated this Decision. They objected to the possibility of the USP being compensated for a net cost arising in respect of the USO, for years that pre-date this Decision. Vodafone pointed to specific statements in ComReg Document No. 07/39 where, in the context of Eircom's application for USO funding in 2006, ComReg had rejected the possibility of compensating Eircom for any net cost arising to it as the USP in the period 25 July 2003 – 11 May 2006. Vodafone suggested that the statements in ComReg Document No. 07/39 are equally valid now. Vodafone also seemed to suggest that these statements gave rise to a legitimate expectation that no funding mechanism could operate retrospectively.

ComReg's Conclusions

A.5 ComReg addressed this issue in ComReg Document No. 11/15 (see, in particular, paragraphs 7.18 – 7.19). In addition to what is stated there, ComReg has given further consideration to this issue and it does not believe that the arguments of O2 and Vodafone are well founded.

A.6 The context of ComReg Document No. 07/39 is distinguishable from this Decision. The relevant section of ComReg Document No. 07/39 only addressed Eircom's USO funding application of 11 May 2006. It was justified then on the basis that no request for USO funding was received from 25 July 2003 – 11 May 2006, whereas a clear intention to seek funding was signalled by Eircom in subsequent years. In addition, it is inevitably and unavoidably the case that an assessment of a USO funding application must be "backward looking" or "in arrears." While an operator may not know the amount it may be required to pay into any USO fund in advance, that cannot be known in advance anyway. It does not follow that because an operator may not know in advance the amount it may be required to pay into any USO fund, that it could have an expectation that there would *never* be an application for funding in respect of a net cost for the USO, or that it would never be called upon to contribute to a USO fund.

A.7 All operators must or should have known from the date of the enactment of the Directive that compensation for any unfair burden caused by being designated as a USO provider was a possibility, if an application for USO funding was made. Furthermore, these operators were, because of the provisions of the Directive, well aware of the services that could potentially be affected and the core general principles on which such compensation could be assessed.

A.8 ComReg does not consider that the comments in ComReg Document No. 07/39 create any general principle, legitimate expectation, or estoppel as to what period(s) would be covered by any USO funding application. Rather, the position is that ComReg is legally obliged to consider any valid application made on time for the period applied for. In considering the period covered by such application, ComReg will consider whether, from the perspective of other operators (including Eircom or any other USO designate), it is consistent with transparency, proportionality, and no distortion of competition, to allow any compensation and, if so, on what basis.

A.9 It may be noted that ComReg's draft Strategy Statement (ComReg Document No. 10/31) stated that ComReg would issue a public consultation on the costing of USO, with a view towards providing regulatory certainty to all stakeholders in relation to applications for funding by the USP for the period 2009/2010, and subsequent periods.[93] Indeed, it would have been known to industry stakeholders that the current USP had applied for USO funding in 2007/2008 (which request ComReg was then considering) and that ComReg had indicated that it was considering consulting on this and other issues pertaining to the funding of USO.[94]

A.10 It should also be emphasised that Eircom as the current USP has made it absolutely clear to ComReg that it will not be making any application to ComReg for USO

[93] As referred to in ComReg Document No.10/45.

[94] See for example the 15th Progress Report on the Single European Electronic Communications Market – 2009 (SEC (2010) 630/1: Country Report Ireland):

http://ec.europa.eu/information_society/policy/ecomm/doc/implementation_enforcement/annualreports/15threport/ee.pdf .

funding for any period prior to 2009/2010. To this extent therefore, ComReg will not entertain an application from Eircom for USO funding that is open-ended; rather, the retrospective period must not extend further back than 2009/2010. Finally, no USO fund — if one is to be established, would be operational until 2012/2013. Therefore, all operators would have reasonable notice if any contribution to a USO fund was to be sought from them.

ECAS and USO

Respondents' Views

A.11 Eircom notes that in their view there should be no difference in the treatment of investment for the provision of ECAS to that of the USO. Furthermore, Eircom submits that it: *"does not believe that the explanation provided by ComReg is satisfactory. eircom maintains accordingly that any favourable treatment afforded the ECA operator should be afforded the USP."*[95]

ComReg's Conclusions

A.12 As noted in the Draft Decisions Paper, ComReg considers the provision of the Emergency Call Answering Service ("ECAS") contract and USO designation as distinctly different.

A.13 The ECAS contract was entered into by the Department of Communications, Energy and Natural Resources ("DCENR") and BT Ireland. As a result of a competitive tendering process, BT Ireland was required to construct a fit for purpose emergency call handling service in green-field sites nominated by the DCENR. BT Ireland's bid was selected as the most efficient for the duration of the tender agreement. However, should it be determined (i.e. for the purposes of a new commercial contract and tendering process) that these sites are either no longer required or better located elsewhere, these current sites may become obsolete (i.e. stranded). As such, it was considered prudent, in line with general accounting practice, that BT Ireland should write-off its investment over the designation period (in that case 5 years).

A.14 Conversely, Eircom was designated as the USO from 1 July 2010[96] for a period of two years, expiring on 30 June 2012. Guided by the principle of efficiency in the Regulations and Directive, ComReg considers that should Eircom or any operator lose its USP obligation, then it would be inefficient to suggest that the *entire* network would need to be re-built. Equally, ComReg would consider it inefficient to suggest that for any new USO to be met using a entirely new duplicate network (which would add excessively to cost). Therefore, the issue of stranding of assets is not as prominent in the context of the USO compared to the ECAS contract.

A.15 For clarity, ComReg considers that the efficiency adjustment (see paragraphs 3.66-3.92) in calculating net costs will provide a mechanism to determine whether the technology used at the time was indeed the most cost efficient: where it is demonstrated that this was not the case; then the net cost would not take account of the "inefficient" expenditure, meaning the operator would not be compensated regardless of the USP designation being retained or not.

[95] Eircom, *supra* n 12, pg.14.

[96] ComReg document number 10/46.

LLU and USO

Respondents' Views

A.16 Eircom notes that in their view the LLU pricing and the provision of the USO is an inter-related issue and that: "*ComReg's current efforts to de-couple the two inter-related issues lacks consistency and is a cause of concern.*"[97] Eircom suggests: "*…that while eircom's competitors and their customers benefit from network access at a price that does not reflect the cost of the USO, eircom, and all of its customers, in the absence of a funding mechanism, must bear the national average cost.*"[98]

ComReg's Conclusions

A.17 Consistent with ComReg's decision on uniform geographic pricing (see paragraph 3.110), ComReg considers that LLU pricing should not be considered in the net cost calculation, its impact (if any) is assessed as part of the unfair burden assessment (in circumstances where a net cost is established).

End to End Valuation

Respondents' Views

A.18 BT notes in their submission that: "*the USO services provided by eircom must be considered as an end-to-end product removing the various mark-ups as these provide profit to eircom rather than a financial burden and could lead to an overstatement of cost. We believe an end-to-end valuation will demonstrate a significant reduction in the financial burden on eircom and provide a realistic view.*"[99]

ComReg's Conclusions

A.19 The net cost calculation will take into account the total wholesale and total retail revenues that the USP will forego if it decided to disconnect certain loss-making customers or areas absent the USO (see paragraphs 3.47-3.65). As such, the various mark-ups are taken into account in the net cost calculation. The unfair burden assessment, will amongst others, assess the USP's financial position which will further take into consideration any additional mark-ups achieved by the USP as part of its profitability assessment.

[97] Eircom, *supra* n 12, pg.32.

[98] ibid.

[99] BT, ComReg's Response to Consultation & Draft Decision, Costing of universal service obligations: Principles and Methodologies (ComReg 11/15). 18th April 2011, pg. 1.

Appendix B –The Legislative Provisions

The principal legislation governing the area of universal service is set out in:

- European Communities (Electronic Communications Network and Services) (Universal Service and Users' Rights) Regulations, S.I.308 of 2003.

- Directive 2002/22/EC of the European Parliament and of the Council of 7 March 2002 on universal service and users' rights relating to electronic communications networks and services (Universal Service Directive).

Appendix C – Glossary of Terms

Acronym	Full Title	Description
ABC	Activity Based Costing	A cost allocation methodology based on activity / cost drivers.
ALTO	Alternative Operators in the Telecoms Market	Representative body of operators entering Ireland's telecoms market across the fixed, wireless, mobile and cable sectors.
ARCEP	L'Autorité de Régulation des Communications Électronique et des Postes	National regulatory agency for France.
AGCOM	Autorità per le Garanzie nelle Comunicazioni	National regulatory agency for Italy.
BOTTOM-UP MODEL	Bottom up model	Forward looking model to estimate the cost of constructing a new efficient network.
BIPT	Belgisch Instiuut voor postdiensten en telecommunicatie	National regulatory agency for Belgium.
BU LRAIC	Bottom up long run average incremental cost	A hypothetical cost modelling methodology which considers the efficient forward looking costs of providing a product or a service by an efficient operator.
	Business Sustaining Costs	Costs which cannot be allocated to services as they are not avoidable.
CAPEX	Capital Expenditure	Amount spent to acquire or upgrade productive assets (such as buildings, machinery and equipment, vehicles) to increase the capacity or efficiency of a firm for more than one accounting period. Also called capital spending.
CCA	Current cost accounting	A system of valuing assets based on their replacement cost rather than their cost when purchased or produced.
CMT	Comisión del Mercado de las Telecomunicationes	National regulatory agency for Spain .
COMMON COSTS		Refer to costs which are common to all services/products.
	Copper Access Model	ComReg's Bottom-Up Long Run Average Incremental Cost model.
DIRECT COSTS		refer to those costs which can be directly attributable to a service/product.
EBITDA	Earnings before interest, taxation, depreciation and amortisation	This figure measures a company's annual earnings before the subtraction of interest payments, taxes, depreciation, and amortization
ECJ	European Court of Justice	
FIXED COSTS		Costs that do not vary with production or

		sales e.g. rent
G&A COSTS	General and administration costs	Costs typically associated with the administration tasks of running a business.
HCA	Historical Cost Accounting	A system where assets are valued at their original cost, less accumulated depreciation
INCREMENTAL COSTS		Increase or decrease in the total cost of a production-run, from making one additional unit of an item.
INDIRECT COSTS		Costs that cannot be directly attributed and therefore need to be apportioned between a number of services/products on the basis of an appropriate cost driver.
LEASED LINES		Refers to fixed, permanent telecommunications connections providing broadly symmetric capacity between two points. A leased line is permanent, in that capacity is available between the two fixed points and generally used to provide dedicated connectivity for business customers.
LFI/FRO	Line Fault Index/Fault Rate Occurrence	Line faults per 100 lines as set in ComReg D02/08
LLU	Local Loop Unbundling	The regulatory process of allowing multiple telecommunications operators use of connections from the incumbents telephone exchange's to the customer's premises.
LRAIC	Long run average incremental cost	Costing methodology. This methodology makes use of CCA accounting principles but place particular emphasis on identifying the costs of a service which are incremental to it in the long run.
MDF	Main Distribution Frames	Also known as local exchange areas.
MEA	Modern Equivalent Asset	Part of a LRAIC methodology which calculates costs based on the most modern assets / technology available.
NBV	Net Book Value	The net value of an asset, which is equal to the original cost price minus depreciation and amortisation.
NPV	Net Present Value	The difference between the present value of cash inflows and the present value of cash outflows.
NRA	National regulatory agency	A state or government agency which regulates businesses in the public interest.
OAO(S)	Other Alternative Operators	Operators, other than the incumbent, providing telecommunication services.
OFCOM	Office of Communications	National regulatory agency for the United Kingdom.
OPEX	Operating expenditure	A company's expenses related to the

		production of its goods and services.
PSTN	Public Switched Telephone Network	An electronic communications network which is used to provide publicly available telephone services; it supports the transfer between Network Termination Points of speech communications and also other forms for communication, such as facsimile and data;
SB-WLR	Single Billing-Wholesale Line Rental	Single Billing via Wholesale Line Rental enables another Authorised Operator (OAO) to issue a single bill to CPS “all calls” customers for voice services; the OAO can offer its own branded telephony service to its CPS “all calls” customers based on wholesale services provided by Eircom. Eircom provides wholesale billing details to OAOs, which then bill their customers at their retail rates.
TD-LRAIC	Top Down Long Run Average Incremental Cost	Cost modelling methodology taking data directly from the accounting system of an operator. The data is then amended to take account of forward looking costs that, hypothetically, would have been incurred by an efficient operator today.
TD	Top down Modelling	Cost modelling methodology taking data directly from the accounting system of an operator to construct an operator’s network.
USO	Universal Service Obligation	A defined minimum set of services, to all end-users, at an affordable price.
USP	Universal Service Provider	An undertaking designated as having the universal service obligations.
VARIABLE COSTS		Costs that vary with production or sales e.g. repair and maintenance costs.
WIFI		A wireless-technology brand owned by the Wi-Fi Alliance, promotes standards with the aim of improving the interoperability of wireless local area network products.

Appendix D – Decision Instrument

1 STATUTORY AND LEGAL POWERS

1.1 The purpose of this Decision and Decision Instrument is to provide guidance to the universal service provider ("USP") and the electronic communications sector on matters related to the costing of universal service obligations ("USO") for the purposes of the European Communities (Electronic Communications Networks and Services) (Universal Service and Users' Rights) Regulations 2003.

1.2 This Decision and Decision Instrument is made by the Commission for Communications Regulation ("ComReg") pursuant to and having regard to:

i. Regulations 11 and 12 and Schedule 2 of the European Communities (Electronic Communications Networks and Services) (Universal Service and Users' Rights) Regulations 2003;

ii. Sections 12 and 13 of the Communications Regulation Act 2002; and

iii. The analysis and reasoning set out in ComReg Document No.11/15 and ComReg Document No. 10/94 and the submissions received from respondents in relation to same.

1.2 This Decision Instrument shall where necessary be construed together with ComReg's conclusions, reasoning and analysis, set out in the other parts of this Decision.

1.3 The abbreviated terms and acronyms used in this Decision Instrument have the same meaning as in the Decision.

2 CALCULATING THE USO NET COSTS AND REVENUES

Costing Methodology

Decision No.1 The HCA methodology, properly adjusted for efficiencies and taking account of the costs that could have been avoided by the USP without having the USO, is the cost methodology that must be used to calculate the net cost of the USO.

Avoidable Costs

Decision No.2 USO net costs shall be calculated on the basis of "all" capital costs and "all" operating costs that could be avoided on a HCA basis, as if the provision of services to uneconomic customers by a commercial operator was not required under a USO. It is only the portion of costs, both capital and operational expenditure for the given financial year, that can be directly attributed to the USO service (i.e. the service activity creates the cost) and which could have been avoided without the USO, which are included in the net cost calculation.

USO Revenue Calculation

Decision No.3 USO revenues shall be calculated on the basis of both the direct and indirect revenues that an operator would forego as a result of ceasing to provide services to uneconomic customers.

Decision No.4 Direct revenues shall include those revenues which are directly invoiced to a customer for the services provided directly by the USP. They include:

- One-off connection charges: where the revenue should be allocated over the expected life of the customer. In circumstances where a line is permanently disconnected, the remaining unallocated one-off connection charges should be allocated to that year of disconnection;
- Revenues associated with access (e.g. line rental);
- Calls (e.g. local, national, mobile, international, directory enquiries ("DQ") and premium rate services); and
- Complementary services, such as, broadband services.

Decision No.5 Direct revenues shall include those revenues from another authorised operator ("OAO") (who is indirectly providing the service to the customer) using the USP's wholesale services and include, amongst other things:

- Wholesale access (single billing wholesale line rental ("SB-WLR");
- Wholesale calls; and
- Complementary wholesale services, such as Bitstream and Local Loop Unbundling ("LLU") etc.

Decision No.6 Indirect revenues shall include those revenues which are not directly invoiced to a customer for the services provided directly by the USP. They include:

- Wholesale interconnection revenues: fixed termination and transit services as a result of inbound calls from another fixed / mobile networks, where an OAO is invoiced for terminating and transiting a call on the USP network;
- Non-geographic numbers (e.g. 1800, 1850, 11811 and 1890 numbers);

- Economic USO customer calls to an uneconomic customer: firstly, the revenue of the economic customers' calls to uneconomic customers shall be allocated to the uneconomic customer. If the uneconomic customer is now economic, as result of the allocation, then a second stage is required to ensure that this treatment does not make the previously economic customer into an uneconomic customer as a result. If as a result of this second stage the economic customer becomes uneconomic, then it is only that portion of revenue which the economic customer can spare without making themselves uneconomic that should be allocated;

- Leased Lines: where initially all revenues associated with the leased line are allocated to the uneconomic line. If the uneconomic point is now economic, as a result of the allocation, then a second stage is required to ensure that this treatment does not make the previously economic point into an uneconomic point as a result. If as a result of this second stage the economic point becomes uneconomic, then it is only that portion of revenue which the economic point can spare without making themselves uneconomic should be allocated; and

- Replacement calls: where a net cost exists, replacement calls shall be estimated and added to the net cost calculation (but only in circumstances where "uneconomic" areas or customers have been firstly identified as commercially uneconomic).

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

Decision No.8 The avoidable costs included in the net cost calculation, shall be those costs reflecting the provision of the USO which a commercial operator would not ordinarily have provided, and which were incurred in the most efficient way. These costs shall relate to: (a) the avoidable capital costs associated with CAPEX i.e. depreciation; (b) OPEX; and (c) overheads for the appropriate financial year.

Efficiency Adjustments

Decision No.9 ComReg may use a number of methodologies to determine the appropriate level of costs that would have been incurred by an efficient operator, in order to determine the quantum of adjustments necessary to the USP's net cost calculation. These methodologies may include, but are not limited to, the use of:

- The review of supporting documentation available, such as: cost-benefit analysis reports; engineering reports; fault reports of geographical areas, and other documents in relation to the business case / investment decisions associated with the network roll-out and upgrade;

- A line fault efficiency rate: applying the national LFI target rate (corresponding to the financial year in question) at a regional level (and allowing for appropriately reasoned variances);

- Independent survey report regarding the USP's efficiency;

- Regulatory decisions from other jurisdictions that provide relevant precedents and benchmarks; and

- The development of a model to assess the appropriateness of the efficiency adjustment proposed by the USP.

Cost Identification and Allocation

Decision No.10 The net cost calculation shall not include those customers who were originally considered "uneconomic" but who have now become profitable. The net cost calculation also does not include those customers attained as a direct result of a competitive tendering process (who are deemed "uneconomic").

Decision No.11 Uneconomic areas shall be identified at an MDF level.

Decision No.12 An average depreciation charge for each class of network element (based on an average cost and asset age) shall be developed by geo-types (e.g. urban, sub-urban, rural etc.). The USP may allocate the relevant depreciation charge (as reconcilable to the HCA accounts and taking account of the principle of avoidable costs) for each exchange area based on the asset requirements as determined by the Copper Access Model (as updated or similar modelling tool). The calculation must be sufficiently granular to allocate costs only to those network elements actually used by users who are potentially uneconomic. In making this allocation, the USP should draw on, and be prepared to substantiate its investment profile / decision making, works-orders etc., so as to ensure that the allocation is appropriate (i.e. the USP should satisfy itself that in making an allocation to an MDF area, it has not allocated costs which are not reflective of the USP's investment profile in that MDF area).

Decision No.13 Uneconomic customers in economic areas shall be identified based on universal account numbers ("UANs"). However, if ComReg is satisfied, because of a lack of information beyond the control of the USP, that it is not practicable to identify uneconomic customers by

UAN, the USP must demonstrate that the use of an alternative approach has the equivalent effect of identifying those customers.

Decision No.14 The USP may calculate uneconomic customers in economic areas using a probability analysis. However, the identification and allocation of these costs must be consistent with Decision No. 12. The parameters and assumptions used in the probability analysis must be clearly documented and duly reasoned as to the circumstances why the USP considers the customer uneconomic.

Decision No.15 During the course of ComReg's assessment of a USO funding application, a number of sample "reality" checks will be undertaken. If material discrepancies are found, ComReg may: require a full assessment for those exchange areas claimed to be uneconomic or include uneconomic customers; apply a proportionate adjustment to the net cost calculation (pre-intangibles); or reject the entire USO funding application (on the basis that the discrepancy is of a magnitude which would render the application not fit for purpose).

ComReg as part of its assessment process, will reserve the right to further interrogate any rationale provided by the USP in relation to uneconomic areas and uneconomic customers and to undertake its own assessment regarding the appropriateness of these net costs.

Cost Identification and Allocation: Uneconomic Payphones and Other USO Costs

Decision No.16 In respect of mandatory public payphone provision, the net cost calculation shall be based on the total avoidable cost, minus the total revenues foregone. Furthermore, for each public payphone that is connected to a single exchange site, the access cost for a payphone will be the same access cost as that of any line at the exchange site on which it is connected. The avoidable access costs shall be calculated as an estimate per line at the exchange site to which the public payphone is connected. If the number of uneconomic payphones is considered excessive and unreasonable, ComReg may adjust the net cost calculation to reflect appropriate payphone coverage (in areas where they are mandatory).

Decision No.17 For Directories, the net cost calculation shall use the total avoidable cost, minus total revenues of this service.

Decision No.18 The net cost for the provision of specific USO services for disabled users, shall be calculated using the total avoidable cost minus the associated total revenues foregone. The avoidable cost shall include the cost associated with the provision of USO special services over the standard minimum level of service (e.g. "minicom" relay services, free directory enquiries, etc) and specialised equipment (e.g. restricted vision phones, inductive couplers, etc) minus the total revenue which is incremental to the total revenue associated with the standard minimum level of service to disabled users (which is appropriate to all operators).

Format of USO Funding Applications

Decision No.19 USO funding applications shall be consistent and in accordance with this Decision and Decision Instrument.

Decision No.20 USO funding applications shall be fit for purpose.

Decision No.21 USO funding applications shall be based on annual information which coincides with the USP's financial year.

Decision No.22 An independent declaration shall be signed off by the Board of Directors of the USP and it must accompany the application. (The required declaration is included in Schedule 1). Financial information shall be provided with an appropriate audit opinion or verification report, where the Auditor (as approved by ComReg and who may be a person, or a corporation sole, or a body corporate, or an unincorporated body) has in no way assisted with the preparation of the USO funding application.

Decision No.23 USO funding applications shall be supported by calculations in an MS Excel, or MS Access format or alternative software which is reasonably capable of proper access and review.

Decision No.24 Any models submitted in support of a USO funding application shall be transparent: there must be limited hard-coded cells (where cells are hard-coded a supporting reference document of such numbers must be provided and be capable of being reconciled and audited) and all numbers must be set out so that there is an audit trail present. The models submitted shall be set out in a clear and transparent manner, showing the separate calculations for each component (e.g. uneconomic areas, uneconomic customers, the provision of public pay telephones and specific services for disabled users). The calculations supplied must clearly set out the capital costs, operating costs, overheads, etc (including General and Administration — ("G&A") costs) and the methods adopted for the allocation of costs which are not directly related to the provision of the USO. Where uneconomic lines/areas are identified, the works orders associated with those areas for the year of assessment must be available upon request by the Auditor as supporting documentation for the USO application.

Decision No.25 Applications shall, with reference to the supporting model, clearly identify (by MDF or by geographic location as appropriate), with adequate reasoning and cogent evidence to justify that, those customers or groups of customers (i.e. area), that in the absence of the USO, the provision of the service would *either* not continue to be provided or would never have been provided, to that customer or groups of customers (i.e. area) by a commercial operator, *or* by the

USP acting as a commercial operator. The USP must provide its commercial reasoning, including the respective parameters used in justifying its decision, including, but not limited to:

- The current loss-making status of those customers or areas;
- The local density of those customers or areas;
- The respective distances from exchange for uneconomic customers;
- The network infrastructure / technology used to serve those customers or areas; and
- Any other pertinent information the USP has used to influence its decision making process

Decision No.26 There may be a requirement to make certain key data / workings publicly available and the USO funding application is deemed to be made by the USP on this understanding

Decision No.27 With respect to the provision of public payphones which are "uneconomic", sufficient detail shall be provided on their geographic location and proximity of other public payphones operated by the USP (irrespective of their profitability).

Decision No.28 The model provided shall be supported by comprehensive documentation, clearly setting out and explaining all inputs (both financial and otherwise), efficiency adjustments applied, engineering rules applied, cost allocation methodologies employed, depreciation methodologies applied and assumptions made.

Decision No.29 Sampling may be used for certain aspects of the modelling of net cost, for example the assumptions driving the size of replacement calls. Where sampling is used, samples must be sufficiently representative of the population being sampled. Where applicable, any application of a sampling methodology by the USP must accord with ComReg Decision D07/10.[100]

Decision No.30 USP funding applications shall, where applicable, accord with ComReg Decision No. D07/10 in relation to accounting separation.

Decision No.31 The calculation of the benefits of the USO shall be completed by an external expert, independent of the USP. These calculations must clearly set out: the respective methodologies; assumptions and supporting documentation used at deriving the benefits of the USO.

[100] ComReg Decision D07/10. (Document ComReg Document No. 10/67, entitled: "Response to Consultation Document No. 09/75 and Final Direction and Decision: Accounting Separation and Cost Accounting Review of eircom Limited", published 31 August 2010).

These calculations must provide: (a) the benefit (in monetary terms) that the USP derives as a commercial operator; (b) the benefit (in monetary terms) that the USP derives as a result of the USO; and (c) a reconciliation with reasoning to explain the incremental difference between (a) and (b).

Timing of USO Funding Applications

Decision No.32 Eircom, the current USP, may submit a request for USO funding to ComReg in respect of its financial period 1 July 2009 to 30 June 2010. If Eircom intends to submit such a request to ComReg, it shall do so no earlier than 1 month, and no later than 6 months following the effective date of this Decision, ComReg may extend this deadline, but only where it considers that there are exceptional reasons for doing so.

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Decision No.33 Subsequent requests for USO funding by a USP(s) may be submitted to ComReg in respect of a relevant financial year. If a USP intends to submit such a request to ComReg, the USP(s) shall do so no later than 9 months following the end of the financial year in respect of which the request is intended to be made. ComReg may extend this deadline, but only where it considers that there are exceptional reasons for doing so.

Decision No.34 ComReg Document No. 07/39 dated 2 July 2007 and entitled *"The Provision of the Universal Service: Request for Funding by Eircom"*, is hereby revoked in its entirety.

3 CALCULATING THE BENEFITS OF THE USO

Identification of Benefits

Decision No.35 The net cost calculation must assess the benefits, including intangible benefits, to the USP. ComReg will consider, at a minimum, the following benefits (as a result of the USO) for a USO net cost calculation:

- Brand Recognition.
- Ubiquity.
- Life-cycle.
- Marketing.

Decision No.36 For the identification of the benefits, ComReg will observe the following key principles:

- The benefits represent effects on a USP of providing the USO which have not been accounted for in the direct costing methodology (for example, any benefits that are directly identifiable to specific revenue streams, including indirect and replacement calls revenues are excluded having been covered by the direct net cost calculation).

- Avoid the double counting of any benefits.
- The benefits are those accruing to the USP, as a consequence of being the designated USP (any benefit arising from the fact that the USP is a large player in the market is to be excluded from the calculations).

Methodologies and Data Requirements for Calculating Benefits

Decision No.37 The methodologies to assess the value of the benefits that will actually be used cannot be prescribed in advance of receiving an application for USO funding from the USP.

Pending the receipt of the first USO funding application, ComReg will actively continue to evolve and refine a number of potential methodologies for the purposes of valuing the benefits of the USO.

ComReg reserves the right to implement alternative methodologies and data sources to verify the appropriateness of the value of the benefits resulting from the USO.

During the course of the USO funding application assessment, ComReg will review the valuation of the benefits provided by the USP.

4 DETERMINING IF THERE IS AN UNFAIR BURDEN

Decision No.38 For an unfair burden on a USP, 3 cumulative conditions must be met:

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

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

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

Decision No.39 If the positive net cost is relatively small, ComReg will determine, on the basis of audited costs of the USO, whether USO financing is or is not justified, taking into account the administrative costs of establishing and operating a sharing mechanism (compared to the positive net cost of the USO) and taking into account whether these costs are disproportionate to any net transfers to a USP.

Decision No.40 If the positive net cost is not relatively small, ComReg will assess whether or not this net cost significantly affects a USP’s profitability and/or ability to earn a fair rate of return on its capital employed; and

Decision No.41 If the positive net cost significantly affects a USP’s profitability, ComReg will assess whether or not such a net cost materially impacts a USP’s ability to compete on equal terms with competitors going forward.

Decision No.42 ComReg will use the following criteria, statically and dynamically, to determine whether or not a net cost burden is actually unfair:

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

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

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

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

v. Changes in prices over time.

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

vii. Market entry barriers.

5 TREATMENT OF CONFIDENTIAL INFORMATION

Decision No.43 With respect to the treatment of confidential information, ComReg will maintain the current published guidelines. However, if exceptional cases arise, ComReg will consider alternative means on an "as needs" basis.

6 RESERVATIONS

6.1 If any section or provision or portion of this Decision and Decision Instrument is found by a Court to be invalid, or otherwise judged by a Court to be unlawful, void or unenforceable, that section, provision or portion shall, to the extent required, be severed and rendered ineffective as far as possible, without modifying the remaining section(s), provision(s) or portion(s) of this Decision or Decision Instrument and this shall not in any way affect the validity or enforcement of same.

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

6.3 Neither this Decision nor this Decision Instrument are exhaustive of all matters that may arise in the course of a USO funding application by a USP. ComReg reserves the right to deviate from this Decision and Decision Instrument, or to modify or amend the principles, or methodologies set out herein where, because of any unknown or unforeseen circumstances, it has reasonable justification for doing so.

7 EFFECTIVE DATE AND DURATION

7.1 The effective date of this Decision and Decision Instrument shall be the date of their publication.

7.2 This Decision and Decision Instrument shall remain in force from the effective date of this decision until further notice by ComReg.

MIKE BYRNE
COMMISSIONER
THE COMMISSION FOR COMMUNICATIONS REGULATION
DATED 31 MAY 2011

Appendix E – Ministerial Policy Directions

Policy Directions

This Decision should also be understood in light of the policy directions issued to ComReg by the Minister for Communications, Marine and Natural Resources on 21 February, 2003 and 26 March 2004. This Decision complies with those policy directions and has due regard for the aims they are intended to promote. The policy directions which are relevant to this Decision are discussed below.

Policy direction No. 2 of 2003 provides that:

> *"The widespread availability of dial-up access to the internet charged at flat rates and at affordable prices would be of substantial benefit to users as well as for the further development of the market for internet access provision. In the first instance, the development and provision of such access services are matters for market players. The Commission shall make use of its powers under the legislation as appropriate, to bring about agreements among market players in order to facilitate early introduction of retail dial-up internet access services charged at flat rates. The Commission shall report to the Minister on progress in relation to this matter within one month of the issue of this direction, and on a monthly basis thereafter until such time as retail services are introduced, making any recommendations it considers appropriate for further action."*

The aims of this policy direction have been largely achieved. The existence of the USO has contributed to this. To the extent that functional internet access comprises an element of the USO, there may be uneconomic customers / areas availing of this service. This Decision takes account of this, particularly in how the net costs associated with those uneconomic customers / areas are calculated and treated.

Policy direction No. 3 of 2003 in relation to broadband provides that:

> *"The Commission shall, in the exercise of its functions, take into account the national objective regarding broadband rollout, viz, the Government wishes to ensure the widespread availability of open-access, affordable, always on broadband infrastructure and services for businesses and citizens on a balanced regional basis within three years, on the basis of utilisation of a range of existing and emerging technologies and broadband speeds appropriate to specific categories of service and customers."*

Broadband is not currently within the scope of the USO. However, it is possible that at some point in the future, it may be mandated at EU level as being within the scope of the USO, or that national regulatory authorities (NRAs) may bring broadband within the scope of the USO. This Decision has regard to this possibility by amongst other things emphasising the principle for the efficient delivery of the USO and providing incentives for the efficient delivery of the USO on a forward looking basis. This principle of efficiency would apply also to the deployment of broadband infrastructure and the provision of broadband services if it were to be brought within the scope of the USO.

Policy direction No. 4 of 2003 in relation to industry sustainability provides that:

> *"The Commission shall ensure that in making regulatory decisions in relation to the electronic communications market, it takes account of the state of the industry and in particular the industry's position in the business cycle and the impact of such decisions on the sustainability of the business of undertakings affected."*

The sustainability of the USO is of crucial importance to consumers. The current USP cross subsidises the provision of the USO when and where it is uneconomic, from revenues earned through the economic provision of the USO. The sustainable provision of the USO to uneconomic customers / areas is relevant to the net cost associated with the uneconomic USO provision, where the net cost represents an unfair burden on the USP. These issues are addressed in the Decision, in particular, how the net cost calculation is to be approached and the factors to be taken into account in determining if a net cost is in fact an unfair burden on the USP. In addition, the Decision also considers sustainability for the rest of industry in terms of its ability or not to contribute to any funding mechanism if a net cost to the USP is in fact an unfair burden.

Policy direction No. 8 of 2003 in relation to the cost of regulation provides that:

> *"The Commission shall ensure that the costs incurred by it in effectively carrying out its functions in relation to the electronic communications market and the management of the radio frequency spectrum are minimised, consistent with best practice in other Member States of the European Community, and, subject to any different conditions that may exist, should not be out of line with the cost of regulation in such Member States.*
>
> *The Commission shall ensure that the costs incurred by it in effectively carrying out its functions in relation to the postal market are minimised, consistent with best practice in other Member States of the European Community, and, subject to any different conditions that may exist, should not be out of line with the cost of regulation in such Member States."*

It is recognised internationally that ComReg adheres to best practice in relation to ensuring the minimisation of costs to it. ComReg does not envisage that this Decision will give rise to significant costs to it. However, ComReg is also cognisant that at a later stage, any audit or verification of the net cost has the potential to increase costs. Again however, ComReg has sought to minimise potential costs to it, in the procedures that it will reasonably expect the USP to carry out.

A general policy direction in 2004 requires ComReg to focus on competition. It provides as follows:

> *"ComReg shall focus on the promotion of competition as a key objective. Where necessary, ComReg shall implement remedies which counteract or remove barriers to market entry and shall support, in all ways possible, entry by new players to the market and entry into new sectors by existing players. ComReg shall have a particular focus on:*
>
> - *Market share of new entrants.*

- *Price margins on offer to operators at the wholesale level with the goal to ensure that such price margins will incentivise and advance competition.*

- *Price level to the end user.*

- *Competition in the fixed and mobile markets.*

- *Possibilities for incentivising alternative technology delivery platforms to support competition."*

The following policy directions of 2003 are inapplicable to this Decision:

Policy direction No. 1 of 2003 in relation to communications objectives as it refers to having regard to the Programme for Government 2002 which is no longer relevant and it refers to the *"…the objectives for the communications sector specified in the in the Statement of Strategy of the Department of Communications, Marine and Natural Resources, when published."*

- Policy direction No. 5 of 2003 in relation to regulation only where necessary is not relevant as it refers to the imposition of obligations but obligations are not being imposed under the Decision.

- Policy direction No. 6 of 2003 requires ComReg to conduct regulatory impact assessment prior to imposing obligations on undertakings in the electronic communications sector. This policy direction is not relevant as the Decision imposes no obligations on undertakings in the electronic communications sector.

- Policy direction No.7 of 2003 refers to the imposition of obligations being consistent and equivalent with those in other EU Member States. Again, this policy direction is not relevant as the Decision imposes no obligations on undertakings. In any case ComReg has had due regard to the approaches in other Member States to the issue of calculating the net costs of the USO and determining whether there is an unfair burden as a result of any net cost arising.

- Policy direction No. 9 of 2003 in relation to consistency across platforms is again not relevant as this Decision imposes no obligations on undertakings. Notwithstanding this, this Decision recognises in any case that the USO can be delivered by different technological means. In addition, the USO should be delivered technologically efficient means (both in the past and in the future). This Decision also has regard to the need to incentivise the USO to make technologically efficient decisions in the future.

- Policy direction No. 10 of 2003 in relation to regulation of prices is not relevant as the Decision imposes no price regulation on any undertakings.

- Policy direction No. 11 of 2003 in relation to management of the radio spectrum is not relevant to this Decision.

- Policy direction No. 12 of 2003 in relation to a universal postal service is not relevant to this Decision.

Schedule 1 – Form of Directors' Certificate on USO Funding Application

ComReg Decision Notice D04/11 permits a provider of Universal Services to apply for funding in respect of net costs arising from the provision of such services. The Decision prescribes principles which must be applied in preparing a USO submission which discloses these net costs. The detailed framework applied by [*insert name of USP*] in the preparation of the USO submission is encompassed in a "USO calculation methodology" published in conjunction with the USO submission. The USO submission and accompanying USO calculation methodology for the year ended [*insert financial year which relates to the USO funding application*] were prepared in accordance with ComReg Decision Notice D04/11.

The USO submission includes:

(i) a Net Cost Calculation; and

(ii) additional disclosure notes

and is prepared in accordance with the USO calculation methodology published with the submission.

[*Insert name of USP]* confirms that, to the best of its knowledge and in good faith, the USO submission for the year ended [*insert financial year which relates to the USO funding application*] has been prepared in accordance with the USO calculation methodology published with the submission. [*Insert name of USP]* also confirms that the USO methodology published with this submission is consistent with the requirements of ComReg Decision Notice D04/11.

[Signature of Chief Financial Officer or Signature of appropriate Director(s)]

[Date]