An Coimisiún um **Rialáil Cumarsáide**
Commission for **Communications Regulation**

Review of Weighted Average Cost of Capital (WACC) – submissions to ComReg Document 19/54 and to Draft Decision

Mobile Telecommunications

Fixed Line Telecommunications

Broadcasting Transmission

Non-confidential versions of submissions to Consultation and Draft Decision

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An Coimisiún um Rialáil Cumarsáide
Commission for Communications Regulation
1 Lárcheantar na nDugaí, Sráid na nGildeanna, BÁC 1, Éire, D01 E4X0.
One Dockland Central, Guild Street, Dublin 1, Ireland, D01 E4X0.
Teil | Tel +353 1 804 9600 Suíomh | Web www.comreg.ie

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Review of Cost of Capital

2rn response to ComReg consultation 19/54 of 31/05/2019

9 Aug 2019

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Glossary

Term	**Definition**
2rn	RTÉ Transmission Network Limited.
CAPM	Capital Asset Pricing Model.
ComReg	The Communications Regulator.
the Consultation	ComReg, Review of Cost of Capital, Reference: ComReg 19/54, 31 May 2019.
ERP	Equity Risk Premium.
Market A	Wholesale access to National Terrestrial Broadcast Transmission Services.
Market B	Wholesale access to Digital Terrestrial Television Multiplexing Services.
WACC	Weighted Average Cost of Capital.
2014 Decision	ComReg Document 14/136 & D15/14

1. Introduction

1.1 2rn welcomes the opportunity to comment on the consultation on the Weighted Average Cost of Capital (“WACC”) (the “Consultation”) issued by the Commission for Communications Regulation (“ComReg”).

1.2 ComReg raises issues relevant to 2rn in sections 3, 4, 7 and 8 of the Consultation and 2rn will comment on each of these sections in this response. ComReg relies on analysis prepared by independent advisors Europe Economics in its report *“Cost of Capital for Mobile Termination Rates, Fixed-line and Broadcasting Price controls”* (“Europe Economics Report”) which we will also refer to where appropriate.

2. Proposed approach to estimation of WACC

2.1 Section 3 of the Consultation sets out ComReg’s overarching approach for estimating the WACC. ComReg uses the Capital Asset Pricing Model (“CAPM”) to estimate the cost of equity element of the WACC.

2.2 2rn agrees that the WACC-CAPM methodology is appropriate and notes that it is consistent with established regulatory practice in the Irish communications sector and more widely across Europe.

Equilibrium concept

2.3 ComReg asks:

Q. 1 Do you agree or disagree with the continued use of equilibrium concept for the estimation of the WACC? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.[1]

2.4 To estimate the main ‘generic’ WACC parameters, ComReg proceeds on the basis that these parameters have an ‘equilibrium value’ which may not be “visible” in current market data. It terms this the ‘equilibrium concept’.

2.5 In particular, in setting the risk-free rate, ComReg disregards the current yields on risk-free assets (i.e. government debt), on the basis that these are artificially depressed as a result of quantitative easing. It instead relies on a theoretical relationship between long run economic growth and the risk-free rate advocated by Europe Economics. 2rn does not consider it within the scope of this consultation response to assess fully the merits of this theory.

2.6 ComReg has concluded that “*the resulting WACCs for equilibrium concept and observed asset approach are such that the overall difference for Ireland in estimation between the two are marginal.*”[2] For the purposes of this consultation, 2rn is satisfied that the parameter estimates of the risk-free rate and ERP are likely to allow 2rn an appropriate return.

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1 ComReg Review of Weighted Average Cost of Capital (wacc)19/54; page 17

2 ComReg Review of Weighted Average Cost of Capital (WACC)19/54; paragraph 3.15 page 16

2.7 However, 2rn considers that in the future, if the 'equilibrium concept' approach were to result in a WACC that diverged significantly from a more conventional estimate of the CAPM parameters, then the merits of this approach would need to be examined in greater detail.

3. Generic WACC parameters

3.1 In section 4 of the Consultation, ComReg sets out its methodology for estimating WACC parameters that are common across its regulated sectors, namely:

- the risk-free rate;
- the Equity Risk Premium ("ERP"); and
- the tax rate.

ComReg asks:

Q. 3 Do you agree with ComReg's proposed approach to estimating the generic parameters for the respective WACCs and the preliminary point estimates chosen? Please explain the reasons for your answer, clearly indicating the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.[3]

3.2 As stated above, for the purposes of this consultation, 2rn is satisfied that the parameter estimates of the risk-free rate and ERP are likely to allow 2rn an appropriate return.

Tax rate

3.3 ComReg asks:

Q. 2 Where a company's effective tax rate is significantly different to the statutory tax rate should the WACC be estimated using the statutory corporation tax rate or the company's effective corporation tax rate? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.[4]

3.4 As noted in the Consultation, the WACC can be estimated on a pre-tax or post-tax basis. The CAPM estimates the cost of equity on a post-tax basis. Therefore, it must be grossed-up using an appropriate tax rate to reflect the pre-tax return needed to generate the required post-tax return to equity-holders.

3.5 The Consultation states that *"the broadcasting WACCs are estimated for a hypothetical efficient broadcaster"*[5].

3.6 Therefore, 2rn agrees with ComReg's approach of using the statutory corporation tax rate in Ireland of 12.5% to estimate the pre-tax WACC. The use of the statutory tax rate is appropriate because this is the tax rate that an efficient standalone operator would expect to pay.

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3 ComReg Review of Weighted Average Cost of Capital (wick)19/54; page 26

4 ComReg Review of Weighted Average Cost of Capital (WACC)19/54; page 25

5 ComReg Review of Weighted Average Cost of Capital (WACC)19/54; paragraph 1.2 page 6

4. Broadcasting-specific WACC parameters

4.1 Section 7 of the Consultation addresses ComReg's approach to parameters that are specific to the broadcasting sector. ComReg asks:

Q. 6 Do you agree with ComReg's proposed approach to estimating the WACC specific to Market A and Market B in the broadcasting sector? Please explain the reasons for your answer, in particular your views on the specific parameters used. Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.[6]

4.2 2rn will comment on the following aspects of ComReg's proposed WACC for the broadcasting sector:

- the WACCs in Market A and Market B;
- the asset beta; and
- the debt premium.

The WACCs in Market A and Market B

4.3 ComReg's preliminary view is that the same WACC should apply to both Market A and Market B.

4.4 2rn considers that a regulatory regime using the WACC as an input into the calculation of regulated prices remains appropriate in Market A. However, 2rn understands that RTÉ will comment separately on the appropriateness of the WACC for regulation of Market B.

Asset beta

4.5 ComReg has proposed a range of 0.30-0.50 for the range for the unlevered beta, with a point estimate of 0.4. This compared with an estimate of 0.55 (before aiming up) in ComReg's previous determination on WACC in 2014 ("the 2014 Decision").

4.6 The asset beta measures a company's relative exposure to systematic risk (i.e. market risk). Typically, it is estimated by measuring how the returns on an individual stock vary with the return on a board portfolio of assets, typically proxied by a broad equity market index. Where the subject business (in this case, 2rn), is not listed, a common approach is to estimate betas for comparable listed businesses which are expected to have similar relative exposure to market risk.

4.7 Europe Economics estimates the asset beta by examining data for a range of comparator companies. However, it is important that the comparator companies are sufficiently similar to the regulated firm such that they are likely to have comparable systematic risk. For a regulated business such as 2rn, this means that they should ideally be subject to a similar regulatory regime.

4.8 In Market A, 2rn provides broadcasting infrastructure. As such, 2rn considers that the comparable companies used to estimate beta should be other companies that provide broadcasting infrastructure services and are subject to somewhat similar regulation.

[6] ComReg Review of Weighted Average Cost of Capital (WACC)19/54; page 51

Analysis

4.9 To assess whether Europe Economics' beta assessment is appropriate, we have:

(1) examined the activities of the comparable companies considered by Europe Economics;

(2) reviewed the evidence relied on by Europe Economics to derive the range for beta; and

(3) considered whether Europe Economics has performed sufficient sensitivity analysis around their beta calculations with regard to time periods and data intervals.

Assessment of comparators

4.10 First, we have reviewed the activities of the comparator companies considered by Europe Economics. We find that neither Crown Castle nor SBA Communications provide any broadcasting infrastructure services. Instead, they provide infrastructure for wireless communications.[7]

4.11 Providers of wireless communications infrastructure may have materially different systematic risk compared to providers of broadcasting infrastructure. Such differences include, for example, differences in the customer base which may mean that broadcasting is more cyclical as it is funded by advertising, whereas mobile operators provide services that is funded by retail contracts.

4.12 On this basis, we do not consider that Crown Castle and SBA Communications are appropriate comparators to estimate the beta for 2rn.

4.13 Second, we have considered the jurisdictions in which the comparable companies operate. Companies operating in the same geographic markets are likely to have more comparable betas since they are more likely to be exposed to more similar systematic risks. For instance, operators in Europe face more similar regulatory regimes compared to those that operate mainly in other markets. The geographies in which the comparator companies operate and the distribution of their revenues across countries is shown in the table below.

Table 1: Comparator companies used by Europe Economics

Company	**Geographies (% of total revenue in region, 2018)**
American Tower	USA (51%), India (21%), Latin America (17%), EMEA (9%)
Crown Castle	USA (100%)
Cellnex	Europe[8] (100%)
SBA Communications	USA (80%), Latin America and Canada (20%)
EI Towers	Italy (100%)

Source: Company reports[9]

7 To perform this analysis, we have examined the 10-k filings of Crown Castle and SBA Communications and the annual reports of American Towers, Cellnex and EI Towers.

8 Consisting of operations in Spain, Italy, France, Netherlands, UK, Switzerland.

9 To perform this analysis, we have examined the 10-k filings of Crown Castle and SBA Communications and the annual reports of American Towers, Cellnex and EI Towers.

4.14 We note that EI Towers and Cellnex operate wholly in European markets, in contrast to American Tower, which operates predominantly in the USA and India, with 9% of its operations in the EMEA (Europe, Middle East and Africa) region.[10] In addition, SBA Communications operates only in the Americas and Crown Castle operates only in the USA.

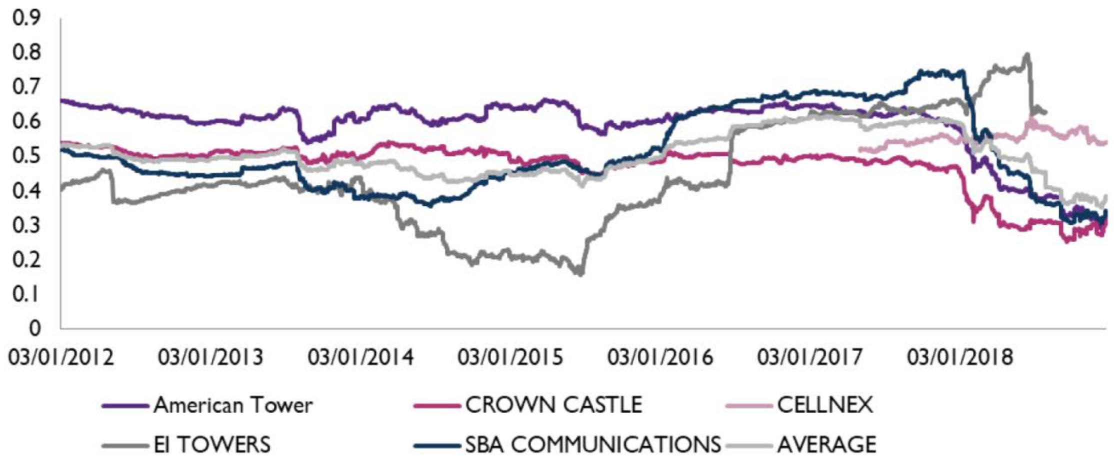
4.15 We therefore consider that Cellnex and EI Towers are likely to face more similar systematic risks and therefore are better comparators for 2rn than American Tower.

4.16 We therefore consider that EI Towers and Cellnex are the most appropriate comparators for 2rn and that American Tower is a less relevant comparator.

Review of evidence relied on by Europe Economics

4.17 Examination of the Europe Economics Report shows that the proposed range of 0.30 to 0.50 appears to disregard the asset beta of EI Towers, which was approximately 0.6 in October 2018.

Figure 1: Europe Economics' asset beta estimates



Source: Europe Economics Report, Figure 7.3.

4.18 An asset beta for EI Towers cannot be estimated after October 2018, because it was acquired by F2i-Mediaset in October 2018, following which its shares were delisted. However, we consider that the estimated data for EI Towers should be considered when assessing the beta for 2rn, particularly when the comparator set is small.

4.19 In fact, Europe Economics explicitly considers EI Towers to be a relevant comparator company, having used data for EI Towers for its gearing analysis, stating:[11]

> *"EI Tower was delisted in 19 October 2018. However, since the de-listing date is relatively close [sic] the cut-off date we use for the analysis (i.e. 31-December 2018), we have decided not to exclude it from the set of relevant comparators."*

4.20 Hence, it would be inconsistent not to consider EI Towers in the asset beta assessment. 2rn notes that neither ComReg nor Europe Economics has suggested that the systematic risk for an operator of broadcasting infrastructure would have changed so materially since October 2018 that EI Towers should not be included.

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10 See Page 2 of the American Towers 2018 Annual Report.

11 Europe Economics Report: 7.3.3 (footnote 37).

Time periods and data intervals for beta assessment

4.21 It appears the Europe Economics have calculated 2 year betas using weekly data. However, this is not clearly set out in the Europe Economics Report and we have been unable to independently replicate the results of their analysis.

4.22 Beta estimates can vary considerably depending on the method used for calculation. For example, if it is calculated over different time periods (e.g. 3 years, 4 years) or using data over different intervals (e.g. daily or monthly). Whilst 2rn considers that there is no reason why more weight should be placed one estimate over another, it is not clear why Europe Economics considers why using 2 year betas calculated using weekly data is most appropriate. Furthermore, there is no evidence that Europe Economics has considered sensitivities using different time periods or intervals to ensure that their estimates are robust to such changes in calculation methodology.

Revised proposed beta range

4.23 Based on our review, we consider that the beta for 2rn should be based on the following evidence:

- primary weight should be placed on the betas for Cellnex and EI Towers, with betas of approximately 0.5 and 0.6, respectively (according to their most recent data);
- less weight should be placed on the beta for American Tower, which has a beta of approximately 0.3; and
- the betas for Crown Castle and SBA Communications should be disregarded.

4.24 This suggests a more appropriate range for the unlevered beta to be approximately 0.30-0.60. As the lower end of this range reflects American Tower, which is likely to be a less relevant comparator for 2rn, the point estimate should be at the higher end of this range. We consider that 0.55 would be an appropriate point estimate.

4.25 As a sense check, the estimate of beta can be compared with the beta estimated previously, since the systematic risk faced by a provider of broadcasting infrastructure services is unlikely to have changed substantially since the 2014 Decision. In the 2014 Decision, ComReg also set an asset beta of 0.55. We note that neither ComReg nor Europe Economics has put forward a reason why the asset beta would have fallen materially since the previous assessment.

4.26 As such, 2rn considers that an unlevered beta value of 0.55 to be more appropriate based on the same evidence that has been examined by Europe Economics.

Debt premium

4.27 ComReg, relying on analysis performed by Europe Economics, has proposed a range of 1.40-1.75 for the debt premium, with a point estimate of 1.5, compared to an estimate of 1.45 in the 2014 Decision.

4.28 Europe Economics relied on debt premium data for American Tower and Crown Castle. Europe Economics does not explain why it did not consider the other comparators used in its beta analysis when estimating the debt premium.

Analysis

4.29 To assess whether Europe Economics' assessment is appropriate, we have:

(1) considered whether the set of comparator companies need to be consistent between the beta and debt premium analyses;

(2) reviewed Europe Economics' approach to selecting comparator firms; and

(3) examined revenue data for 2rn and the comparator firms.

Consistency with beta analysis

4.30 Whilst arguments relating to differences in systematic risk between providers of broadcasting and mobile communications infrastructure mean that Crown Castle and SBA Communications are not appropriate comparators for the purposes of estimating beta, such arguments do not apply when considering comparators for the debt premium.

Review of Europe Economics approach

4.31 The debt premium is fundamentally related to the default risk associated with the debt. The higher the default risk, the higher the debt premium is expected to be. Default risk is assessed by the major credit ratings agencies (Moody's, Fitch and S&P), which measure this risk using a standardised credit ratings scale. Of particular significance, credit ratings of Baa3 (Moody's) or BBB- (Fitch and S&P) or higher are referred to as "investment grade" and typically attract a lower debt premium than lower-rate debt.

4.32 Europe Economics notes the credit ratings of the comparator firms for which it has calculated the debt premium. However, neither ComReg nor Europe Economics has set out whether the WACC benchmark for the operator in Market A should assume an investment grade credit rating. We note that 2rn's licence does not require it to achieve a particular credit rating.

4.33 The basis on which Europe Economics' has assessed the debt premium for Market A is not wholly clear.

4.34 First, Europe Economics did not consider Cellnex to be a relevant comparator company, despite Cellnex holding a BBB- rating from Fitch.[12] Whilst Europe Economics has not set out its criteria deciding which companies' to use for estimating the debt premium, Cellnex has an "investment grade" credit rating. It may be that, because Cellnex is on "negative" outlook with Fitch and is rated BB+ by S&P, Europe Economics did not consider it to have a sufficiently high credit rating.

4.35 Second, Europe Economics does not set out why SBA Communications or EI Towers were not considered to be a relevant comparator company for the purposes of estimating the debt premium.

4.36 Third, whilst EI Towers was de-listed in October 2018, this does not necessarily mean it is not an appropriate reference point for the debt premium.

4.37 It is not clear why the debt premia for these firms should not be considered in the assessment. In principle, we consider that data for all of the comparator firms identified by Europe Economics should be considered in assessing the appropriate debt premium

12 Europe Economics Report: Table 7.4

Comparison of 2rn to comparator companies

4.38 While 2rn does not have a credit rating, a firm's size and the breadth of its activities are important inputs into the credit risk assessment. All the comparator firms considered by Europe Economics are much larger in both size and scope than 2rn. Cellnex, American Tower and SBA Communications all operate across multiple countries. Also, whilst 2rn had reported total regulated revenue of €16 million in 2018[13] all five comparator firms have much higher revenues than 2rn, as show in the table below.

Table 2: Revenues of comparator firms

Companies	Revenues (€m), 2018[14]
American Tower	6,503
Crown Castle	4740
Cellnex	898
SBA Communications	1,631
EI Towers	272

Source: Company reports[15]

4.39 Given the very significant difference in size and geographic scope between 2rn and the comparator firms in the analysis, it may not be reasonable to expect an efficient operator of broadcasting infrastructure in Ireland to have a comparable debt premium. As such, any estimate using these comparator companies is likely to underestimate the appropriate debt premium for 2rn.

Estimate of debt premium

4.40 Given the debt premium data for the full range of comparator firms and the relative sizes and scopes of the comparator firms compared to 2rn, we consider that the debt premium of 1.50 proposed by ComReg in the Consultation is likely to represent a lower bound for the appropriate discount rate.

5. Other issues regarding the WACC

5.1 Section 8 of the Consultation deals with issues outside of the specific parameters for calculating the WACC.

Frequency of reviews

5.2 ComReg asks:

Q. 7 Do you agree or disagree with ComReg's preliminary view that WACC parameters could be updated more frequently and consulted on separately (as part of a pricing consultation) as opposed to conducting a full WACC methodology review and consultation? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.[16]

13 RTÉ Transmission Network DAC, Regulated Accounts Market A for year ended 31 December 2018.

14 For Cellnex and EI Towers Based on 1 USD = 0.874 EUR (exchange rate at 31 Dec 2018).

15 To perform this analysis, we have examined the 10-k filings of Crown Castle and SBA Communications and the annual reports of American Towers, Cellnex and EI Towers.

16 ComReg Review of Weighted Average Cost of Capital (WACC)19/54; page 53

5.3 ComReg suggests that WACC parameters could be updated "*more frequently than has been the practice up to now, if possible annually, using the methodologies ultimately decided upon as part of the consultation. These updated parameters may be consulted on as part of a separate price review*."[17]

5.4 2rn considers that, in the context of the broadcasting sector, it is unclear whether ComReg's proposals would result in sufficiently frequent updating of the WACC parameters. ComReg last conducted a market review in 2013, meaning that there has been at least six years between reviews.[18] In addition, ComReg provides oversight of 2rn's pricing that is updated annually, although this currently does not allow for any updating of the WACC parameters.

5.5 2rn considers that ComReg should consider mechanisms that more explicitly allow the regulatory framework to adapt to changes in wider economic circumstances that are outside the control of regulated firms such as 2rn.

5.6 In particular, 2rn considers that there are a number of events that could result in material changes in the relevant parameters for the WACC. These include, but are not limited to:

- Britain's exit from the European Union ("Brexit"), which may have economic-wide impacts that affect the full range of WACC parameters;
- changes to Irish corporate tax rates, which are currently under scrutiny by European authorities; and
- fluctuations in the inflation rate due to macroeconomic fluctuations (in addition to the considerable uncertainties created by Brexit).

5.7 As such, 2rn considers that there is considerable uncertainty around WACC parameters. Furthermore, such uncertainties could potentially materially affect the WACC parameters and hence WACC itself.

5.8 Crucially, uncertainties such as Brexit are outside the control of 2rn and other regulated firms. As such, it is not reasonable to expect regulated firms to bear these risks by being constrained by *ex ante* regulated prices that did not anticipate such developments. This is in line with good regulatory practice.

5.9 Therefore, whilst 2rn acknowledges ComReg's stated intention to review the WACC parameters more regularly and as part of pricing consultations, 2rn considers that there is merit in giving ComReg and the industry more flexibility to seek a reassessment of the WACC parameters in the event that these material uncertainties are realised and have a significant impact on financial markets.

5.10 2rn considers that a more appropriate mechanism may be one where elements of the WACC determination can be re-opened and re-examined with the consent of the regulated firm and its customers. Such a mechanism would guard against the risk of WACC parameters changing materially between ComReg's periodic pricing consultations and allow the regulatory regime to be more responsive to changes in circumstances.

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17 ComReg Review of Weighted Average Cost of Capital (WACC)19/54; paragraph 8.4 page 52

18 ComReg Decision D11/13.

Aiming up

5.11 ComReg asks:

Q. 8 Do you consider that the risk free rate, asset beta and debt premium should be aimed up? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views[19]

5.12 In the 2014 Decision, ComReg 'aimed-up' three key parameters.[20] These were:

- the risk free rate;
- the asset beta; and
- the debt premium.

5.13 In the 2014 Decision, ComReg explained that aiming up was good regulatory practice on the following grounds: [21]

> *"ComReg has "aimed-up" certain components of the WACC to reflect the asymmetry of consequences between setting the cost of capital too low and setting it too high and that the negative consequences of the former materially exceed those of the latter"*

5.14 ComReg also noted that aiming was supported by regulatory precedent:[22]

> *"ComReg considers that choosing a value for the WACC that is above the regulator's expected value for the WACC has been standard practice for regulators for many years, across many regulated sectors and in particular in the communications sector, both in Europe and the rest of the world. The process by which this is done has often been implicit – via the choice of a "conservative" estimate of a particular parameter such as the beta or the equity risk premium."*

5.15 2rn considers that the reasons cited by ComReg for aiming up in the 2014 Decision remain valid. In particular, 2rn does not consider that the consequences of setting the cost of capital too low have diminished. To now abandon a policy of aiming up would be a departure from ComReg's established practice and established regulatory precedent in Ireland.

5.16 ComReg appears to acknowledge that the risks remain, but advocates moving away from the aiming up approach on the following grounds:[23]

> *"If WACCs were revised more frequently than at present, there would be less risk of using a WACC that was either too low or too high in a pricing decision."*

5.17 It is not clear that ComReg's proposals would result in more or sufficiently frequent updating of the WACC in the context of the broadcasting sector.

5.18 As such, 2rn considers that ComReg's previously stated merits of aiming up are still valid and that the relevant WACC parameters should be aimed up in this determination.

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[19] ComReg Review of Weighted Average Cost of Capital (WACC)19/54; page 54

[20] Consultation: paragraph 8.7.

[21] ComReg 14/136: paragraph 2.9.

[22] ComReg 14/136: paragraph 2.9.

[23] Consultation: paragraph 8.11.

Implementation of new WACCs

5.19 ComReg sets out the following three options for how the proposed WACCs should be implemented:

- *Option 1 – Apply the revised WACC with immediate effect to all cost oriented prices;*
- *Option 2 – Apply the revised WACC only as new price controls are imposed;*
- *Option 3 – Apply the revised WACC as new price controls are imposed. Furthermore the revised WACC should be applied immediately in assessing compliance with cost oriented prices including any submissions by regulated entities.*

5.20 ComReg asks:

Q. 9 Do you agree or disagree with ComReg's preliminary view that Option 3 is the most appropriate method to implement the revised WACC? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.[24]

5.21 2rn agrees with ComReg's preliminary view that Option 3 is the most appropriate method for implementing the revised WACC as this takes into account the way prices are set in the broadcasting sector. 2rn considers that Option 1 is not appropriate as it would require the changing of prices that have already been agreed.

6. Draft decision instrument – Broadcasting

6.1 ComReg asks:

Q. 14 Do you believe that the draft text of the proposed decision instrument for Broadcasting - Market A is from a legal, technical and practical perspective, sufficiently detailed, clear and precise with regards to the specifics proposed? Please explain your response and provide details of any specific amendments you believe are required.[25]

6.2 In the Consultation, ComReg states:

"the application of the revised WACC to subsequent price controls that come into effect after this review and reflects ComReg's proposal that more frequent WACC reviews are undertaken. Option 3 would apply to the WACCs proposed in this consultation and also to any future revisions."[26]

6.3 In the draft text of the decision instrument ComReg, states*:*

"In the on-going assessment of compliance with cost recovery and price control obligations (including regulated wholesale prices) imposed prior to the Effective Date, 2rn shall apply the revised nominal pre-tax WACC rate of X% as set out in section 4.1 of this Decision Instrument."[27]

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[24] ComReg Review of Weighted Average Cost of Capital (WACC)19/54; page 56

[25] ComReg Review of Weighted Average Cost of Capital (WACC)19/54; page 82

[26] ComReg Review of Weighted Average Cost of Capital (WACC)19/54; page 55 paragraph 8.18

[27] ComReg Review of Weighted Average Cost of Capital (WACC)19/54; page 86 paragraph 4.2

6.4 2rn believes that there is a lack of clarity as to the actual effective date for implementation of the revised WACC. 2rn understands from paragraph 8.18 that the revised WACC which may be established following the Consultation will be implemented from the next 2rn price review. 2rn believes that any ongoing assessment of compliance should take account of the revised WACC in assessing results for periods commencing after the conclusion of the Consultation and the publishing of a revised WACC by ComReg.

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alto

alternative operators in the communications market

Consultation: Review of Weighted Average Cost of Capital (WACC) - Ref: 19/54 & Extended by 19/66

Submission By ALTO

Date: August 13th 2019

ALTO is pleased to respond to the Consultation: Review of Weighted Average Cost of Capital (WACC) – Ref: 19/54 & Extended by 19/66.

ALTO welcomes this opportunity to comment on this important consultation.

Preliminary Remarks

ALTO notes with some concern that the issue of WACC has been a problem for the Irish Telecommunications market for some years. It is also one that ALTO has raised with ComReg on a number of occasions in the context of incumbent recovery.

ComReg's own consultation paper highlights a number of areas and decisions where the WACC beta deployed is one that is clearly no longer relevant to the markets within which it has been deployed is apparent. This is not an ideal scenario.

Further, ALTO notes that for the purposes of Eircom's network and recovery figures which are +12%, the WACC beta deployed also seem to be very unrealistic considering aspects of the market and network that have changed over time.

Having carefully considered the matters in this Consultation, it will be clear to ComReg that the Brexit factor looms largely over the sector. WACC may require revision sooner that ComReg might ordinarily contemplate or deem necessary.

Response to Consultation Questions:

Q. 1 Do you agree or disagree with the continued use of equilibrium concept for the estimation of the WACC? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

A. 1. ALTO agrees with the continued use of equilibrium concept for the estimation of the WACC.

ALTO also agree with ComReg at clauses 2.4 and 2.12 and we suggest that it is important to determine the Weighted Average Cost of Capital – WACC, for regulated services as a central aspect of regulatory price setting to prevent over recovery, set the correct competitive signals and incentivise investment.

ALTO observes at clause 2.6 that the European Commission has issued a consultation on estimating the WACC and consider it appropriate that ComReg take utmost regard of this best in practice guidance.

ALTO notes ComReg's comments at 3.15 that the overall difference between the equilibrium used in Ireland gives an outcome that is only marginally different to recently used Observed Asset Approach in the UK. The closeness of the outcomes tends to suggest continuing with the tried and test equilibrium approach at this review. However, given the unknown potential of Brexit on the Irish economy it would be advisable to track both over the coming years. Please also see our response to question 7 on the WACC review period.

Q. 2 Where a company's effective tax rate is significantly different to the statutory tax rate should the WACC be estimated using the statutory corporation tax rate or the company's effective corporation tax rate? Please

clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

A. 2. ALTO suggests that prior to addressing the tax rate to use, we would like to address the discussion in clauses 4.10 through to 4.14 of the Consultation paper concerning the nominal risk-free rate.

On the 25 June 2019 the Minister of Finance provided the Summer Economic Statement – SES, for Ireland highlighting the need for the October 2019 budget to prepare for a possible UK hard Brexit (currently proposed for 31 October 2019). The Minister took the position the economy would grow at circa 3.5% absent Brexit, but a hard Brexit is likely to reduce GDP to between 0 and 1%. Given the potential for such a major impact on the Irish economy and downward pressure on inflation we consider such cannot be ignored in this assessment.

ALTO submits that with regard to the situation where a company's tax rate is significantly different to the statutory tax rate then we agree the company's effective tax rate should be used. To support this ALTO notes that it is very possible to maintain high gearing in Ireland for such long periods (circa 10 years in time) and evidence suggests that such can be the norm rather than exception.

Q. 3 Do you agree with ComReg's proposed approach to estimating the generic parameters for the respective WACCs and the preliminary point estimates chosen? Please explain the reasons for your answer, clearly indicating the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

A. 3. ALTO submits per our previous responses that we are concerned that ComReg has not considered the potentially significant impact of a hard Brexit (which the Minister of Finance has estimated in his SES) and also that the norm for Eircom is its effective tax rate that has existed for the best part of 10 years, or more, and is lower than the 12.5% tax rate set by the Government. We therefore consider

ComReg is overestimating the value of the WACC and we do not agree with the point estimates chosen.

Q. 4 Do you agree with ComReg's proposed approach to estimating the WACC specific to the mobile telecommunications sector? Please explain the reasons for your answer, in particular your views on the specific parameters used. Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views

A. 4. ALTO does not submit any particular feedback in relation to the mobile telecommunications sector.

Q. 5 Do you agree with ComReg's proposed approach to estimating the WACC specific to the fixed line telecommunications sector? Please explain the reasons for your answer, in particular your views on the specific parameters used. Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant evidence and argumentation supporting your views.

A. 5. ALTO agrees with ComReg's proposed approach to estimating the WACC specific to the fixed line telecommunications sector.

Our answer is based on the logic explained and the comparative examples with Portugal and Slovenia which were both reviewed without serious concerns by the European Commission.

ALTO's only concern is as raised previously and that is whether Ireland is in the cusp of a major financial upheaval should a hard UK Brexit materialise. Given the very recent analysis presented by the Minister of finance in the 2019 Summer Economic Statement. ComReg needs to apply caution, or at least a commitment, to re-review should a hard Brexit happen. ALTO submits that this looks more likely as time passes.

Q. 6 Do you agree with ComReg's proposed approach to estimating the WACC specific to Market A and Market B in the broadcasting sector? Please explain the reasons for your answer, in particular your views on the specific parameters used. Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

A. 6. ALTO does not make any specific submission in relation to the broadcasting sector.

Q. 7 Do you agree or disagree with ComReg's preliminary view that WACC parameters could be updated more frequently and consulted on separately (as part of a pricing consultation) as opposed to conducting a full WACC methodology review and consultation? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

A. 7. ALTO considers at this time we need to consider the environment as is, and also the possible disruption should a hard UK Brexit materialise.

It is recognised that the WACC can go up as well as down and continuously changing many telecoms prices can be disruptive. However, long periods between WACC reviews (e.g., 3 years, 5years, 6years and now 5years) means the WACC is often very dated when product price control decisions.

ALTO notes that the recent ComReg Broadband Price Control Decision D11/18 issued in November 2018, and was based on the WACC from 2014 which is probably related to 2013 data. If the WACC being consulted now aligns with the average lifetime from previous WACC decisions then it's unlikely to apply until the next Broadband Decision price control in around 2022 or later. Hence the Broadband pricing will be subject to a WACC of 12% (8.18%) whereas in 2019 ComReg already proposes it should be 6.42%.

ALTO notes that at clause 8.22 of this consultation highlight that the Broadband Pricing Decision D11/18 has made provision to apply this proposed WACC Decision.

Given it has been 5 years since the last WACC Decision and that the Price Control runs until at least 2022 we consider such too long a period not to have an update. We therefore strongly consider this WACC decision should be applied to decision 11/18.

Going forward ALTO considers that the WACC should be calculated on an annual basis for two reasons:

1. An annual calculation would more accurately reflect the changing market and minimise the risk and potential disruption of having to implement significant price changes; and
2. An annual approach would provide a more accurate view to ComReg price control decisions at the time of the decision. The November 2018 Broadband Price Control is based on a WACC issued in 2014. This approach cannot be correct as a matter of fact and timing.

Again we must note Brexit – As a nation, are potentially about to enter a disrupted economic environment should Brexit occur, particularly if it's a hard Brexit which the Minister is already issuing different expected GDPs for Ireland depending on what happens. Given information is rarely instantly available on the market we consider in a post Brexit environment that the WACC should be calculated at least annually to accurately capture change. This would also align with our proposal above for annual reviews to improve the accuracy when ComReg set future price controls.

Q. 8 Do you consider that the risk-free rate, asset beta and debt premium should be aimed up? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views

A. 8. ALTO considers that if ComReg were to review the WACC on an annual basis there would be no need to aim up as the duration of time would be short allowing minimal drift from the Decision.

Q. 9 Do you agree or disagree with ComReg's preliminary view that Option 3 is the most appropriate method to implement the revised WACC? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

A. 9. ALTO disagrees with ComReg's preliminary view that Option 3 is the most appropriate method to implement the revised WACC.

ALTO submits that there is absolutely no justification for delaying implementation of a revised WACC until new market reviews are conducted. ComReg's own analysis highlights eir is earning substantially above both the true cost of capital (see Figure 1) and estimated cost of capital for many years (see Regulatory accounts).

Q. 10 What principles do you think should be adopted, if any, for differentiating WACCs? What principles should be adopted, if any, to decide if project specific risks need to be taken into account? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

A. 10. ALTO submits that ComReg will have to deal with these issues on a case by case basis and clearly identify what if any additional risks are posed by such investment choices. For example, a blanket premium on FTTH investment would not appear to be justified. Clearly in the rural 300k footprint Eircom face little or no risk from infrastructure competition, a fact conceded by ComReg, and there is clearly pent up demand for high speed broadband in this footprint. Consequently it is difficult to see how any case can be made for a premium on the cost of capital for such a project that if anything is less risky than investments in areas where there is competition.

Q. 11 Are there any aspects that respondents consider important and that have not been covered under the previous questions? Please explain the reasons for your answer, clearly indicating the relevant paragraph numbers to which your comments refer, along with evidence and argumentation supporting your views.

A. 11. N/A.

Q. 12 Do you believe that the draft text of the proposed decision instrument for Mobile Telecommunications is from a legal, technical and practical perspective, sufficiently detailed, clear and precise with regards to the specifics proposed? Please explain your response and provide details of any specific amendments you believe are required.

A. 12. ALTO submits no substantive comments in relation to the proposed draft decision instrument for Mobile Telecommunications at this juncture.

Q. 13 Do you believe that the draft text of the proposed decision instrument for Fixed Line Telecommunications is from a legal, technical and practical perspective, sufficiently detailed, clear and precise with regards to the specifics proposed? Please explain your response and provide details of any specific amendments you believe are required.

A. 13. ALTO agrees with the proposed decision instrument for Fixed Line Telecommunications as drafted.

Q. 14 Do you believe that the draft text of the proposed decision instrument for Broadcasting - Market A is from a legal, technical and practical perspective, sufficiently detailed, clear and precise with regards to the specifics proposed? Please explain your response and provide details of any specific amendments you believe are required.

A. 14. ALTO submits no substantive comments in relation to the proposed draft decision instrument for Broadcasting – Market A at this juncture.

ALTO

13th August 2019

eir

Review of Weighted Average Cost of Capital (WACC)

- Mobile Telecommunications
- Fixed Line Telecommunications
- Broadcasting (Market A and Market B)

Response to Consultation and Draft Decision 19/54

13 August 2019

DOCUMENT CONTROL

Document name	eir response to ComReg Consultation & Draft Decision 19/54 Review of Weighted Average Cost of Capital
Document Owner	eir
Status	Non Confidential

The comments submitted in response to this consultation document are those of Eircom Limited and Meteor Mobile Communications Limited (trading as 'eir' and 'open eir'), collectively referred to as 'eir Group' or 'eir'.

Please note that, for the purposes of the Freedom of Information Act 2014 and the Communications Regulation Act 2002 (as amended) and in the context of the eir Group's general rights and obligations, information supplied by the eir Group to you may contain confidential, commercially sensitive or price sensitive information consisting of financial, commercial, technical or other information, whose disclosure to a third party could result in financial loss to the eir Group, could prejudice the competitive position of the eir Group in the conduct of its business, or could otherwise prejudice the conduct or outcome of contractual or other negotiations to which the eir Group is a party.

Accordingly, you are requested to contact a member of eir Group's Regulatory Strategy Team where there is a request by any party to have access to records which may contain any of the information herein and not to furnish any information before the eir Group has had an opportunity to consider the matter.

Executive Summary

1. As investment in the Irish telecommunication market continues, with further capital intensive programmes recently announced by privately owned companies[1] and state-aid intervention, the review of the Weighted Average Cost of Capital ('WACC') is both opportune and — against the uncertain back-drop of Ireland's future macro-economic conditions — a cause for concern.

2. The WACC plays an important role in setting cost-oriented regulated wholesale prices and can influence the prices ultimately paid by end-users. It provides a direct signal to the telecommunications market on the future investment choices of competing with eir's cost-oriented wholesale services and for eir to invest further in those services. The WACC also impacts the future business case sensitivities for Fibre-to-the-Home investments by eir and Siro[2] and the level of subsidy, including the success, of the Irish Government's National Broadband Plan.

3. There is a real investment flight risk from the Irish economy towards higher returns available internationally. Consequently, any misjudgement in determining the WACC for the mobile and fixed line telecommunication sectors will have significant adverse impacts on the Irish economy to the detriment of end-users.

4. Given that the appropriate WACC must be computed so as to maintain the correct incentive to investment, it *"implies that when calculating the WACC for wholesale price regulation purposes, NRAs* [National Regulatory Authorities] *cannot focus only on theory; a practical view on the estimation process is also necessary to take into account regulatory objectives as well as previous regulatory decisions and the role of the WACC in the cost models"*.[3]

5. After careful review of ComReg's Consultation and Draft Decision paper 19/54 (the 'Consultation'), and of the preliminary views developed therein by ComReg, including the Europe Economics 2019 Report[4], it does not appear that any such balance has been achieved.

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[1] https://www.irishtimes.com/business/technology/eir-plans-500m-upgrade-to-broadband-network-1.3789447 and https://www.siliconrepublic.com/comms/siro-funding-banks.

[2] Including alternative technologies such as cable.

[3] The Body of European Regulators for Electronic Communication, BoR (18) 167.

[4] Europe Economics, *"Cost of Capital for Mobile Termination Rates, Fixed-Line and Broadcasting Price Controls"*, ComReg Document 19/54a, May 2019. The 'EE 2019 Report'.

6. Consistent with the equilibrium concept, ComReg must exercise its judgement in a way that properly reflects its regulatory objectives and recognise that the WACC is *"not merely applying a fully-defined formula".*[5]

7. The evidence ComReg has presented does not support the unlevered asset beta for the mobile or fixed line markets proposed in the Consultation. The market fundamentals that influence the asset beta are currently significantly influenced by transient market whims. The distortion in current markets is shaped by macroeconomic quantitative easing programmes, market uncertainty (e.g., Brexit, US-China trade wars) and is an artefact of short time period observations. When an appropriate peer group and a longer time period — as preferred by the European Commission — is considered those transient market conditions are corrected. Furthermore, when NRA precedent values are considered, together with the independent expert report[6] of the likely appropriate range, the under-estimation by ComReg is apparent. When appropriately adjusted, as calculated by eir, those values are closer aligned and comparable.

8. When considering that the equity risk premium must reflect the additional return demanded from an investor's perspective it *"needs to be kept in mind that the investor looks at the conditions of the specific (national) market".*[7] In this regard, ComReg's use of a single historic data source lacks the sample data of what investors' expectations are for a return they demand for investing today. While those expectations may be different to actual future outcomes, it is nevertheless the case that investment decisions are influenced by those expectations. In order to correctly capture those expectations, a wider data source must be considered. The wider source of equity risk premium information, as proposed by eir, which includes country specific risk, is recognised by the European Commission and has been included (and approved) as part of other NRA WACC notifications.

9. As the telecommunications market is capital intensive, even minor changes in the WACC will have a significant impact on regulated prices. Coupled with the fact that those capital investments once deployed are a sunk cost with limited alternative use value, the WACC provides an important "build" or "wait" signal for infrastructure-

[5] The Body of European Regulators for Electronic Communication, BoR (18) 167.
[6] The Brattle Group, "*Review of approaches to estimate a reasonable rate of return for investments in telecoms networks in regulatory proceeds and options for EU harmonization*", July 2016. The 'Brattle Report'.
[7] The Body of European Regulators for Electronic Communication, BoR (18) 167.

based competition. Consequently, the WACC influences investment choices in the Irish economy. As capital is fluid, those investment choices are compared against available international-based returns in the telecommunications sector. In this respect, ComReg's large tolerance of ~€57 million when comparing its preliminary WACC against NRA precedents is alarming. ComReg's WACC is in all cases not only lower but materially so. The comparative gap represents a reduction in the return of efficiently incurred costs of Irish operators and an erroneous extraction of re-investment capital from the Irish economy.

10. The Consultation also seeks views from interested parties on a more frequent update of the WACC. The European Commission has already warned ComReg of the dangers of pricing predictability by updating pricing remedies with revised WACC.[8] Frequent revision of key inputs to the regulatory regime should be avoided. Consistent with the time horizon considered appropriate for price controls, it is fitting to review the WACC only when ComReg undertakes a new market analysis decision. This ensures that the WACC is appropriate for the duration of the price control.

11. Similarly, in the assessment of cost-orientation obligations it is unclear how an updated WACC could be used in the consideration of, or revision to, those pre-existing regulated prices. ComReg must recognise the "fair bet" principle faced by all operators (in particular, infrastructure-based investors) and the decisions made at the time, and subsequent to, a ComReg decision on appropriate pricing remedies.

[8] Request for Information, 18 September 2018, Case IE/2018/2115.

The Way forward

12. There is a significant body of financial and regulatory literature published on calculating the WACC. eir's submission is informed and guided by those publications. In particular, in arriving at our view and recommended adjustments, eir has considered the following:

    i. The European Commission Consultation.[9] In reaching its final decision, ComReg is required to notify its proposed decision to the European Commission. ComReg is required to take the utmost account of the European Commission in making its final decision. The EC Consultation sets out a number of the governing bodies preferred approaches for calculating the WACC.

    ii. The Brattle Report: The Brattle Group was commissioned by the European Commission to recommend appropriate WACC methodologies. For a number of parameters, the Brattle Group published an indicative range which they considered representative of reasonable outcomes.[10]

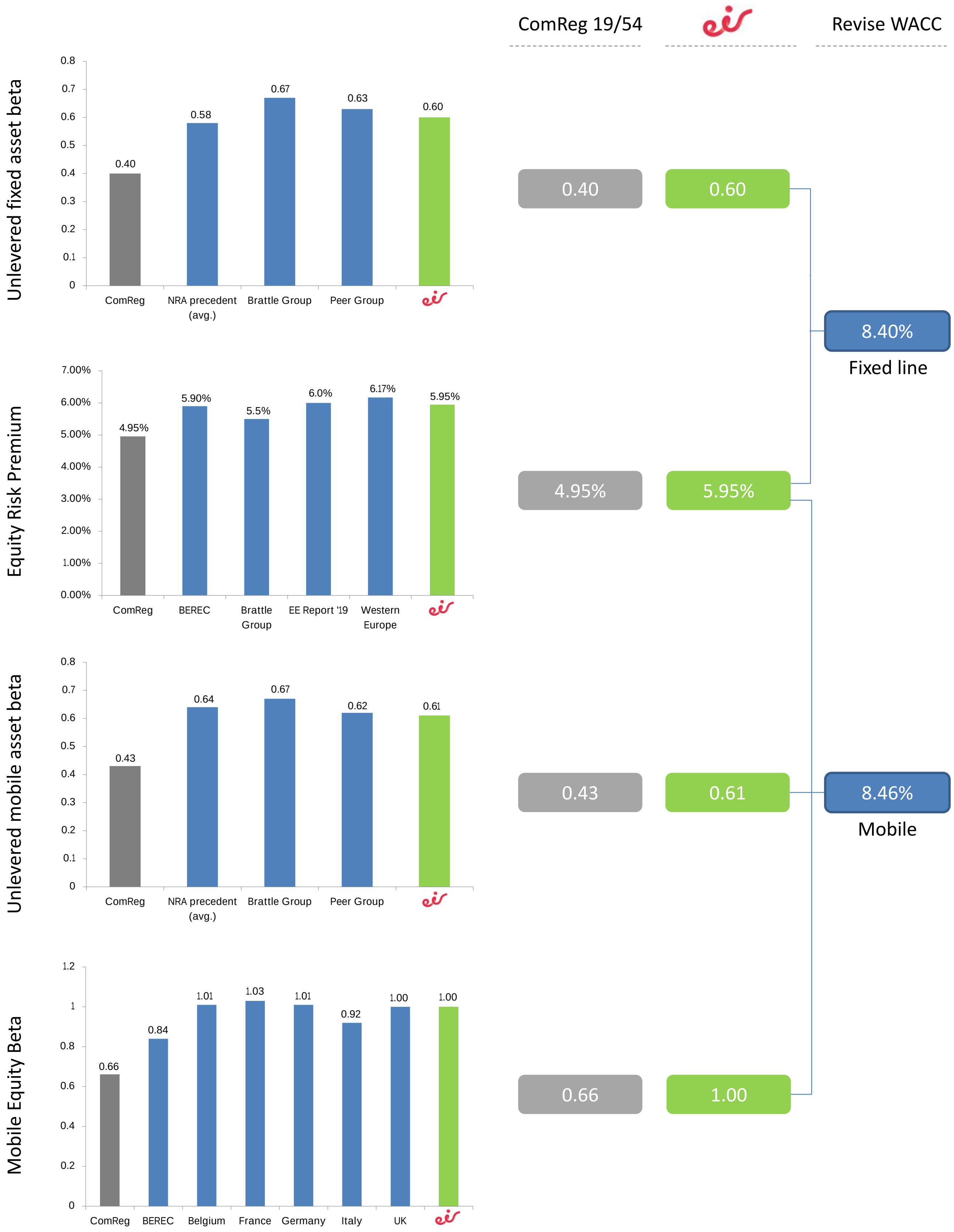
    iii. BEREC: The Body for European Regulators for Electronic Communications ('BEREC'), of which ComReg is a member, published a document in 2018[11] which sets out the WACC methodologies and average values notified by its members. BEREC has also published its response to the EC Consultation.[12]

    iv. Supporting Article 7 notifications on WACC decisions made by other NRAs.

13. Given that the European Commission's guidance on the WACC is expected later in 2019, eir considers that it may be beneficial for ComReg to consider whether further rounds of consultation are required with interested parties before publishing a final decision. This will allow both ComReg and interested parties to consider the recommendations of the European Commission, the views of BEREC and provide some time to allow clarity of the Brexit situation to manifest.

[9] The European Commission, *"Targeted consultation on guidance on cost of capital for EU electronic communications regulators"*, July 2018. The 'EC Consultation'.
[10] The Brattle Report, July 2016.
[11] The Body of European Regulators for Electronic Communication, BoR (18) 215.
[12] The Body of European Regulators for Electronic Communication, BoR (18) 167.

14. eir is looking forward to engaging with ComReg on the WACC and arriving at an appropriate rate which supports ComReg's statutory objectives and the continued evolution of telecommunication services in Ireland.



Question 1: Do you agree or disagree with the continued use of equilibrium concept for the estimation of the WACC? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

15. eir agrees with the continued use of the equilibrium concept by ComReg. However, eir supports this methodological choice on the basis that the approach is correctly applied.

16. The WACC estimation is forward looking and as such requires regulatory judgement to assess the most relevant evidence. As stated by BEREC "*According to the goal of regulation and following from the efficiency requirement of Art. 13 AD the WACC estimation is forward looking even when based on historical information. As such, estimating the WACC requires regulatory judgement to assess whether current or historical evidence is more relevant on a forward-looking basis (that is to say the weight to give to historical series vs. recent or spot data). In that sense a trade-off between short term accuracy and long term predictability is a crucial element in the NRA's discretion to calculate the WACC according to the regulatory objectives and strategy*".[13]

17. The equilibrium concept is the correct choice in terms of consistency with a forward looking approach. Placing more emphasis on regulatory judgement, aids in mitigating the risk of underestimating the WACC, by allowing NRAs to take account of the various distortions in the observed data as well as regulatory objectives and precedent.

18. For example, as noted by ComReg at paragraph 3.8 of the Consultation "*with quantitative easing in the aftermath of the financial crisis rates on government bonds are at historic lows*". Over the past number of years, several regulators have considered the effects of central banks' quantitative easing policies when setting the allowed rates of return.[14] eir agrees with ComReg that basing the risk free rate on current government bonds would "*lead to an artificially low estimated risk-free rate for forward-looking WACC estimates*". Various institutional features of the market

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[13] The Body of European Regulators for Electronic Communication, BoR (18) 167.

[14] Belgium (BIPT) takes QE explicitly into account. The Belgian RFR is based on a composed Bloomberg index. Denmark (DBA) and Spain (CNMC) took QE purchase programmes explicitly into account when updating the WACC in 2017.

including quantitative easing ('QE'), market pressures to acquire highly liquid assets, regulatory liquidity requirements and Eurozone breakup speculation have resulted in the real return of sovereign bonds becoming a less accurate approximation of the risk free rate. These distortions to the market would result in an outcome for the WACC that is substantially sub-optimal. Regulatory policy can therefore mitigate the effect of this distortion through the use of adjustments — using the equilibrium concept — in its estimation of the various parameters.

19. As noted in paragraph 3.7 of the Consultation, the equilibrium concept is also the approach that ComReg has historically adopted. In maintaining this approach, ComReg can remain consistent in its treatment of the WACC over time and limit variations between market reviews. This will enhance the predictability of its decisions. Predictability limits uncertainty and thereby minimises risks in an industry that is characterised by long term investment.

Question 2: Where a company's effective tax rate is significantly different to the statutory tax rate should the WACC be estimated using the statutory corporation tax rate or the company's effective corporation tax rate? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

20. eir agrees that the statutory tax rate should be used.

21. This view is supported by BEREC, in responding to the European Commission's Consultation on calculating an appropriate WACC, it stated that *"the WACC should be calculated as a pre-tax value (using the domestic corporate tax rate)".*[15]

22. On this matter, ComReg concluded in ComReg D15/14 (ComReg's extant WACC decision) that *"it would be inappropriate to factor in company specific factors such as the availability of losses forward or accelerate capital allowances"*. eir agrees with this view. As the WACC is based on a hypothetical efficient operator it is inappropriate to include company specific factors.

23. Furthermore, as the WACC is based on a hypothetical efficient operator it is unclear what the effective tax rate would be as *"computing an explicit tax allowance is complex, in the sense that it requires the NRA to make a much more detailed overview of the firm's tax liabilities than computing a tax uplift to the WACC".*[16]

24. As identified by ComReg the *"[t]reatment of tax in regulatory WACC models can strongly affect returns on historic investments as well as incentives for future investment"*.[17] Furthermore, it is inappropriate, as identified by Europe Economics, *"…for regulators to claw back the benefits of such allowances through the use of the effective tax rate when policymakers have deliberately allowed differences between the effective and statutory tax rates in order to provide particular forms of incentive"*.[18] Therefore, there are good policy reasons designed at a macro-level that companies can operate within and whose investments directly benefit Irish telecommunication

[15] The Body of European Regulators for Electronic Communication, BoR (18) 167.

[16] The Brattle Report.

[17] ComReg, the Consultation, paragraph 4.23.

[18] Europe Economics, "Cost of Capital for Mobile, Fixed Line and Broadcasting Price Controls", Report for ComReg, April 2014.

consumers. Section 16 (2) (d) of the Framework Regulations[19], provides that in making its decisions ComReg shall promote *"efficient investment and innovation in new and enhanced infrastructures".* Using the statutory tax rate in the WACC decision is consistent with those regulatory objectives.

25. Finally, eir agrees with the view of ComReg's consultant Europe Economics, who concluded in advising both the Irish Commission for Energy Regulation and Irish Water on this very issue, in 2015 and 2016 respectively, that *"[o]ur main view of substance is that the approaches based upon the headline rate of tax are conceptually superior to those based upon the effective rate, since they leave the discretion to change investment incentives across the economy, via tax allowances, with the tax authorities (where they should lie) instead of with the regulator."*[20] [emphasis added].

[19] European Communities (Electronic Communications Network and Services) (Framework) Regulation 2011 (the 'Framework Regulations').

[20] https://www.cru.ie/wp-content/uploads/2015/07/CER15193-Europe-Economics-Report-on-WACC.pdf and https://www.cru.ie/wp-content/uploads/2016/07/CER16346-Europe-Economics-IRC2-WACC-Report.pdf

Question 3: Do you agree with ComReg's proposed approach to estimating the generic parameters for the respective WACCs and the preliminary point estimates chosen? Please explain the reasons for your answer, clearly indicating the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

Risk Free Rate

26. ComReg's point estimate of 2.1% for the Irish risk free rate appears reasonable.

27. The risk free rate component of the WACC formula is attempting to replicate the minimum equity returns shareholders demand from an investment that bears no risk.

28. Government bonds are a good proxy for a "risk-free" investment, as they are (typically) repaid.

29. However, due to the on-going global market uncertainty, the price of bonds has increased (based on increased demand) as investors seek to reduce their overall risk by further diversifying into "risk-free" investments. The relationship between bond prices and yields means that as bond prices increase their yield decreases and may even become negative.

30. At low yields, the relationship between bond prices and yields (also known as convexity) increases and this makes the bonds increasingly sensitive to a change in yields. As evident in Figure 1, at low levels of bond yields "*the chance of a sharp decline in returns going forward begins to rise as the potential for bond yields to increase and a lower yield provides less of a cushion*".[21] Consequently, eir agrees with ComReg's view that "*to base the risk-free rate on current yields on government bonds would lead to an artificially low estimated risk-free rate for forward-looking WACC estimates*". This is particularly relevant when a number of bond market commentators are also forecasting bond yields rising again.[22]

31. See also paragraph 18.

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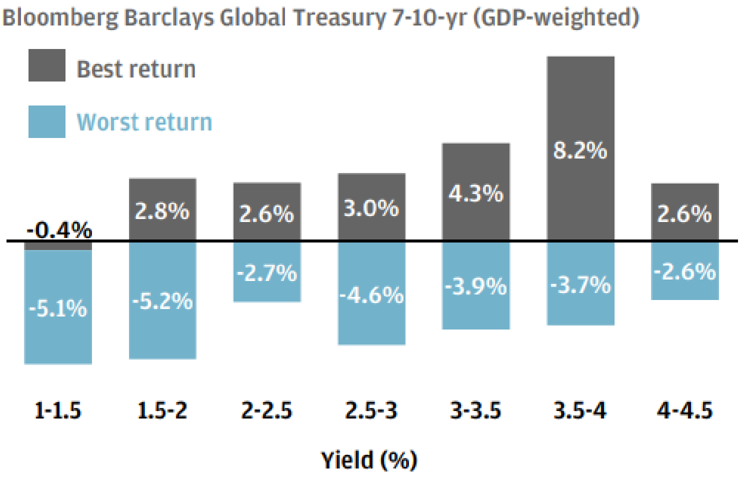
[21] JP Morgan, Market Bulletin, 2 May 2019.

[22] For example, https://www.cnbc.com/2019/05/31/chart-points-to-extremely-overbought-conditions-in-bond-market.html and https://www.marketwatch.com/story/jpmorgan-says-bond-market-rally-faces-risk-of-tantrum-like-2013-and-2016-2019-07-08

Figure 1: 3-Month best and worst price returns at given yields



Source: Barclays, Bloomberg, Thomson Reuters, J.P. Morgan Asset Management. Data reflect historical performance and is not indicative of future returns. Data are as of April 30, 2019.

32. Similarly, in setting a risk-free rate it is important to remember that capital is fluid. Investors can switch between currencies and invest in non-euro denominated government bonds to generate a positive yielding risk-free investment. For example, a 10 year US Government bond yield currently has yields of over 2%.[23]

33. Consequently, eir agrees with Europe Economics that a normalised risk-free rate for Ireland of 2.1% is appropriate. Using an average rate across a period of time before the pre-crisis levels provides an appropriate balance of a "normalised" risk-free rate and recognises that current rates may be artificially low.

[23] https://www.cnbc.com/quotes/?symbol=US10Y, as at 16/07/2019.

Future uncertainty

34. While the Irish Central Bank inflation forecast for 2020 is 1.1% it is important to note that the Irish Central Bank has also stated that *"[u]ncertainty surrounding the forecast primarily relates to external factors. Most importantly, developments in the negotiations surrounding the UK's exit from the European Union may result in a deviation in the path for the Euro/Sterling exchange rate away from that which is assumed in the current forecast, and a higher tariff environment would have knock on effects for consumer prices".*[24]

35. As inflation forecasts for Ireland are typically only provided for a 2 year period, eir recommends that any revision to the components of the WACC formula, as a result of the outcome of Brexit, including the inflation forecast, is updated and consulted on (prior to a ComReg decision) — as this could have a significant impact on the cost of capital. However, in circumstances where the WACC is updated as part of each market analysis cycle (3-5 years)[25] then these specific future uncertainties which are known today may be less pronounced. It may also take some time before the market settles on the appropriate re-aligned values resulting from any Brexit outcome. See also paragraph 69.

36. ComReg should aim-up its point estimate of 1.3% towards the ECB inflation rate target of 2%. This appears reasonable in the context of EE 2019 Report which states that the long term inflation rate for the Euro area is 1.8%[26] and on the potential inflationary impact of Brexit on Irish prices. This is also consistent with the Brattle Group's view that where possible inflation should be *"for a time period equal to the maturity of the bond from which the NRA is estimating the risk-free rate".*[27] In those circumstances, eir considers that the prospective inflation rate over a 10 year period is more likely to move towards the ECB inflation target.

[24] https://www.centralbank.ie/docs/default-source/publications/quarterly-bulletins/qb-archive/2019/quarterly-bulletin-q2-2019.pdf#page=13

[25] See paragraphs 148-154.

[26] EE 2019 Report, section 13.3.

[27] The Brattle Report.

Over reliance on a single source estimate

37. In setting the Equity Risk Premium ('ERP'), ComReg has exclusively used the historical data estimate by Dimson Marsh Staunton ('DMS').

38. The DMS method calculates the average excess return of stocks over bonds over more than 100 years for a number of global countries.

39. As identified by ComReg a *"long-run historical data set can significantly reduce the variation in ERP"*. However, solely relying on the DMS historical data has a number of limitations:

    i. As DMS themselves recognise *"there is no single figure for the risk premium that theory says is correct"*;[28]

    ii. Historical returns are not indicative of potential future returns nor the expected returns sought by investors today;

    iii. It is not an uncontested source, as the data is subject to adjustments and assumptions including the availability of data. *"Stelhe argues…that due to the importance of data quality when calculating ERP, only DMS data from the United States, United Kingdom and Germany should be used".*[29]

40. The ERP is the additional return sought by investors for the higher risk associated with investing in equity. In this regard, the ERP is a component of the WACC which is informed by *"the same level of risk as in the undertaking seeking funding".*[30] In other words, the ERP represents a forward-looking expectation of returns for investing in the shares of a company whose returns are volatile (unlike a risk-free rate) and based exclusively (in the context of regulation) on its Irish-based activities and investment.

41. The analysis undertaken by Europe Economics, on which ComReg relies, is based exclusively on a single source of historical data for its empirical support. This, by definition, means that the calculation does not take into account specific risks associated with current or future investments and is bound by the limitations of that

[28] E. Dimson, P. Marsh, M. Staunton, *"The worldwide Equity premium: a smaller puzzle"*, (2006).
[29] The Body of European Regulators for Electronic Communication, BoR (18) 167.
[30] ComReg, Consultation, page 10.

data source. As recognised by the Brattle Group, a potential criticism of relying on historical data *"is that it does not react in a coherent way in the face of an economic crisis"*.[31] This is particularly relevant in the context of setting an appropriate WACC which directly sets future build/buy signals for the telecommunications sector in Ireland.

42. In the context of future specific risks the higher the perceived or actual future risk the higher the returns demanded by investors. The Brattle Report states *"The notion that market volatility increases the ERP is consistent with the academic literature which finds a positive relationship between the ERP and volatility. For example, Kim, Morley and Nelson (2004) find a positive relationship between the stock market volatility and the equity premium, while Bansal and Yaron (2004) demonstrate that economic uncertainty plays an important role in explaining the ERP. In their model, <u>higher uncertainty (measured in their paper by volatility of consumption) leads to higher conditional ERP</u>"* [emphasis added].[32] Consequently, the future economic outlook for Ireland is relevant.

43. The Irish Central Bank notes that *"[w]hile the underlying outlook for growth in the Irish economy remains positive, it is subject to heightened levels of risk and uncertainty related to the future path of the Brexit process. The central projection continues to assume that a disorderly, no deal Brexit scenario can be avoided and that trading relationships between Ireland and the UK remain unchanged over the forecast horizon. However, the risk of a disorderly, no deal Brexit cannot be fully ruled out"*[33]. Similarly, the former Head of the International Monetary Fund, Christine Lagarde, in a recent interview on Brexit stated that *"the inevitable delay [will] sort of defer the uncertainty and contribute to increasing the risk…[Brexit] will have an impact on its trading partners…We know that some of the European countries particularly in the euro area will suffer more than others. <u>We know that Ireland will be affected significantly</u>"* [emphasis added].[34]

44. Consequently, given the short-comings of relying solely on DMS (see paragraphs 39 and 41), a wider methodological approach must be used by ComReg and its consultants in setting an appropriate ERP for Irish investment. This is also consistent

[31] The Brattle Report.
[32] ibid.
[33] https://www.centralbank.ie/publication/quarterly-bulletins/quarterly-bulletin-q2-2019
[34] The Economist podcast, *"Does the International Monetary Fund need to change"*, 7 March 2019.

with the equilibrium concept adopted by ComReg (see eir's response to Question 1). Such a view is supported by BEREC *"a regulatory judgement might be necessary to estimate the level of the expected ERP in the forward looking calculation of the WACC"*[35] and the European Commission supports the use of other databases *"on historical ERP (e.g., Dimson Marsh and Staunton…Damodaran (2017) or Duarte (2015)"*.[36]

45. Indeed, the recent NRA fixed line WACC notifications, as identified by ComReg in its Consultation, have all supplemented their ERP methodological approach beyond DMS. These are summarised below:

    i. Portugal: Anacom's WACC notification included an ERP of 6.22%. Anacom uses the derived average from three sources: Damodaran; Fernandez survey[37]; and DMS. The Portuguese NRA received a "No Comments" letter from the European Commission.[38]

    ii. Slovenia: Akos's WACC notification included an ERP of 5.71%. The ERP is based exclusively on the Damodaran method for Slovenia. The Slovenian NRA received a "No Comments" letter from the European Commission.[39]

46. Given Ireland's country specific investment risk (see paragraph 43), eir considers that the Damodaran method addresses some of the risk of relying solely on a single data source to determine the return demanded from investors investing in Ireland today. The Damodaran method measures a company's exposure to a country's risk.[40] In this specific case, the Damodaran method measures how volatile Irish equity stocks are relative to the Irish economy and how much additional return an investor seeks for investing in Irish companies. In other words, it provides a more current view based on historical data of what the ERP is for Ireland.

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[35] The Body of European Regulators for Electronic Communication, BoR (18) 167.

[36] The EC Consultation.

[37] Fernandez, Pablo and Pershin, Vitaly and Fernández Acín, Isabel, Market Risk Premium and Risk-Free Rate used for 69 Countries in 2019: A Survey, 23 March 2019. The 'Fernandez survey'.

[38] C(2019) 3246 final.

[39] C(2018) 6369 final.

[40] The Damodaran method is based on historical data which also relies on a country's current default risk and therefore provides an "updated" view of the equity risk premium required from investors today. This is particularly relevant here as the opportunity cost of capital, which is only applicable to, and is only relevant at that time, when the investment decision is taken. It is widely used by financial advisors, accountancy firms and corporate wealth managers.

47. This is also consistent with ComReg's view that "*the return that investors expect to achieve in financial markets at the same level of risk as in the undertaking seeking funding*". In other words, it reflects the non-diversifiable risk of the regulated company. The company's return on regulated services is wholly dependent on the Irish economy and ComReg's regulatory objectives to allow a reasonable return. Specifically the Access Regulations state that "*the Regulator shall, when considering the imposition of obligations under paragraph (1), take into account the investment made by the operator which the Regulator considers relevant and allow the operator a reasonable rate of return on adequate capital employed*" [emphasis added].

48. Similarly, the Fernandez survey[41] contains relevant and useful information as to the expectations for the ERP for Irish investments. The Fernandez survey is well-established, consistent and comprehensive. The results are used by NRAs in setting country specific equity risk premia including by Anacom — which ComReg has identified as a comparable fixed line WACC notification. The Fernandez survey is also used by NRAs globally in deriving an appropriate ERP.[42]

49. As set out paragraph 54 and paragraph 142, when adjusting for Irish specific circumstances, if ComReg applied a consistent ERP methodological approach to that used by those NRAs — as identified by ComReg as appropriate fixed-line WACC notification comparators — it generates an ERP in the range of 5.95% - 7.14%.

50. eir does not agree with Europe Economics proposed amendment to DMS methodology for Ireland. In section 3.2.2 of the EE 2019 Report, Europe Economics applies a downward adjustment to the DMS methodology to reflect their desire to capture the economic contraction (as identified by Europe Economics) of the Irish market between 1960Q2 and 2018Q3. This is inappropriate for two reasons:

    i. The data should be allowed to speak for itself: As the DMS data series is sufficient long, no further adjustment is needed. While the DMS methodology has certain drawbacks, the arithmetic mean provides the expected value of return of that data source. The data source is updated annually. Therefore, any economic expansion and contractions are implicit in the data. In

[41] The Fernandez survey.

[42] http://www.qca.org.au/getattachment/c8b8fb77-7d76-4e56-8aad-a0ed0ae56c3f/Frontier-Economics-Recent-evidence-on-the-market.aspx

addition, the arithmetic mean[43] is widely used in an investment appraisal context; and

ii. In disaggregating the long-run ERP into a "recession" and "non-recession" ERP. There is a risk that Ireland could enter into recession and then the "recession" ERP should be applied or vice-versa. eir considers that to the extent that a more forward-looking view of current investor expectations is reflected in the ERP that this can be achieved by expanding the sources of data considered (see paragraphs 52-55) without adjustment to the DMS.

51. Finally, in the Europe Economics' 2014 Cost of Capital Report to ComReg, Europe Economics proposed no such adjustment. In fact, at that time, Europe Economics discussed only an upward adjustment to the ERP of 4.6% (which is opposite to that proposed today) stating that *"we do recognise that there are some downside risks to the nascent economic recovery in Europe that may justify an ERP above the DMS long-run average".*[44] No justification, in either the Consultation or EE 2019 Report, is provided for this change in approach. eir reserves its rights to respond to any such future reasoning. At this time, based on the available information, it appears unlikely that a downward adjustment could be justified in 2019, when the time series used by Europe Economics to "support" the decrease is between 1960 and 2018 — when only an upward adjustment was considered appropriate in 2014.

52. eir considers that a wider methodological approach, in supplementing the historical data approach (DMS) with the country risk premium for Ireland using the Damodaran method and a survey approach (Fernandez), strikes the appropriate balance of combining predictability with a real life forward-looking investor perspective of additional returns expected from equity investments in the Irish market. In addition, a wider methodological approach stabilizes / mitigates any sharp differences (or short-falls) that might be present in a single particular approach. As stated by the Brattle Group *"the final ERP estimate will often be, and perhaps should be, the result of data and judgement".*[45]

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[43] In addition, to other data sources.

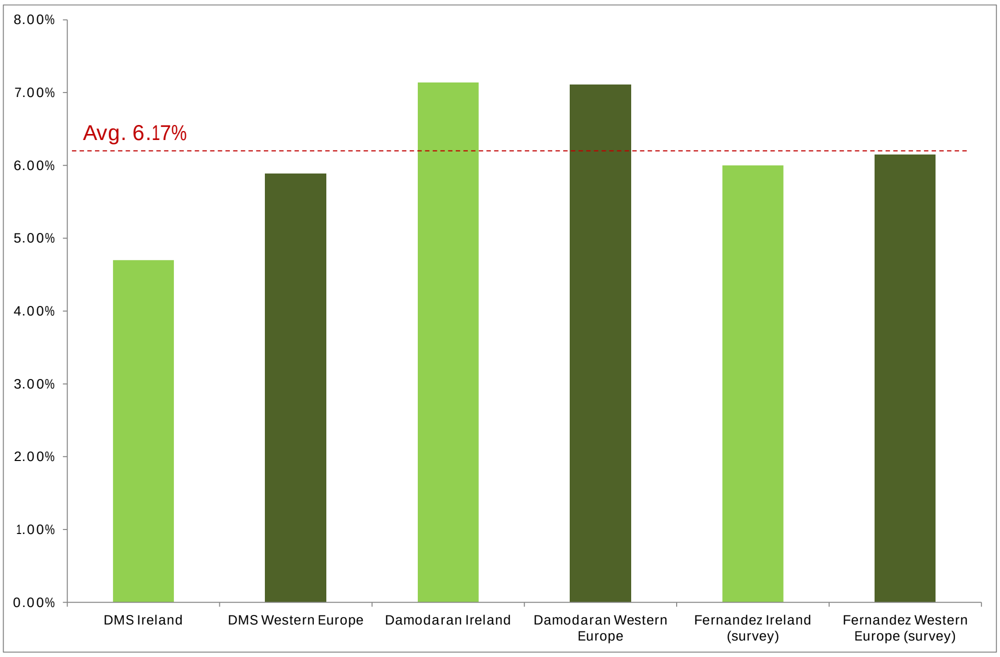
[44] Europe Economics, "*Cost of Capital for Mobile, Fixed Line and Broadcasting Price Controls*", Report for ComReg, April 2014.

[45] The Brattle Report.

53. This is also consistent with ComReg's objectives, see paragraph 47, and as provided for under the Access Regulations and Article 13(1) of the European Access Directive to allow operators a reasonable return on adequate capital employed. A component of that reasonable return is determined by the ERP.

54. A wider approach — combing the derived Irish ERP from DMS, Damodaran and Fernandez survey — which is accepted by the European Commission as an appropriate methodology to calculate the ERP[46], generates an Irish ERP of 5.95%. As a benchmark comparison, applying this wider methodology consistently across all Western European[47] countries generates an overall average of 6.17%.

Figure 2: Comparison of ERP Ireland and Western Europe[48]



55. An Irish ERP of 5.95%, is close to the BEREC 2018 benchmark of 5.90%,[49] is comparable with the indicated range (5.0% - 5.5%) in the Brattle Report for the European Commission and falls within the precedent range identified in the EE 2019 Report 2019 (see Table 3.3) for Irish regulatory determinations between 2000-2018 of 4.75% - 6.0%. A higher Irish ERP also acknowledges the Brattle Report findings that

[46] See paragraph 45.i and 45.ii.
[47] Western Europe is defined as: Spain, Germany, UK, Italy, France, Sweden, Belgium, Norway, Denmark, Portugal, Finland and Ireland.
[48] Source: Damodaran, Italian WACC notification C(2019) 5406 final and eir analysis.
[49] The Body of European Regulators for Electronic Communication, BoR (18) 215.

an upward adjustment is consistent with a higher risk premium demanded by investors in times of economic uncertainty. See paragraph 42.

Other considerations

56. eir agrees that the risk free rate and inflation should be estimated separately. ComReg's proposed approach is appropriate given that changes in the nominal risk free rate can occur due to changes in either the real risk free rate or in the rate of inflation. It is therefore correct to consider these parameters individually in order to account for such effects.

Question 4: Do you agree with ComReg's proposed approach to estimating the WACC specific to the mobile telecommunications sector? Please explain the reasons for your answer, in particular your views on the specific parameters used. Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

Gearing for mobile telecommunications

57. Gearing refers to the ratio of net debt to the value of the firm.

58. eir agrees that if the WACC is based on a hypothetically efficient operator then it is appropriate to use a notional industry-wide gearing. The use of a generic notional operator is also consistent with the methodology applied by the majority of NRAs.[50]

59. However, eir considers that the point estimate of 35% appears low in comparison to the average gearing of relevant mobile peers. Using the gearing data as published in Table 5.3 of the EE 2019 Report and removing less relevant peers (see paragraphs 76-77) suggests that a gearing of 39% is more appropriate and reflective of the hypothetical efficient operator.

	Gearing Dec 2018
Deutsche Telekom	38.2%
Orange	41.6%
Telefonica	48.8%
Telia	11.7%
Telecom Italia	61.3%
Vodafone	33.6%
Average	**39.2%**

60. In order to replicate the gearing of a hypothetically efficient operator, it should be reflective of current industry-wide gearing.

61. Finally, when combined with the unlevered asset beta, the gearing ratio is used to calculate the equity beta. Using a gearing ratio of 39% generates an equity beta of 1.00. While this is above the average of 0.84 as reported by BEREC[51] it is in line with

[50] The Body of European Regulators for Electronic Communication, BoR (18) 215.

[51] ibid.

the recent NRA mobile WACC notifications (average value 0.99, median value 1.01). See also paragraphs 89-91.

Asset Beta for mobile telecommunications

62. eir does not agree that ComReg's proposed approach to calculating the unlevered mobile asset beta is valid or that the unlevered asset beta of 0.43 is appropriate.

63. In particular, eir considers that ComReg has:

    a. relied on an inappropriate methodological approach to market data;

    b. calculated an unlevered asset beta based on an incomplete peer group; and

    c. failed to adequately consider recent regulatory precedents.

Incorrect methodological approach to interpreting market data

64. In forming its draft decision of a point estimate of 0.43 for the unlevered asset beta, ComReg has incorrectly relied on the comparator range identified by Europe Economics of 0.3 and 0.5 (see paragraph 5.15 of the Consultation) and 0.42 to 0.44 (see section 5.2.2 of the EE 2019 Report).

65. The unlevered asset beta measures the volatility of the stock against the market index. In identifying a peer group, the relevant beta of the mobile telecommunications industry can be determined. As this is market/industry data it is directly observable and comparable to peers.

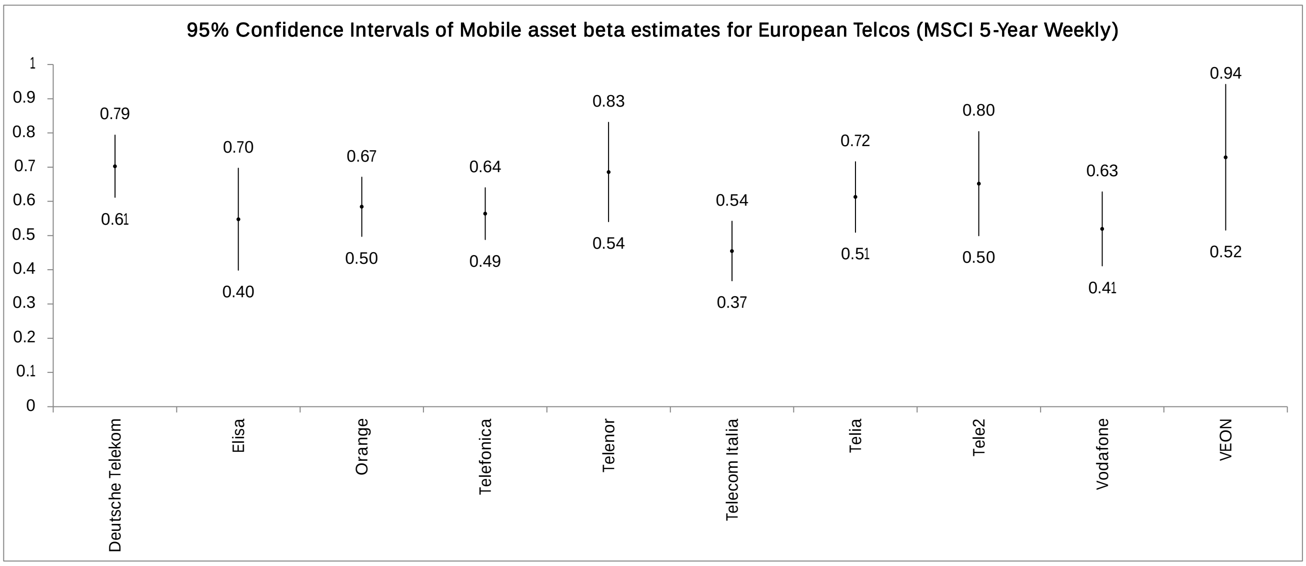
66. It is not readily apparent how Europe Economics has derived their indicative range of 0.42 to 0.44 other than it is based on the "most recent range".[52] The most recent data for this peer group, which eir does not consider is complete or the appropriate time horizon, is 0.47-0.52.[53]

[52] eir's formal request for access to the underlying data used by Europe Economics was denied by ComReg on the basis that it was propriety data.

[53] See **Table 2**. The increased range from 0.42 and 0.44 (as identified by Europe Economics) to 0.47 and 0.52 (as identified by eir) highlights the fluctuations evident in short-term data sets. This short-term volatility is not appropriate to incorporate into medium/long-term investment signals.

67. Investigating the relevant peer group mobile telecommunications companies in Europe, demonstrates that the unlevered asset beta of telecommunication companies is much higher than 0.43 over the last five years[54].

Figure 3: 5 year unlevered mobile asset beta



68. The European Commission has stated that their preferred time period for asset beta observations is 5 years using the arithmetic average.[55] Which eir agrees is correct.

69. A longer time horizon is also consistent with the reasoning of Europe Economics for adjusting the current risk-free rate (see section 3.1.3 of the EE 2019 Report). Therefore, it is wholly inconsistent to use a 2-year time horizon to estimate the unlevered mobile asset beta when other parameters have taken a more conservative view of recent data and applied regulatory judgement to determine normative ranges. Furthermore, when updating the parameters in reaching a final decision (if appropriate), a 2 year time horizon will be heavily skewed/influenced by the Brexit decision/further speculation expected on the 31 October 2019. As recognised by the European Commission, it is more important that the parameters of the WACC *"reflects the financial conditions over the life of the investment rather than at any specific point in time over the life of that investment".*[56]

[54] See **Table 2**.

[55] The European Commission, the EC Consultation, July 2018.

[56] ibid.

70. Similarly, there are no recent technology developments which could support a view that the medium/long-term riskiness of the mobile telecommunications market relative to the market has recently declined (*vis-a-vis* the results of a 2 year view against a 5 year view). This error (including its range — see paragraph 66) is compounded by the shortcomings of the additional information used to inform ComReg's preliminary view (i.e., an incomplete peer group and failure to adequately consider regulatory precedent).

71. A longer period of observations provides enhanced accuracy and is consistent with the equilibrium concept for calculating the WACC. More specifically:

   i. enlarging the period of calculation allows the smoothening of the return volatility and thus the beta: This volatility is called "noise" in Behavioural Finance and was theorized by Fischer Black.[57] According to Fischer Black, each return dataset is biased due to over-reaction or under-reaction on short term issues (such as profit warnings or merger & acquisition activity/rumours etc.) and these over-reactions and under-reactions tend to disappear with time. Therefore, taking a larger dataset gives a lower weight to abnormal returns which could be over-represented in a shorter time frame. Similarly, for example, NERA Consultants identified that the 2 year beta for BT (including a number of its peers such as TalkTalk and Sky) was notably impacted by events related to the Brexit vote on 23 June 2016.[58]

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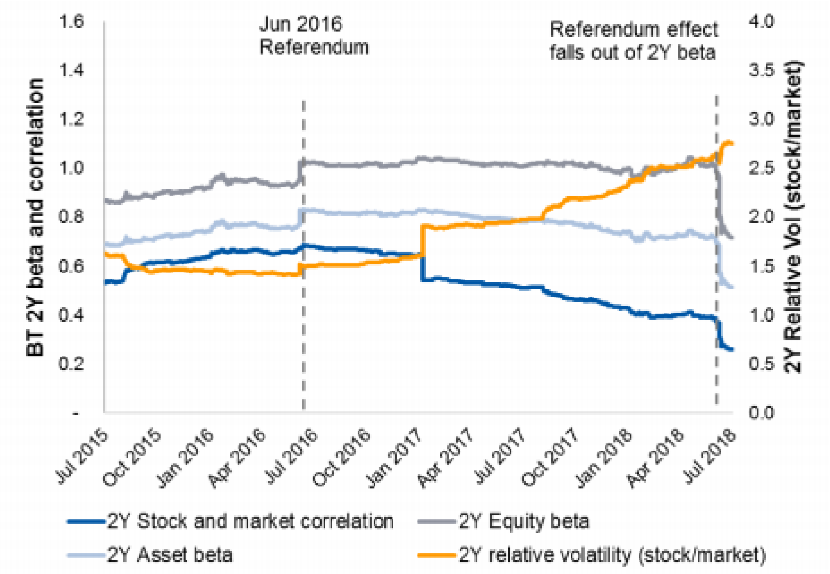
[57] https://onlinelibrary.wiley.com/doi/full/10.1111/j.1540-6261.1986.tb04513.x

[58] https://www.ofcom.org.uk/__data/assets/pdf_file/0018/124740/nera-wacc-report.pdf

Figure 4: Market volatility evident in 2 year data



Source: NERA analysis based on Bloomberg data. Cut-off date is 20 July 2018. Note: Daily data, 2-year estimation window, FTSE All Share as reference index.

ii. taking a longer period gives the opportunity to give a lower weight to current macro-economic trends such as QE: Launched in 2015 in the Eurozone, QE has greatly contributed to the distortion of the financial markets and to yields. Empirical evidence shows that QE has a positive correlation on the stock market value and a negative correlation on interest rates. As a result, QE partially explains that Europe and the US are experiencing one of the longest equity bull runs in history. Since the asset beta is based on a return calculation, it is more accurate to take a larger time frame in order to smooth the distortion effect caused by QE.

iii. choosing a 5-year period is also a way to better reflect the business cyclicality of the economy: Over the past 2 years European economies have been experiencing higher than average growth rates (10-year high in 2017 for the Euro zone) and a 2-year time frame is not representative of the average business performance. As a consequence, enlarging the period to 5 years provides a more accurate snapshot of business activity, business cyclicality and mirrors the recommended market review period (3-5 years) for telecommunication regulation.

iv. consistent with position of the European Commission: The European Commission states that *"a 5-year averaging period is likely to strike the right* *balance between predictability and efficiency".*[59] Moreover, that *"5 years take into account the relatively long lifetime of investments in electronic communications networks (20-30 years) while at the same time being consistent with the academic literature, which has concluded that an averaging period of 4-9 years is appropriate. It is also consistent with the economic research that has concluded that economic cycles tend to have an average duration of 5 years".*[60]

72. When applying the five year methodological approach, the resulting unlevered asset beta is in the range of 0.59-0.62 (see Table 2).

Incomplete peer group

73. The EE 2019 Report identifies nine relevant peers for the mobile telecommunications sector. Europe Economics states that Vodafone *"is the only pure play mobile comparator in our list"*. However, Vodafone's revenues are also generated from other services including fixed line and broadband.[61] Therefore, it is incorrect to suggest that Vodafone are a pure-play mobile operator.

74. With the convergence of telecommunication services many operators offer fixed line, broadband, voice, television and mobile services. eir accepts that the identification and use of pure play mobile comparators for estimating the appropriate beta is complex.

75. Similarly, given the level of convergence, a beta decomposition exercise to determine whether there is a relationship between the asset beta and the percentage of revenue from mobile activities may give spurious results due to statistical anomalies.

76. However, based on the percentage of revenue that peer group companies derive from mobile activities may give some indication as to whether they are appropriate peers. eir considers that ComReg should consider undertaking a revenue analysis of potential peers. eir considers that when revenues generated from mobile activities are less than 40% of total revenue those companies should be excluded from the mobile peer group analysis.

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[59] The European Commission, the EC Consultation, July 2018.

[60] ibid.

[61] https://www.vodafone.com/content/index.html

77. Based on a 40% mobile revenue requirement, BT (29%), KPN (31%) and Swisscom (35%) are excluded from Europe Economics list of relevant peers.

78. eir has identified a further four possible mobile peers (Elisa, Telenor, Tele2, Veon). All additional peers have an investment credit rating and mobile revenues generated account for more than 40% of total revenue.

Table 1: Mobile Company Rating Benchmark

	Moody's			S&P		
Company	Long Term	Short Term	Outlook	Long Term	Short Term	Outlook
Deutsche Telecom	Baa1	P-2	Negative	BBB+	A-2	
Elisa	Baa2		Stable	BBB+	A-2	Stable
Orange	Baa1	P-2	Stable	BBB+	A-2	Stable
Telefonica	Baa3	P-3	Stable	BBB	A-2	Stable
Telenor	A3	P-2	Stable	A-	A-1	Negative
Telecom talia	Ba1		Negative	BB+	B	Stable
Telia	Baa1	P-2	Stable	BBB+	A-2	Stable
Tele2				BBB	A-2	Stable
Vodafone	Baa2	P-2	Negative	BBB+	A-2	
VEON	Ba2		Positive	BB+		Stable

79. Consistent with the Brattle Groups recommendation[62] and NRAs' best practice the range of unlevered asset beta values is calculated on a 2 year daily and 5 year weekly basis using both the raw beta and Blume methodology (which is the methodology used for the adjusted beta values as reported by Bloomberg. The Blume method is part of the chartered financial analyst curriculum and ubiquitously used in the finance industry for investment decision appraisals). The Blume methodology is also used by the Italian Regulator in notifying the mobile WACC and is identified by ComReg as a relevant mobile NRA comparator.[63] The Italian notification did not receive any comments from the European Commission on the use of the Blume methodology.[64] BEREC reports that that the majority of NRAs use a Bayesian/Blume adjustment when calculating the unlevered asset beta.[65] For comparison, the unlevered asset beta is also calculated for the peer group as originally identified by Europe Economics ('ComReg 2019').

[62] The merits of a two year daily data set and the Brattle Group recommendation has been criticised by experts including by Professor Ian Cooper of the London Business School. Professor Cooper has published extensively on the WACC and its individual components. The European Commission has since published their preferred view of a 5 year time horizon in the EC Consultation.

[63] C(2018) 7709.

[64] In 2019, the Italian regulator notified a fixed line WACC of 8.64%. The fixed line calculation also used the Blume method based on 5 year weekly data. The Italian NRA received a "No Comments" letter from the European Commission. C(2019) 5406 final.

[65] The Body of European Regulators for Electronic Communication, BoR (18) 215.

Table 2: Unlevered mobile asset beta values

		MSCI Index		Blume adjusted	
	Ticker	2-Year Daily	5-Year Weekly	2-Year Daily	5-Year Weekly
BT	BT.A-GB	0.48	0.49	0.54	0.55
Deutsche Telekom	DTE-DE	0.45	0.70	0.51	0.68
Elisa	ELISA-FI	0.47	0.55	0.61	0.66
KPN	KPN-NL	0.46	0.61	0.54	0.64
Orange	ORA-FR	0.37	0.58	0.44	0.58
Swisscom	SCMN-CH	0.53	0.52	0.62	0.61
Telefonica	TEF-ES	0.43	0.56	0.44	0.53
Telenor	TEL-NO	0.47	0.69	0.60	0.74
Telecom Italia	TIT-IT	0.36	0.45	0.36	0.42
Telia	TELIA-SE	0.53	0.61	0.60	0.66
Tele2	TEL2.B-SE	0.74	0.65	0.77	0.70
Vodafone	VOD-GB	0.59	0.52	0.61	0.56
VEON	VEON-US	0.41	0.73	0.46	0.68
Average - All		**0.48**	**0.59**	**0.55**	**0.62**
Average - ComReg 2019		**0.47**	**0.56**	**0.52**	**0.58**
Average - eir Peers		**0.48**	**0.61**	**0.54**	**0.62**
Median - All		**0.47**	**0.58**	**0.54**	**0.64**
Median - ComReg 2019		**0.46**	**0.56**	**0.54**	**0.58**
Median - eir Peers		**0.46**	**0.60**	**0.56**	**0.66**

Source: FactSet, cut-off date 18 July 2019, KPMG Corporate Tax Table

80. As evident in Table 2, a 2 year daily range for the unlevered asset beta is 0.48-0.55 and a 5 year weekly range is 0.59-0.62.

81. The 2 year daily period captures the uncertainty in apparent trends and it would be incorrect for ComReg to infer that the data indicates a genuine material downward movement in mobile sector's relative riskiness. A longer window is less likely to be impacted by one-off events and more likely to be representative of long-term trends while still capturing the current volatility. This approach is also consistent with the reasoning put forward for the adjustments to the risk free rate as recommended by Europe Economics. For the reasons set out in paragraphs 68-71, a longer time period is more appropriate. See also paragraphs 120-122.

82. A 5 year time horizon indicates that a range of 0.59-0.62 is appropriate.[66] The median value[67] of 0.66 suggests that a point estimate should be weighted towards the higher end of the range of 0.62. When taken together with recent precedent NRA notifications for mobile unlevered asset betas — which averaged 0.64 (see paragraphs 83-88) — eir considers that a point estimate of 0.61 is appropriate.

[66] Using the peer group as identified by eir (see paragraphs 73-78) generates a 5 year range of 0.61-0.62.
[67] See footnote 98.

Failed to consider recent regulatory precedents

83. Table 5.4 of the EE 2019 Report provides the recent regulatory precedent, as identified by Europe Economics, on mobile asset betas.

84. In section 5.2.1 of the EE 2019 Report, Europe Economics compares the point estimate of Ofcom in 2015 of 0.60 to the lower bound estimate of 0.55 in 2018 to "*suggest some potential fall in asset betas*". This comparison is misleading and results in inappropriate conclusions being inferred from the data. Europe Economics are comparing two different values. Indeed, when setting the point estimate in 2015, Ofcom would have also contemplated explicitly or implicitly a lower bound estimate. It is inappropriate to compare the results of a point estimate to a lower bound estimate. The correct comparison is to the point estimate in 2018 (see paragraph 131).

85. eir notes that, in 2015, Belgium notified an updated WACC calculation which included an unlevered mobile asset beta of 0.60.[68] The EC issued a "No Comments" letter. This regulatory precedent has been omitted by Europe Economics.[69]

86. As identified by ComReg in paragraph 5.28 of the Consultation, the Italian regulator notified a mobile WACC in 2018 which used an unlevered asset beta of 0.47. That beta was calculated using only four peers[70] across a 2 year daily observation period.[71] This regulatory precedent has been omitted by Europe Economics.

87. In the last 3 years, the unlevered asset beta for mobile WACC notifications are as follows:

	Unlevered asset beta
Belgium (2019)	0.75
Italy (2018)	0.47
UK (2018)	0.73
France (2016)	0.62
Average	**0.64**

[68] C (2015) 1347.

[69] Since publication of the Consultation, Belgium notified a further revised WACC (C (2019) 5209), which used an unlevered mobile asset beta of 0.75.

[70] Namely, Telecom Italia, Iliad, Vodafone and Veon.

[71] See also footnote 64.

88. The average unlevered asset beta of 0.64 is also comparable to the precedent unlevered asset beta of NRA notifications as identified in Table 5.4 of the EE 2019 Report, between 2018 and 2014 — including that of Ireland in 2014 of 0.65.

Equity beta

89. eir agrees that the formula to calculate as presented in paragraph 5.18 of the Consultation is correct. However, as set out in paragraphs 62-88, ComReg has incorrectly calculated the unlevered asset beta. Similarly, ComReg's gearing ratio of 35% is low in comparison to current peer group ratios. See paragraphs 57-61.

90. When the more appropriate point estimate of 0.61 (see paragraph 82) is used for the unlevered asset beta the equity beta derived is **1.00**:

Equity beta = unlevered asset beta / (1- Gearing)

Equity beta = 0.61 / (1 – 0.39)

91. As the equity beta is industry specific it is directly observable. In stark contrast to the preliminary equity beta as calculated by ComReg of 0.66, an equity beta of 1.00 is in line with the recent equity beta for mobile peers.

	Equity beta
Belgium (2019)	1.01
Germany ('18)	1.01
Italy (2018)	0.92
UK (2018)	1.00
France (2016)	1.03
Average	**0.99**

Cost of Equity

92. eir does not agree that the pre-tax cost of equity of 7.39% is correct.

93. As set out in paragraph 55, the correct ERP for Ireland is 5.95%. Similarly, the appropriate equity beta is equal to 1.00, when the unlevered asset beta is corrected. See paragraphs 89-91.

94. Table 3 sets out the correctly adjusted values. Consistent with the Portuguese and Italian notifications, which ComReg has identified as comparable WACC notifications, the unlevered asset beta is based on the Blume method.

Table 3: Corrected Mobile nominal pre-tax cost of equity

Parameter	ComReg (2019)	Implied Ireland (ComReg peers)	Implied Ireland (Corrected peer group)	Comment
Unlevered Beta Telecom Sector	0.43	0.59	0.61	5 year weekly adjusted beta (Blume method)
Gearing (D/E)	35.00%	35.00%	39.00%	Gearing increased to 39% to reflect hypothetical operator
Leverage (D/(D+E))	25.9%	25.9%	28.1%	
Tax Rate	12.5%	12.5%	12.5%	
Equity beta	0.66	0.91	1.00	
Risk Free Rate	2.10%			
Inflation	1.3%			
Nominal Risk Free Rate	3.43%	3.43%	3.43%	As per ComReg estimate of appropriate value for Ireland
Equity Risk Premium	4.60%	5.95%	5.95%	The equity risk premium is based on an average of the equity risk premium values for Ireland from three historical series, namely, (i) Damodaran; (ii) Fernandez survey and (iii) DMS.
Cost of Equity (EUR)	6.47%	8.83%	9.38%	
Pre-Tax Cost of Equity (EUR)	7.39%	10.09%	10.72%	

95. As evident in Table 3, even when using ComReg's identified mobile peer group and a gearing ratio of 35%— which eir does not consider complete or representative of a hypothetical operator — the pre-tax cost of equity is 10.09% (compared to ComReg's 7.39%). When the appropriate peer group and corrected gearing ratio is used the pre-tax cost of equity is 10.72%.

96. Continuing from Table 3, when appropriately calculated, the nominal pre-tax WACC for mobile is 8.46%[72]:

Table 4: Corrected Mobile nominal pre-tax WACC

Parameter	ComReg (2019)	Implied Ireland (ComReg peers)	Implied Ireland (Corrected peer group)	Comment
Pre-Tax Cost of Equity (EUR)	7.39%	10.09%	10.72%	
Debt Premium	1.50%	1.50%	1.50%	As per ComReg estimate of appropriate value for Ireland
Cost of Debt (Pre-Tax)	4.93%	4.93%	4.93%	As per ComReg estimate of appropriate value for Ireland
Cost of Debt (EUR) - Post Tax	4.3%	4.3%	4.3%	
Pre-tax WACC	6.53%	8.29%	8.46%	~2% higher than ComReg original draft estimate

[72] A pre-tax WACC of 8.46% is comparable to the recently notified mobile WACC rates of Italy (8.55%), Belgium (8.35%) and UK (8.9%).

Question 5: Do you agree with ComReg's proposed approach to estimating the WACC specific to the fixed line telecommunications sector? Please explain the reasons for your answer, in particular your views on the specific parameters used. Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant evidence and argumentation supporting your views.

Gearing for fixed line telecommunications

97. eir agrees that if the WACC is based on a hypothetically efficient operator then it is appropriate to use a notional industry-wide gearing. The use of a generic notional operator is also consistent with the methodology applied by the majority of NRAs.

98. eir considers that the point estimate of 40% appears reasonable and is in line with the median value used by other NRAs.[73] The Portuguese regulator in its fixed line WACC notification to the European Commission used a gearing ratio of 40.05% based on 16 identified peers.[74]

99. eir does not agree with ComReg's view, in paragraph 6.6 of the Consultation, that eir's capital structure does not represent that of an efficient operator. First, there is no pre-requisite requirement, for an operator to be deemed "efficient", that it must be a publicly listed company. Second, as at June 2019, eir's net debt to EBITDA ratio was 4.1x and it has a debt rating of B1/B+. eir's net debt to EBITDA ratio is also the lowest of the large private telecoms operators in Europe.[75] For example, the Danish incumbent TDC Group also has a rating of B1/B+ and 5.6x net debt to EBITDA. While Virgin Media has a net debt to EBITDA multiple of 5.4x.

	Net debt/EBITDA
eir	**4.1x**
Salt S.A.	4.4x
Wind Tre	4.6x
UPC Holdings	4.9x
Virgin Media	5.4x
Unity Media	5.5x
TDC	5.6x
Vodafone Ziggo	6.2x

[73] The Body of European Regulators for Electronic Communication, BoR (18) 215.
[74] C(2019) 3426 final.
[75] Barclays Credit Research, Barclays LTM, Q2 and FY19 Estimates, 27 June 2019.

Asset Beta for fixed line telecommunications

100. The unlevered asset beta is a material parameter in determining the pre-tax WACC rate. eir's wholesale prices are predominantly set by cost-orientation. Over a five year price control period, based on ComReg's estimate set out in paragraph 8.27, for WLR and wholesale central access services alone, a 10% error in this parameter results in a reduction in the recovery of eir's efficiently incurred costs of ~€10 million. For capital intensive wholesale products such as ducts and poles, where investment cycles may be expedited outside of normal capital expenditure programmes (set at 8% for poles in ComReg D03/16 but this may be significantly higher due to the National Broadband Plan), the impact of such an error is larger given the long-payback period.

101. In ComReg D15/14 the fixed line asset beta was set at 0.55. The reduction to the proposed value of 0.40 represents a significant reduction not only in absolute value terms but a deviation from BEREC's guidelines that NRAs "*cannot focus only on theory; a practical view on the estimation process is also necessary to take into account regulatory objectives as well as previous regulatory decisions and the role of the WACC in the cost models*".[76] The reduction also highlights the fluctuations evident in short-term data sets. For the reasons listed in paragraph 104, a fixed line asset beta of 0.40 is not appropriate to set medium/long term investment signals.

102. In paragraph 6.16, ComReg states that the asset beta is based on "*several different methodologies*" and "*is in line with asset betas of other fixed line incumbents across Europe*". However, as is evident from the regulatory precedent (when correctly updated, see paragraph 132), recent NRA notifications and appropriately adjusted peer group analysis the average unlevered beta is significantly higher than 0.40. As the asset beta is industry specific, the results of the peer group analysis is directly observable and comparable.

103. Consequently, eir does not agree that ComReg's proposed approach to calculating the unlevered asset beta is valid or that the unlevered asset beta of 0.40 is appropriate.

104. In particular, eir considers that ComReg has:

    a. relied on an inappropriate methodological approach to market data;

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[76] The Body of European Regulators for Electronic Communication, BoR (18) 167.

b. calculated an unlevered asset beta based on an incomplete peer group;

c. relied on an incorrect presentation of regulatory precedent range;

d. erroneously applied a large materiality threshold; and

e. failed to adjust for country specific circumstances in benchmark comparisons.

Incorrect methodological approach to interpreting market data

105. In forming its draft decision of a point estimate of 0.40 for the unlevered asset beta, ComReg has incorrectly relied on the comparator range identified by Europe Economics of 0.38 and 0.41. The unlevered asset beta measures the volatility of the stock against the market index. In identifying a peer group the relevant beta of the telecommunications industry can be determined which is directly comparable to the unlevered asset beta proposed in the Consultation and eir's response.

106. It is not readily apparent from the EE 2019 Report what the indicative range of 0.38 to 0.41 is based on. It would appear from section 4.3.3 that it is the "rolling two-year" beta as "*…we place the most weight on rolling two-year beta estimated on daily data … The choice of a one- to two-year estimation period is based on Smithers and Co.'s finding that standard errors are generally low and betas reasonably stable over this estimation period*". It is important to note that the empirical evidence used by Smithers and Co (2003) based on 5 year rolling regressions was to demonstrate that the stability of betas increases the shorter the observations over that period, "*The graphs reveal apparent signs of major changes in beta when we use monthly or quarterly data…The daily and weekly betas, in contrast, look much more stable and rarely move much from unity*".[77] Smithers and Co is not recommending a time horizon for the betas to be observed over (2 years or 5 years) but merely "*that the problems with using monthly data—a five year window only gives 60 observations and random fluctuations in estimated beta will arise as one observation is dropped and one added because the standard error of the estimate is large*".[78] In other words, consistent with the recommendations of the Brattle Group and BEREC, Smithers and Co (2003) conclude that the beta should be calculated using daily or weekly data.

[77] http://www.bbk.ac.uk/ems/faculty/wright/pdf/mason%20miles%20wright
[78] ibid.

107. Some indication for the lower approximation of Europe Economics range may be due to a methodology difference, as Europe Economics states that *"If one used the beta estimation methodology recommended by the European Commission…one would obtain an asset beta for the fixed-line sector of 0.5"*.[79] It is surprising to eir that this methodology difference is not discussed in either the EE 2019 Report or in the Consultation.[80] In addition, given the materiality of the impact on the WACC from this difference, it is unclear to eir why ComReg did not investigate this matter further, when an unlevered asset beta of 0.40 would be the lowest used by telecommunications NRAs in Europe.[81] Had ComReg investigated further, it would have identified that:

i. the majority of NRAs use a daily or weekly sampling period;

ii. the period under consideration is typically 2, 3 or 5 years. The majority of NRAs use 5 years and that the European Commission and BEREC also favour this time period;

iii. the majority of NRAs make an adjustment to the observed value (sometimes referred to as "raw beta"). The most common adjustment by NRAs to adjust the observed values is by the Bayesian or Blume method[82] (which includes the Portuguese NRA, identified by ComReg as a fixed line WACC comparator); and

iv. the majority of NRAs use the arithmetic average.

108. By ComReg incorrectly proposing an unlevered asset beta of 0.40, it is in effect implying that:

i. investing in telecommunications services in Ireland carries the lowest investor risk for the sector in Europe:[83] First, neither ComReg nor Europe Economics provide any supporting argumentation to this effect. Second, even a cursory

[79] EE 2019 Report, Section 5.2.4.

[80] Having failed to consult transparently on this methodology difference, eir reserves its future rights to submit further views on the appropriateness of and methodologies used in such a test.

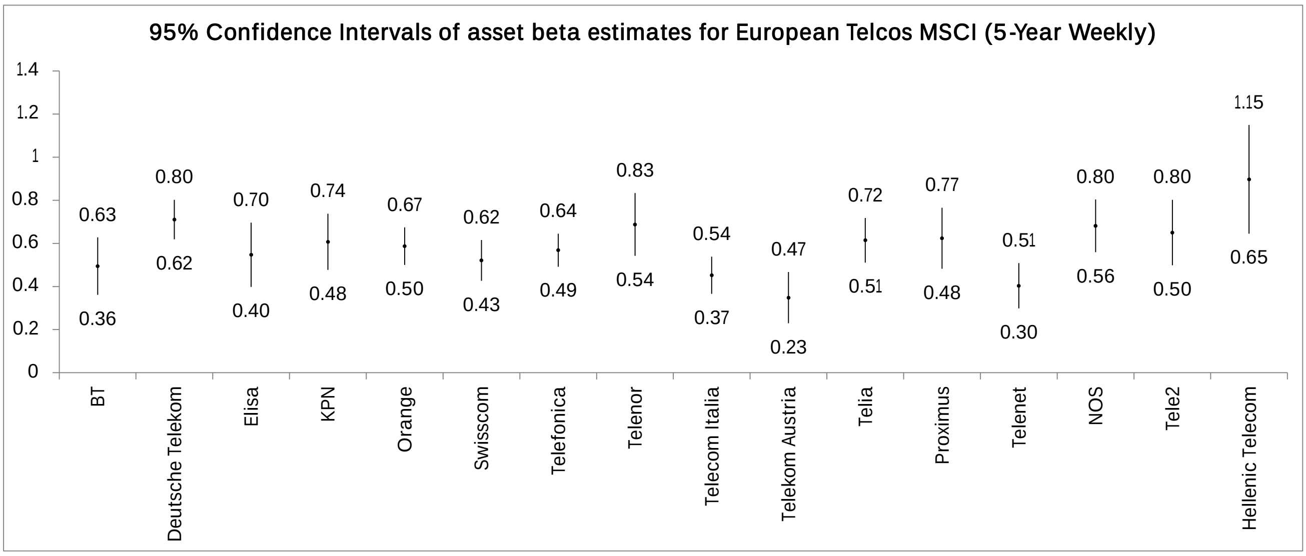
[81] BoR (18) 215 reports that the maximum unlevered asset beta currently in use is 0.98 with a minimum of 0.43.

[82] The Body of European Regulators for Electronic Communication, BoR (18) 215.

[83] The unlevered asset beta describes the volatility of the stock (without the impact of debt) relative to the market returns. A beta of 1 means that the stock is as risky as the market while betas greater or less than 1 reflect risk thresholds higher or lower than the market, respectively.

look at peer group telecommunications companies in Europe demonstrates that the unlevered asset beta of telecommunication companies is much higher over the last five years[84].

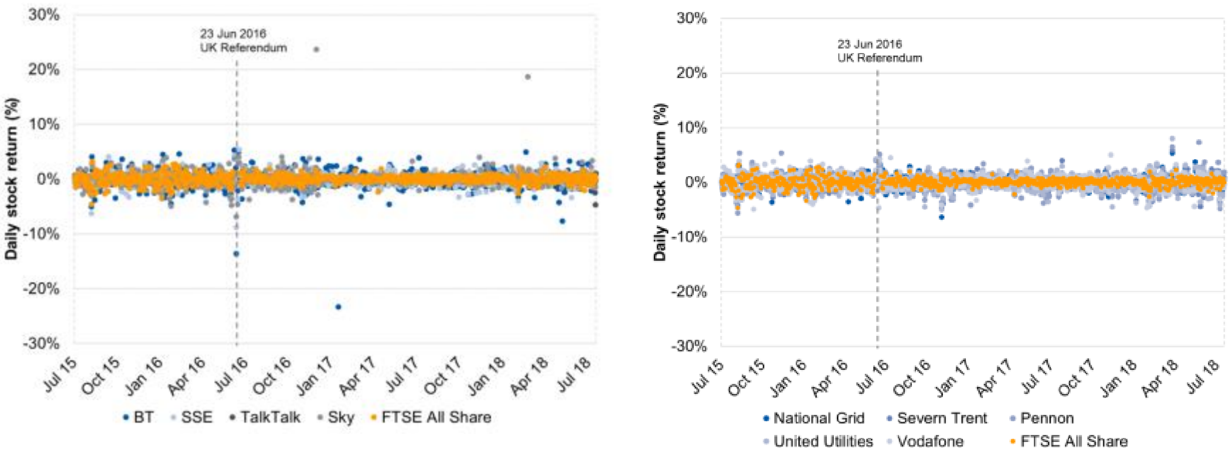
Figure 5: 5 year unlevered fixed line asset beta[85]



ii. telecommunication services have defence stock characteristics akin to utility stocks: NERA Consultants states that *"Traditional utilities are 'defensive' stocks, offering stable returns in times of uncertainty, while returns for other riskier firms are typically more affected by general market movements during these times".*[86] However, as further demonstrated by NERA Consultants, telecommunications are not a defensive stock. In analysis undertaken by NERA Consultants, the impact of Brexit — a market wide impact (also known as a shift in systematic risks) — on telecommunication stocks clearly deviates from that of utility stocks.[87] Given the forecasted impact of Brexit on the Irish economy (see paragraph 43), the implied insulated/less risky returns of telecommunications investment by ComReg is simply misplaced.

[84] See **Table 7**.
[85] See also footnote 93 and paragraph 131.
[86] https://www.ofcom.org.uk/__data/assets/pdf_file/0018/124740/nera-wacc-report.pdf
[87] See Figure 6: NERA analysis Teleco vs utility stocks.

Figure 6: NERA analysis Teleco vs utility stocks



Source: NERA analysis based on Bloomberg data. Cut-off date is 20 July 2018.

109. The European Commission has stated that their preferred time period for asset beta observations is 5 years. Which eir agrees is correct. The European Commission states that *"weekly data seems the most efficient choice as regards the frequency of the sampling period, as combined with a 5-year averaging period it is likely to provide sufficient observations to derive a robust estimate and is also likely to somewhat mitigate problems of illiquidity of stocks (if any)"*.[88] In response to the EC Consultation, BEREC has also agreed that the 5 year time horizon is appropriate.[89]

110. A longer time horizon is also consistent with the reasoning set out in paragraphs 69-71.

111. When applying the correct methodological approach, the resulting unlevered asset beta is in the range of 0.59 – 0.63 (see also paragraphs 112-124).

Incomplete peer group

112. The Brattle Report established a sample of EU telecommunications firms as suitable peers to fixed line telecoms networks based on a list of criteria — including that they must not only be active in the telecoms industry but that *"they should own and invest in telecoms infrastructure, rather than simply rent it"*.

113. The Brattle Report identified 17 suitable EU telecos that they recommended for inclusion in an NRA WACC estimate. For the purposes of our analysis we have also incorporated NOS Portugal — which was included by the Portuguese regulator as a

[88] The European Commission, the EC Consultation, July 2018.
[89] The Body of European Regulators for Electronic Communication, BoR (18) 167.

relevant comparator in calculating the fixed line WACC for Portugal. The EE 2019 Report peer group was limited to only seven companies (all of which are included in the peer group identified by the Brattle Group).

114. eir has excluded two peers based on recent merger activity involving PJSC Telesystems[90] and subsequent delisting of TDC. Consistent with the European Commission criterion that the firms should not be involved in any substantial mergers & acquisitions and that the comparators should have shares trading at the time of the price control.

115. Vodafone Kabel Deutschland is excluded on the basis of not meeting the investment credit rating. The remaining comparator firms have an investment credit rating.

Table 5: Fixed Company Rating Benchmark

	Moody's			S&P		
Company	**Long Term**	**Short Term**	**Outlook**	**Long Term**	**Short Term**	**Outlook**
British Telecom				BBB	A-2	Stable
Deutsche Telecom	Baa1	P-2	Negative	BBB+	A-2	
Elisa	Baa2		Stable	BBB+	A-2	Stable
Vodafone Kabel Deutschland						
KPN	Baa3	P-3	Stable	BBB	A-2	Stable
NOS				BBB-		Stable
Orange	Baa1	P-2	Stable	BBB+	A-2	Stable
Proximus	A1	P-1	Stable	A	A-1	Stable
Swisscom	A2		Stable	A		Stable
Tele2				BBB	A-2	Stable
Telecom talia	Ba1		Stable	BB+	B	Stable
Telefonica	Baa3	P-3	Stable	BBB	A-2	Stable
Telekom Austria	Baa1	P-2	Stable	BBB	A-2	Positive
Telenet	Ba3		Stable	BB-		Stable
Telenor	A3	P-2	Stable	A-	A-1	
Telia	Baa1	P-2	Stable	BBB+	A-2	Stable

116. In order to ensure, consistent with Smithers and Co (2003) findings, that daily data can be used of the identified peer group, the liquidity of those stocks is assessed. To test liquidity, the average bid-ask spread for each stock over a 2-year period is checked to ensure it does not exceed the threshold of 1%. All stocks are considered liquid.[91]

[90] https://www.sec.gov/litigation/admin/2019/34-85261.pdf
[91] A Dimson adjustment is therefore not required.

Table 6: Liquidity Test

BID-ASK SPREAD ANALYSIS		
Threshold	1 0%	
Company	**2Y av. Bid-Ask Spread**	**Threshold reached? (Y/N)**
BT Group	0.04%	No
Deutsche Telekom	0.05%	No
Elisa	0.07%	No
Hellenic Telecom	0.69%	No
KPN	0.20%	No
NOS	0.31%	No
Orange	0.12%	No
Proximus	0.36%	No
Swisscom	0.04%	No
Tele2	0.08%	No
Telecom Italia	0.06%	No
Telefonica	0.03%	No
Telekom Austria	0.30%	No
Telenet	0.36%	No
Telenor	0.11%	No
Telia	0.04%	No

117. Consistent with the Brattle Group's recommendation[92] and NRAs' best practice the range of unlevered asset beta values is calculated on a 2 year daily and 5 year weekly basis using both the raw beta and Blume methodology. For comparison the unlevered asset beta is also calculated for the peer group as originally identified by Europe Economics ('ComReg 2019').

Table 7: Unlevered fixed asset beta values

		MSCI Index		Blume Adjusted	
	Ticker	2-Year Daily	5-Year Weekly	2-Year Daily	5-Year Weekly
BT	BT.A-GB	0.48	0.49	0.54	0.55
Deutsche Telekom	DTE-DE	0.46	0.71	0.52	0.69
Elisa	ELISA-FI	0.47	0.55	0.61	0.66
KPN	KPN-NL	0.47	0.61	0.54	0.64
Orange	ORA-FR	0.37	0.59	0.44	0.58
Swisscom	SCMN-CH	0.54	0.52	0.62	0.61
Telefonica	TEF-ES	0.43	0.57	0.45	0.54
Telenor	TEL-NO	0.48	0.69	0.61	0.75
Telecom Italia	TIT-IT	0.36	0.45	0.35	0.42
Telekom Austria	TKA-AT	0.32	0.35	0.45	0.46
Telia	TELIA-SE	0.53	0.61	0.61	0.66
proximus	PROX-BE	0.61	0.62	0.69	0.70
Telenet	TNET-BE	0.38	0.40	0.45	0.46
NOS	NOS-PT	0.49	0.68	0.58	0.71
Tele2	TEL2.B-SE	0.75	0.65	0.77	0.70
Hellenic Teleco	HTO-GR	0.58	0.90	0.69	0.90
Average - All		**0.48**	**0.59**	**0.56**	**0.63**
Average - ComReg 2019		**0.46**	**0.57**	**0.52**	**0.59**
Median - All		**0.48**	**0.60**	**0.56**	**0.65**
Median - ComReg 2019		**0.47**	**0.59**	**0.54**	**0.61**

Source: FactSet, cut-off date 14 July 2019, KPMG Corporate Tax Table

[92] See footnote 62.

118. As evident in Table 7, a 2 year daily range for the unlevered asset beta of 0.48-0.56[93] and a 5 year weekly range of 0.59-0.63.[94] The Brattle Group considers that an asset beta of 0.50 to 0.67 is reasonable based on *"a range of suitable firms active in the European telecoms market"* which reflects the upper and lower 95% confidence interval for the median asset beta. While the two year daily range is to the lower end, both time periods provide unlevered asset betas within the Brattle Group's range.

119. For the reasons set out in paragraphs 81 (including paragraphs 68-71), a longer time period is the most appropriate methodology to calculate the unlevered asset beta.

120. Similarly, the economic consultants NERA demonstrated in their report to Ofcom (in setting an appropriate WACC) that the 2 year beta for BT (including a number of its peers such as TalkTalk and Sky) was notably impacted by events related to the Brexit vote on 23 June 2016.[95] This resulted in NERA recommending that weight be given to the 5-year beta estimates.

121. As noted in paragraph 109, the European Commission favours a five year arithmetic average method. Which eir agrees is correct.

122. For the reasons set out in paragraphs 71, on balance eir considers that the five year estimation window is appropriate. A five year window is also consistent with BEREC's proposal that *"a 5-year time horizon could provide stability and consistency with other parameters…"*.[96] Similarly, based on statistical regression to the mean, where current market deviations will tend to revert toward an average on subsequent measurements, supports greater weight towards the results of the Blume adjusted method. The Blume methodology has been adopted in the recent Italian and Portuguese, WACC notifications, which ComReg has identified as comparable benchmarks. See also paragraph 123.

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[93] Telekom Austria's free-float of the company accounts for 20.5% of the total share capital. This leads to low stock activity. Moreover, the main shareholders of the company are America Movil (51%) and the government of Austria (28.4%), which have been long term shareholder for over 5 years. This limits the free float size. This suggests that it may be appropriate to remove Telekom Austria from the peer group. Removing Telekom Austria increases the arithmetic average based on raw data to 0.49 and 0.60 for 2 and 5 years respectively.

[94] ibid.

[95] https://www.ofcom.org.uk/__data/assets/pdf_file/0018/124740/nera-wacc-report.pdf

[96] The Body of European Regulators for Electronic Communication, BoR (18) 167.

123. BEREC states that *"most NRAs use a Bayesian/Blume adjustment. Some NRAs apply the Blume adjustment explaining their choice (i) to report evidence from an academic study* [https://media.iese.edu/research/pdfs/DI-0822-E.pdf] *(ii) remarking that in case of "off the shelf" data provided by Bloomberg, the Blume adjustment is applied, (iii) stating that the Blume adjustment reflects future risks".*[97]

124. Finally, based on the results of the five year data (0.59-0.63) and taking into account the median value[98] of 0.65 together with the recent regulatory precedents average of 0.58 (see paragraph 132) and the Brattle Group recommended range of 0.50-0.67, suggests that a point estimate should be weighted towards the lower end of the 5 year range but above the absolute lower bound of 0.59. eir considers that a point estimate of 0.60 strikes the right balance between stability and statistical robustness.

Incorrect presentation of regulatory precedent

125. In section 6.2.4 of the EE 2019 Report, Europe Economics mistakenly identifies that the regulatory precedent for the unlevered asset beta is between 0.42 and 0.61.

126. As evident from Table 6.3 of the EE 2019 Report this range relies on both the Portuguese notifications of 2012 (0.42) and 2018 (0.61). As the 2012 data has been updated by the regulator, it is not appropriate to include this out-dated value as an appropriate precedent and should be excluded from the high-low range.

127. The result of the unlevered asset beta precedent is incorrect for Sweden. The correct unlevered beta for Sweden is 0.44.[99] Furthermore, in 2018, PTS undertook a new analysis which determined an unlevered asset beta of 0.55.[100] This regulatory precedent has been omitted by Europe Economics.

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[97] The Body of European Regulators for Electronic Communication, BoR (18) 215.

[98] The use of the median is preferred by the Brattle Group. The Brattle Report states that it *"recommend using the median (rather than average) beta, since this gives less weight to more extreme beta values".* The European Commission favours the arithmetic mean.

[99] The Swedish regulator (PTS) uses the raw stock market beta of 0.62 from relevant telecoms operators and adjusts it using Blume's formula to 0.74. PTS then applies a ratio of market cap / enterprise value of 0.59 of these companies to derive an unlevered (asset) beta of 0.44.

[100] PTS, "*Kalkylränta (WACC) för det fasta nätet*", 18/09/2018.

128. eir notes that in 2015 Belgium notified an updated WACC calculation which included an unlevered asset beta of 0.45.[101] The EC issued a "No Comments" letter. This update excludes the 2010 precedent of 0.50 from the high-low range estimate (for the reasons set out in paragraph 126). This regulatory precedent has been omitted by Europe Economics.[102]

129. Similarly, in 2017 France updated its WACC using an equity beta of 0.80. Based on a gearing of 40% implies an unlevered asset beta of ~0.48. This regulatory precedent has been omitted by Europe Economics.

130. It is unclear to eir how the unlevered asset beta for Portugal (2018) of 0.61 is calculated by Europe Economics in Table 6.3 of their report. Based on a gearing of 40% implies an unlevered asset beta of ~0.48. This is also consistent with the average unlevered asset beta reported by Mazars (Anacom's advisors). These values are included in the notified measure to the European Commission.[103]

131. Finally, Ofcom's 2018 WACC calculation uses an unlevered asset beta 0.78 for the BT Group. The BT Group unlevered asset beta of 0.78 is disaggregated between openreach's 'copper network' (0.59) and BT's 'other UK telecoms' business (0.73).[104] BT's other UK telecoms consists of BT's wholesale and retail leased lines, fixed voice, broadband (including fibre), mobile and bundled services. As ComReg are not proposing to disaggregate the beta in this way, the most appropriate comparison is the BT Group figure of 0.78.[105]

[101] C (2015) 1347.
[102] Since publication of the Consultation, Belgium notified a further revised WACC (C (2019) 5209), which used an unlevered asset beta of 0.63.
[103] C(2019) 3426 final.
[104] https://www.ofcom.org.uk/__data/assets/pdf_file/0020/112493/wla-statement-annexes-17-27.pdf
[105] Although views are sought from ComReg on the principles for project specific risks associated with CEI, FTTC and FTTH. See eir's response to Question 10.

132. Therefore, the regulatory precedent range is 0.48 (France (2018)) – 0.78 (UK (2018)). This range is 20% and 95% higher than ComReg's point estimate. In the last two years, the unlevered asset beta for fixed WACC notifications are as follows:

	Unlevered asset beta
Belgium (2019)	0.63
Portugal (2019)	0.48
Italy (2019)	0.53
UK (2018)	0.78
Sweden (2018)	0.55
France (2017)	0.48
Average	**0.58**

Erroneously applied a large materiality threshold

133. In paragraphs 6.31-6.33 of the Consultation, ComReg makes a benchmark comparison between the Portuguese fixed line WACC and ComReg's estimate. In making this comparison, which eir does not accept is complete (see paragraphs 136-142), eir is concerned by the apparent tolerance for variance in ComReg's assessment.

134. Specifically, ComReg appears to apply a significantly high threshold in concluding that its proposed WACC remains appropriate. This is despite the fact that the Portuguese WACC when (only) adjusted for the Irish tax rate is ~1% higher (7.35% vs 6.42%) than ComReg's estimate.[106] In monetary terms, a 1% difference for eir alone is equivalent to the extraction of~€57 million of investment capital from Ireland over a five year price control period. As investment in this sector has relatively long lives (20-30 years) such a tolerance level is inconsistent with ComReg's regulatory objectives.

135. ComReg's wide tolerance level has a direct impact on the telecommunications market in Ireland. First, the WACC sets an appropriate "build buy" signal for both eir and other operators. Considering that all telecommunications investment in Ireland is being undertaken by privately funded operators this direct impact cannot be overstated. Second, the anchoring pricing effect between Fibre-to-the-Cabinet ('FTTC') and Fibre-to-the-Home ('FTTH') could also have implications for the National Broadband Plan. Third, it directly influences Ireland's digital economy and global

[106] As identified in paragraph 138, further adjustments are required.

competitiveness through encouraging efficient investment and innovation. Therefore, such a tolerance is inconsistent with ComReg's statutory objectives and runs counter to specific obligations, such as that *"[t]o encourage investments by the operator, including in next generation networks"*. Finally, the combination of these outcomes will negatively impact end-users benefits contrary to Regulation 6(1) of the Access Regulations.

Failed to adjust for country specific circumstances

136. In making the benchmark comparison between ComReg's nominal pre-tax WACC to that of the Portuguese and Slovenian WACC estimate, ComReg has incorrectly only adjusted for the Irish tax rate.

137. Had ComReg adjusted the Portuguese WACC methodology (which includes Portuguese specific factors) for equivalent Irish specific values then the further materiality of its error would have been apparent.

138. As is evident from Table 8, the Portuguese NRA methodology (which was approved by the European Commission) correctly adjusted, results in an Irish nominal pre-tax WACC of 8.34% (using only the peers identified by Europe Economics) and a nominal pre-tax WACC of 8.61% (using the wider peer group per paragraphs 112-115). This is ca. 2% higher than ComReg's draft WACC estimate. The Portuguese regulator calculates the unlevered asset beta using the Blume adjustment based on weekly 5 year data.[107]

139. When considering the seriousness of this error, as identified in paragraph 8.27 of the Consultation, for WLR and cost-oriented broadband prices alone the impact is over ~€97 million over the course of a five year control period, it is clear that ComReg has erred in it evaluation of "compared the parameters" to conclude that its proposed value "remains appropriate". When CEI poles are considered the reduction in reasonable return for capital investment in Irish telecommunications services is close to €✂ million.[108] In other words, nearly €✂ million is incorrectly being extracted from

[107] The same peer group used in the Portuguese notification generates an unlevered asset beta of 0.57 using the MSCI index. An unlevered asset beta of 0.57 results in a Portuguese methodology appropriately adjusted for Irish factors of 8.20%. See footnote 109.
[108] Based on a pro-rata adjustment, as calculated by ComReg in paragraph 8.27 of the Consultation and a further estimated ~€✂ million for the impact on the return on poles over five years.

the capital investment programme for eir to the detriment of end-users and competition in the Irish market.

Table 8 Comparison of Irish WACC using Portuguese NRA EC approved methodology[109]

Parameter	Portugal (2018)	Implied Ireland (ComReg peers)	Implied Ireland (Corrected peer group)	Comment
Unlevered Beta Telecom Sector	0.48	0.59	0.63	Weekly 5 year adjusted beta (Blume method)
Gearing (D/E)	40.05%	40.00%	40.00%	As per ComReg estimate of appropriate value for Ireland
Leverage (D/(D+E))	28.6%	28.6%	28.6%	
Tax Rate	22.5%	12.5%	12.5%	
Equity beta	**0.80**	**0.98**	**1.05**	
Nominal Risk Free Rate	3.11%	3.43%	3.43%	As per ComReg estimate of appropriate value for Ireland
Equity Risk Premium	6.22%	5.95%	5.95%	The equity risk premium is based on an average of the equity risk premium values for Ireland from three historical series, namely, (i) Damodaran; (ii) Pablo Fernandez and (iii) DMS.
Cost of Equity (EUR)	8.11%	9.28%	9.68%	
Pre-Tax Cost of Equity (EUR)	**10.47%**	**10.61%**	**11.06%**	
Debt Premium	1.36%	1.50%	1.50%	As per ComReg estimate of appropriate value for Ireland
Cost of Debt (Pre-Tax)	4.47%	4.93%	4.93%	As per ComReg estimate of appropriate value for Ireland
Cost of Debt (EUR) - Post Tax	**3.5%**	**4.3%**	**4.3%**	
Pre-tax WACC	8.07%	8.34%	8.61%	~2% higher than ComReg original draft estimate

140. The increase from ComReg's draft WACC estimate of 6.42% to 8.34%-8.61% brings into sharp focus three important issues.

i. The difference is solely due to methodology differences and not market fundamentals.[110] In particular, the approach used by ComReg to calculate the unlevered asset beta is a significant departure from that recommended by the European Commission and implemented by the majority of telecommunication

[109] As Anacom included country specific adjustments to the Equity Risk Premium for Portugal, these also need to be adjusted for Irish specific circumstances — otherwise the benchmark comparison is not comparing appropriate parameters. Similar, adjustments are required to the appropriate peer group asset beta and debt premium and substitution of the Portuguese nominal risk free rate to the Irish value calculated by Europe Economics.

[110] For the avoidance of doubt, eir is not suggesting that all telecommunication WACCs should be the same across Europe. But that those differences should be as a result of country specific circumstances and fundamentals and not as a result of a departure in this case from the standard accepted forms of calculating the unlevered asset beta over 5 years — as used by the majority of NRAs and as preferred by the European Commission and BEREC.

NRAs including Portugal — which ComReg has identified as a relevant benchmark comparison.

ii. ComReg's methodology error will negatively impact the return of eir's efficiently incurred costs by at least €✂ million. In this context it is important to note that the incorrect calculation of the WACC will also distort the investment choices and operators' "make or buy" decisions for all operators in Ireland. The WACC calculated by ComReg does not reflect "*the return that investors expect to achieve in financial markets at the same level of risk as in the undertaking seeking funding*". ComReg's methodological error is contrary to ComReg's objectives pursuant to Section 12 of the Communications Regulation Act 2002 (as amended) — in particularly, in promoting competition and to contribute to development of the internal market.

iii. Without correction, ComReg's proposed WACC will have a detrimental effect in the medium to long run benefit of consumers and the wider Irish economy. As identified by the Brattle Group "*an SMP operator may be allowed a different WACCs in different MS, simply because of underlying differences in the WACC methodology applied by the NRA. Different WACCs could then bias investment decisions, pulling investment towards high WACC jurisdictions and starving low WACC jurisdictions, ultimately creating inefficiencies and distorting the single market*" *[emphasis added]*. This is contrary to ComReg's objectives pursuant to Section 16(2) (d) of the European Communities (Electronic Communications Network and Services) (Framework) Regulations 2011 (as amended) in "*promoting efficient investment and innovation in new and enhanced infrastructures*" and Section 12 of the Communications Regulation Act 2002 (as amended) which states that ComReg's objectives include "*(ii) ensuring that there is no distortion or restriction of competition in the electronic* communications sector; (iii) encouraging efficient investment in infrastructure and promoting innovation [...]" [emphasis added].

141. Similarly, if ComReg had undertaken a more thorough review "*having compared the parameters*" in undertaking its benchmark comparison to the Slovenia fixed line WACC estimate, it appears to eir that ComReg could not have reached the conclusion that its WACC remained appropriate.

142. The Slovenian WACC estimate is predominantly informed by the listed Telekom Slovenije. Therefore, for the purposes of this exercise, eir has not adjusted the equity beta calculation — if eir had done so the resulting nominal pre-tax WACC would have been higher. The Slovenian methodology, as approved by the European Commission, includes a specific Slovenian country risk premium in setting the ERP using the Damodaran method. Amending this ERP for <u>the Irish specific country risk premium</u> using the same methodology increases the nominal pre-tax WACC from 7.16% to 7.50%. This is over 1% higher than ComReg's pre-tax WACC estimate of 6.42%, or in monetary terms an error of ~€57 million on eir's efficiently incurred costs. The gravity of this error would be further compounded by inefficient and inaccurate build/buy signals in the telecommunications sector in Ireland to the detriment of end-users.

Debt Premium for fixed line telecommunications

143. eir agrees that the point estimate of 150bps for the debt premium is appropriate.

144. While the peer group used by ComReg may be enlarged if a wider peer group as identified in paragraphs 112-115 is used (subject to those additional peers satisfying the Europe Economics criteria for bond selection as set out in section 6.3 of their report), the proposed debt premium is line with the average used by NRAs of 130bps.[111]

[111] Calculated by using the average cost of debt minus average risk-free rate as reported (4.31%-3.01%) as reported in BoR (18) 215.

Other considerations

145. When appropriately calculated (see paragraphs 97-144) the nominal pre-tax WACC for fixed is 8.47%:

Parameter	Draft ComReg (2019)	Implied Ireland (ComReg peers)	Implied Ireland (Corrected peer group)	Comment
Unlevered Beta Telecom Sector	0.40	0.55	0.61	Weekly 5 year adjusted beta (Blume method)
Gearing (D/E)	40.00%	40.00%	40.00%	As per ComReg estimate of appropriate value for Ireland
Leverage (D/(D+E))	28.6%	28.6%	28.6%	
Tax Rate	12.5%	12.5%	12.5%	
Equity beta	**0.67**	**0.92**	**1.02**	
Nominal Risk Free Rate	3.43%	3.43%	3.43%	As per ComReg estimate of appropriate value for Ireland
Equity Risk Premium	4.60%	5.95%	5.95%	The equity risk premium is based on an average of the equity risk premium values for Ireland from three historical series, namely, (i) Damodaran; (ii) Fernandez survey and (iii) DMS.
Cost of Equity (EUR)	6.50%	8.88%	9.48%	
Pre-Tax Cost of Equity (EUR)	**7.42%**	**10.15%**	**10.83%**	
Debt Premium	1.50%	1.50%	1.50%	As per ComReg estimate of appropriate value for Ireland
Cost of Debt (Pre-Tax)	4.93%	4.93%	4.93%	As per ComReg estimate of appropriate value for Ireland
Cost of Debt (EUR) - Post Tax	**4.3%**	**4.3%**	**4.3%**	
Pre-tax WACC	6.43%	8.06%	8.47%	~2% higher than ComReg original draft estimate

146. When the point estimate of 0.60 is used for the unlevered asset beta, as proposed by eir, see paragraph 124, the nominal pre-tax WACC is 8.40%.

Question 6: Do you agree with ComReg's proposed approach to estimating the WACC specific to Market A and Market B in the broadcasting sector? Please explain the reasons for your answer, in particular your views on the specific parameters used. Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

147. Not applicable to eir.

Question 7: Do you agree or disagree with ComReg's preliminary view that WACC parameters could be updated more frequently and consulted on separately (as part of a pricing consultation) as opposed to conducting a full WACC methodology review and consultation? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views

148. eir considers that a balance needs to be achieved between ComReg's desire to update the WACC calculations more frequently, the resulting regulatory burden placed on interested parties in responding to more frequent consultations and the predictability/certainty of investment incentives (see paragraphs 169).

149. eir does not agree with ComReg's view in paragraph 8.4 of the Consultation that the WACC could be updated annually. See paragraphs 168-171.

150. eir considers that a full WACC consultation should be undertaken at the same time as a market analysis consultation/decision. The resulting point estimate WACC decision can then be applied to any new pricing decisions which are further specifications of that market analysis decision.[112] This is consistent with the approach used by Ofcom and this regulatory best practice is observed by other NRAs.[113]

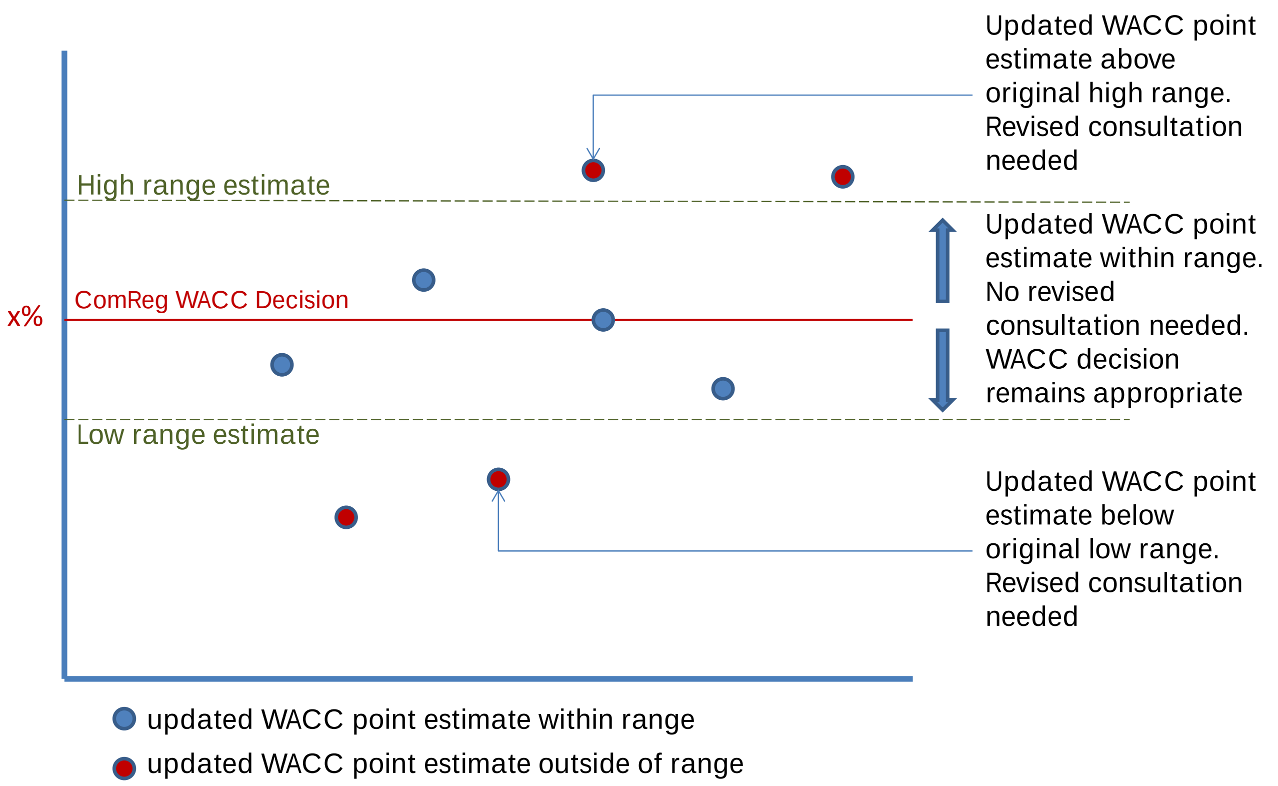
151. This sequencing of relevant decisions[114] ensures that any further specifications of pricing remedies, to which the forward looking WACC applies, is also consistent with the time horizon considered as part of the market analysis in determining that such pricing remedies are warranted. The European Commission also notes that *"Long averaging periods (i.e. 5 years) together with a commitment from the NRA not to change its estimation approach in sequential market reviews (i.e. regulatory predictability) is likely to meet this objective".*[115]

[112] However, this could only be in circumstances of a new price control, subject to appropriate consultation after the market analysis decision has been made. This does not apply to pre-existing price controls made under previous market analysis decisions which are simply being rolled-over and carried into new market analysis decisions. For those circumstances, the pre-existing WACC should continue to apply.
[113] The Body of European Regulators for Electronic Communication, BoR (18) 215.
[114] Including that the revised WACC is only applicable to those specific market analysis pricing remedies (see also footnote 112).
[115] The European Commission, the EC Consultation, July 2018.

152. In the event that there is a significant delay of a pricing remedy decision which is a further specification of that market analysis, then ComReg need only re-consult (on the WACC)[116] in circumstances where an updated WACC point estimate falls outside the high-low WACC range identified in the WACC decision for that market.[117] Where the updated point estimate falls within the high-low range then the original WACC decision remains appropriate and is not changed. See Figure 7.

153. This approach recognises that when ComReg decided on its WACC point estimate (as part of the market analysis decision) that there was a range of other possible outcomes. To the extent that an updated WACC point estimate falls within the high-low outcomes of the applicable WACC decision — it demonstrates that the systematic risk has not materially changed between updates and that its tolerance levels are within the bounds ComReg decided were reasonable at the time of decision.

Figure 7: Illustrative determination of WACC revision



154. See also eir's response to Question 9.

[116] As part of the wider pricing consultation.
[117] The methodologies used to calculate the WACC must be consistently applied, otherwise the point estimate could be as a result of a methodology change and not market fundamentals.

Question 8: Do you consider that the risk free rate, asset beta and debt premium should be aimed up? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

155. eir considers that it is an appropriate policy decision, consistent with ComReg's objectives, that various parameters of the WACC formula are aimed-up.

156. It is unclear to eir how ComReg has arrived at a preliminary policy view based on "the data available to it". The decision to aim-up is not based on data but rather on regulatory policy objectives to promote competition, infrastructure-investment, innovation and maximise consumer benefits.

157. In this context, aiming-up recognises that the implications of setting the WACC too low, through lower investment and innovation, outweigh the impact of the WACC being set too high.

158. Furthermore, Table 19 of the Consultation specifically provides the value the WACC needs to be adjusted by. This in monetary terms is equivalent to improperly excluding ~€✂ million of a reasonable return over a five year period.

159. The only reason provided by ComReg, see paragraph 8.11 of the Consultation, which in their view reduces the risk of the WACC being set to high or low is if the WACC is updated more frequently. While this is correct, ComReg has failed to consider the wider and greater impact of increased industry uncertainty which arises from the WACC being updated annually, as currently proposed in paragraph 8.4 of the Consultation.

160. Therefore, while the risk of setting a parameter too high or low is removed, an annual update of the WACC increases the regulatory uncertainty and unpredictability of available fair returns to all operators. In not recognising the fair bet (see paragraph 169), ComReg will certainly dampen investment and innovation decisions in the telecommunications market — which is the very risk ComReg should be trying to avoid and the reason why aiming-up was considered an appropriate policy decision in ComReg D15/14.

161. Furthermore, neither the EE 2019 Report nor the Consultation provides any guidance to interest parties as to why ComReg's policy objectives have changed. To the extent

that, ComReg in taking the utmost account of the European Commission's comments in implementing ComReg D15/14 stated that:

"The asymmetry in welfare loss associated with arising from over- versus underestimation of the WACC has also been highlighted in the academic literature. For example, Wright et al [2003] examine a simple 'one period' model in which the regulator makes an estimate of the WACC, imposes a price cap based on this, and the firm then uses the 'true WACC' (viewed as a random variable) in deciding on whether and how much to invest in capacity. There is a tendency in this type of model for the firm to choose not to invest at all if the realised WACC is greater than that set by the regulator. Thus, there tends to be a large welfare loss from setting a regulatory WACC that is too low, whilst the welfare losses arising from setting a regulatory WACC too high tends to be much smaller. Dobbs [2007] noted that markets like telecoms are likely to feature greater welfare loss asymmetries than in more mature/static industries such as water supply due to the fact in emergent/innovative markets, investment may have positive intertemporal spillover effects – in that investment now may promote greater innovation in future service provision, new product development, and in future technical innovation reducing future production costs".[118]

and further supported its view that *"…ComReg, in applying the principle of aiming-up, considers that in order to address its objectives it is more appropriate to err on the side of setting the costs of capital too high rather than too low".*[119]

162. As set out in paragraphs 168-171, eir considers that a WACC should be calculated/consulted on a per market basis, and published at the same time as the market analysis decision. While this ensures that the WACC is updated more frequently and therefore timely to the market in question, it does not address the risk of the WACC being set too low for the duration of the market analysis review period and further specification (if any) of the associate pricing remedies. Consequently, the WACC parameters should be aimed-up.

163. In ComReg D15/14, ComReg stated that *"Europe Economics has analysed the variance surrounding the relevant range of figures that have been used to inform its point estimates. The aiming up of key parameter point estimates is implemented on*

[118] ComReg, Cost of Capital, ComReg Document 14/136, ComReg D15/14.
[119] ibid.

this basis, essentially accommodating for variance that exists within the range" [emphasis added]. At that time, Europe Economics recommended the aiming up of the risk free rate, asset beta and debt premium. ComReg's regulatory policy in seeking "*to address its objectives it is more appropriate to err on the side of setting the costs of capital too high rather than too low*" should not have changed since 2014.

164. On this basis, as there is continued uncertainty surrounding the parameters of the risk free rate, asset beta and debt premium these should be aimed-up. In addition, as discussed in paragraphs 34-36, the future inflation rate is uncertain and therefore must be included in the relevant parameters that qualify in the assessment of aiming-up.

Question 9: Do you agree or disagree with ComReg's preliminary view that Option 3 is the most appropriate method to implement the revised WACC? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

165. eir agrees in part that Option 3 is the most appropriate method. eir agrees that the WACC should be updated more frequently. Specifically, see eir's response to Question 7, eir considers that a revised WACC should be implemented for a specific market as part of that associated market analysis review cycle. However, eir does not agree that it is appropriate to apply a revised WACC to pre-existing cost-oriented price controls when assessing compliance with cost-orientation.

166. *"[P]romoting regulatory predictability by ensuring a consistent regulatory approach over appropriate review periods"* is a central tenet of the regulatory framework and is likely critical in achieving ComReg's objective of "*promoting efficient investment and innovation in new and enhanced infrastructures*" (see Regulation 16 2 (a) and (d) of the Framework Regulations). Therefore, as noted by the European Commission in their Request for Further Information to ComReg,[120] it is unclear how ComReg could maintain such predictability, where existing pricing remedies are updated with a revised WACC.

167. The effect of assessing compliance with updated revised WACC is consistent with the approach outlined in Option 1 which ComReg has rejected (see paragraph 8.15 of the Consultation).

168. Furthermore, when price controls were set using specific assumptions including the WACC for the forthcoming price control period, it set appropriate build/buy signals for that price control period. The telecommunications market is highly capital intensive and is categorised by large sunk capital investments, whose deployment may span multiple price control periods. Consequently, there are sound economic and policy reasons for not reviewing existing price controls within price control periods.[121]

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[120] As part of EC notification, ComReg Decision D11/18, Case IE/2018/2115.

[121] Or changing pre-existing cost-oriented tariffs and/or price paths set by regulatory decisions prior to a revised WACC decision.

169. ComReg must respect the 'fair bet' assumptions relative to the investment risk as it presented itself to eir as well as to other operators when ComReg set cost-oriented tariffs or margin squeeze obligations. eir considers that in making such a proposal ComReg has failed to take account of Regulation 13 (2) of the Access Regulations, which requires ComReg to encourage investment in imposing pricing regulatory obligations. Failure to recognise industries' fair bet (in particular infrastructure-based investors) will retrospectively distort build/buy signals and will impact future investment cases.

170. The regulatory uncertainty created by ComReg's proposal to retrospectively apply the WACC to existing price-controls and/or the proposal to update the WACC annually will have a chilling effect on investment by eir and by other operators (considering or already investing in alternative infrastructures). Such outcomes are inconsistent with ComReg's objectives — as set out in Regulation 6(1) of the Access Regulations — in that ComReg's proposal fails to promote efficiency, competition, efficient investment and innovation, or to maximise benefit to end-users.

171. Consistent with eir's proposal in paragraph 153, assessment of cost-orientation obligations could be assessed against the high-low bands from the relevant WACC decision. However, regulatory consideration will also need to be given to the fact that price controls are multi-year and how those costs will evolve may change — including the future recovery of those costs impacted by related regulatory decisions. In addition, ComReg must give consideration to the impact legacy copper prices have on the migration incentives for end-users towards future technologies including FTTH (including the incentive for infrastructure-based investment in those future technologies).

Question 10: What principles do you think should be adopted, if any, for differentiating WACCs? What principles should be adopted, if any, to decide if project specific risks need to be taken into account? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

172. Any assessment by ComReg to determine an alternative project specific WACC must follow the consultation procedures referred to in Articles 6 and 7 of the Framework Directive. Therefore, ComReg's question, at this time, is more akin to a "Call For Input" and eir's high-level response is provided in this context. eir reserves its rights to expand and submit further views following such further ComReg consultation(s).

FTTC

173. The EC's 2010 NGA Recommendation[122] states that "*NRAs should estimate investment risk, inter alia, by taking into account the following factors of uncertainty: (i) uncertainty relating to retail and wholesale demand; (ii) uncertainty relating to the costs of deployment, civil engineering works and managerial execution; (iii) uncertainty relating to technological progress; (iv) uncertainty relating to market dynamics and the evolving competitive situation, such as the degree of infrastructure-based and/or cable competition; and (v) macroeconomic uncertainty.*"

174. It is unrealistic for ComReg to have decided in ComReg D11/18, and continue to do so in this Consultation (see paragraph 8.44), that a fibre-based infrastructure which is continuing to penetrate the market and where infrastructure competition is emerging — including from new FTTH investment, has an investment risk equivalent to that of legacy copper today or at the time the investment first took place. Any such suggestion completely misreads the investment framework set out in the EC's 2010 NGA Recommendation (in particular section 6)[123], which is clear about the need for a risk premium. The Brattle Report states that "*we would expect to see higher asset betas for NGA networks relative to legacy networks…we would expect lower asset*

[122] http://ec.europa.eu/smart-regulation/impact/ia_carried_out/docs/ia_2013/c_2013_5761_en.pdf
[123] ibid.

betas for FTTC – which involves only investment up to and within the cabinet – relative to an FTTH network".[124]

175. ComReg's response to the Request for Information ('RFI') from the European Commission on why a WACC premium was not considered appropriate for FTTC did not address all the conditions identified in the 2010 NGA Recommendation[125]. It is these omissions which must now be addressed and rectified by ComReg.

2010 NGA Recommendation	ComReg RFI response	eir' comment
(i) uncertainty relating to retail and wholesale demand;	*"As pricing and quality of service is similar to FTTC it is easier to make predictions on EVDSL penetration rates, while the use and cost of copper lines can be estimated with a reasonable level of certainty."*	These are modelling parameters. These are considered in ComReg D11/18.
(ii) uncertainty relating to the costs of deployment, civil engineering works and managerial execution	*"ComReg's view it is recognised that there is a reduced investment risk for FTTC deployment. FTTC services can reutilise the D-Side copper network and the deployment of Eircom's FTTC network has been underway since 2013."*	These are modelling parameters. These are considered in ComReg D11/18. However, as a result of changing the underlying national cost recovery of WLR as set out in ComReg D03/16 and the lower recovery of those network access costs through ComReg D11/18 there is now a stranding of eir's network access costs

[124] The Brattle Report.
[125] Request for Information, 18 September 2018, Case IE//2018/2115.

2010 NGA Recommendation	ComReg RFI response	eir' comment
(iii) uncertainty relating to technological progress	*"At this stage the majority of the associated investment in FTTC infrastructure such as cabinets, DSLAMs and E-Side fibre, has taken place and a significant uptake of these services has already been achieved. Similarly, EVDSL reutilises the copper loop thereby limiting the level of new investment required."*	These are modelling parameters. These are considered in ComReg D11/18.
(iv) uncertainty relating to market dynamics and the evolving competitive situation, such as the degree of infrastructure-based and/or cable competition		This, in part, has been considered in the market analysis decision. However, ComReg failed to consider whether a WACC premium was appropriate relative to the investment decisions as they presented themselves to eir (in 2013) and the uncertainty of outcomes at the time of investment — including the potential short time horizon before over-build from FTTH.
v) macroeconomic uncertainty		Not considered or revisited by ComReg

176. Furthermore, the impact of FTTC pricing as an anchor product for FTTH prices (which was raised by a number of operators including eir during the consultation process) is clearly not addressed in ComReg D11/18. To state that FTTH and FTTC prices are set independently due to different price controls is misrepresenting the economic and regulatory issue. The issue is that, irrespective of the price control for FTTH, once FTTC prices are set (in this case by regulation) it immediately caps any FTTH returns relative to any premium available above those FTTC prices. Put simply, pricing flexibility for FTTH is directly limited by the "premium" consumers are willing to pay for an FTTC product and an FTTH product at better speeds. Therefore, while they have independent regulatory controls, as an anchor product FTTC directly influences FTTH pricing. ComReg is not proposing to revisit the WACC for FTTC in this Consultation. Which eir agrees is correct (see eir's response to Question 7 and Question 9). However, the risk of downward pressure on FTTH prices due to ComReg setting low FTTC prices remains. This uncertainty over FTTH prices could have direct implications for the business case assumptions and subsidy levels sought for the state-aid NBP roll-out intervention. This is also particularly relevant should ComReg (incorrectly) decide that eir's cost-orientation obligations are assessed relative to a revised WACC on an annual basis.

177. Consistent with eir's views regarding the timing of revised WACC calculations (see eir's response to Question 7, Question 9 and Question 13) the relevant WACC for prices set pursuant to D10/18 should not be revisited until such time as the market analysis is revised by ComReg.

FTTH

178. In the context of FTTH, the 2013 EC Recommendation states that *"…pricing flexibility at wholesale level is necessary to allow both the access seeker and the SMP operator's retail business to introduce price differentiation on the retail broadband market in order to better address consumer preferences and foster penetration of very high-speed broadband services".*[126] Consequently, it is premature to seek views even at a principle level on this matter.

179. If a wholesale pricing remedy continues to be warranted following future market reviews, the FTTH wholesale pricing remedy (subject to SMP) should continue to be regulated by an appropriate margin squeeze test for the foreseeable future. Allowing eir pricing flexibility to undertake a pricing differentiation strategy will better meet ComReg's regulatory objectives, as it:

i. preserves the investment incentives faced by competitors to eir. In particular, it ensures that the appropriate "build or buy" signals are maintained.

ii. preserves the long-term network investment incentives faced by eir, by allowing eir the pricing flexibility to manage its own commercial risk and fair bet return.

iii. recognises that there is already countervailing buying power in the retail market (which is the litmus test as to how much consumers are willing to pay for different profile speeds) and in the wholesale market by Siro as an alternative FTTH network provider.

iv. maximises benefits to end-users, by not distorting investment decisions. The market will be allowed to be demand-led and should result in better innovation and lower consumer prices as pricing elasticities evolve as the market matures.

v. is consistent with the 2013 EC Recommendation.

180. While eir is the predominant investor in FTTH technologies in Ireland, there are a number of operators proposing to roll-out smaller footprints. In this regard, it is interesting to note that e-net's previous owners, the Irish Infrastructure Fund, were targeting returns of 15-20%.[127] Virgin Media's, Project Lightning, for their UK & Ireland

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[126] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32010H0572&from=EN; recital (49).
[127] https://bizplus.ie/infrastructure-fund-lands-convention-centre-dublin/

cable expansion, is targeting IRRs of 25-30%.[128] Siro's co-investor, Vodafone, have also separately stated that *"Fibre builds will bring incremental growth and attractive returns, given our disciplined investment criteria: - IRR materially above WACC"*.[129]

181. Similarly, eir notes that a number of NRAs have also notified a range of FTTH WACC premia. ComReg should inform their approach with appropriate comparisons and peer groups. In particular, ComReg must recognise industries "fair bet" when considering the appropriate principles.[130]

Civil Engineering Infrastructure ('CEI')

182. While certain CEI assets owned by eir may be used for the National Broadband Plan ('NBP'), eir does not consider that a revised separate WACC is appropriate.

183. In any future consultation, eir considers that ComReg should consider the following principles:

    a. commercial risk of the NBP project;

    b. alternative infrastructure available within the NBP intervention area;

    c. CEI infrastructure has long-term payback period;

    d. lack of comparators;

    e. commercial agreements and regulatory predictability;

    f. cost allocation methodologies already share the benefits with Irish consumers; and

    g. company specific factors.

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[128] https://www.libertyglobal.com/pdf/presentations/Liberty-Global-Q4-2017-Earnings-Presentation.pdf

[129] https://www.vodafone.com/content/dam/vodafone/investors/conference_presentations/2017-09-19-Vodafone-Fixed-Convergence-Open-Office-Presentation.pdf

[130] ✂

Commercial risk of the NBP project

184. eir understands that the successful company chosen by the Irish Government will be awarded the NBP contract for a duration of at least 25 years.

185. Over that period operational risk lies with the awarded company. For example, in the event that the roll-out costs are higher than anticipated those additional costs are financed by the awarded company. Likewise, if the take-up rates (from lack of demand or competing current and future technologies such as fixed wireless access and 5G) are lower than expected that risk is borne by the awarded company. Any upside in estimate returns is to be clawed back in part by the Irish Government.

186. Given the asymmetric risk and that a number of future challenging technologies that may present over the term of the contract, there is a real risk that any awarded company may be unsuccessful. In those circumstances, eir understands that the current government policy is that the Irish State would step-into the contract and complete the project. However, as governments and government policies change there is no guarantee to suppliers such as eir that the NBP contract will succeed or continue over 25 years. This should inform, in part, whether the systematic risk for eir's CEI is different — noting in particular that the pay-back period of CEI investments.

187. In other words, it is only if there is a provision in the NBP contract which **guarantees** that the CEI of eir will be used (or at least paid for over the full 25 year contract) then it may suggest that the systematic risk faced by the project was significantly different from that faced by eir in its overall business.

188. However, even in circumstances where demand/payment is guaranteed for 25 years, as time elapses and the remaining length of the NBP contract (if awarded) is lower than the remaining asset lives (i.e., the recovery timeframe) the riskier new investments (or replacement of existing assets) by eir in CEI will become over time.

189. Conversely, even in the context of a 25 year contract, if there is a termination clause provision in the NBP contract, this will directly impact the beta or riskiness of the project for eir (see paragraphs 194-197).

Alternative infrastructure available within the NBP intervention area

190. eir is not the only supplier of network infrastructure within the NBP intervention area and the awarded company for the NBP may engage in negotiations with the ESB, eNet and other infrastructure owners in the area. In addition, the awarded company may make significant investments to erect its own poles and dig its own ducts within the intervention area.

191. The awarded company is free at any stage to stop using eir infrastructure and instead use alternative infrastructure from other providers or build its own. Similarly, the awarded company could change the technology from a fibre solution to a future wireless solution provided that it achieves the same level of service as fibre. It is therefore quite possible that even if the awarded company makes a success of the NBP, eir would not see a 25-year return on its infrastructure as some or the entire network is migrated from eir to another provider.

192. eir currently generates revenue from a diverse base of more than 40 wholesale customers using its copper network in the NBP intervention area which ultimately contributes to the maintenance of that pole and duct network. This customer base will fall to a single wholesale customer (i.e., the NBP awarded company) for infrastructure access within the NBP intervention area after the retirement of the copper network. Therefore, the commercial risk to eir will increase significantly after the NBP rolls out, as that single customer could move some or all of its business away from our network at any stage. The loss of a single customer in the intervention area today would be manageable; however, the future loss of eir's only customer would be an existential threat to that part of the network in the future. This would suggest a higher WACC within this region after the roll-out of the NBP may be appropriate.

CEI has long-term payback periods

193. While the underlying assets used in NBP are unlikely to play any significant part in the risk associated with variations in a project's cash inflows to eir, the upfront capital outlay by eir and the long payback period for CEI is significant and a relevant factor.

194. This means that eir's ability to recover its efficiently incurred costs is **tied** to the success or continued payment for those assets by a third party or the Irish Government. Any break or termination clause in the NBP contract increases eir's exposure to the tied success and/or continuation of the NBP programme.

195. The alternative use of CEI in NBP intervention areas is low. With high fixed costs and given that eir's investment to facilitate the NBP may not be fully diversifiable means that eir's risk over the foreseeable future (see paragraph 185) will increase. This will directly influence the project's beta. This cannot be ignored.

196. Absent state-intervention the accelerated capital investment programme required by eir would not occur. In other words, the investment programme would divert to business as usual which is dictated by *inter alia* health & safety and separate quality performance targets set by ComReg.

197. This means that in the context of CEI investment in NBP intervention areas — absent a guarantee of demand and revenues for that infrastructure — there are alternative investment options — including in the telecommunications market — which would attract a higher capital return. For example, eir could alternatively invest in regulated wholesale products which currently generate a WACC of 8.18%.

Lack of comparators

198. In the absence of pure play civil engineering comparators in the telecommunications sector (i.e., companies that only offer CEI for telecommunication services); a beta for eir's CEI wholesale offering could not be estimated with any reliability.

199. Given the capital intensive nature of CEI and their pay-back period the materiality of any incorrect determination of the asset beta used is significant.

Commercial agreements and regulatory predictability

200. If there is any prospect of commercial agreement outside of the regulated prices, it is important that regulation does not harm such prospects.

201. Absent regulatory predictability, it is unclear how any commercial agreement outside of regulatory prices (as appropriate) could be reached if ComReg creates uncertainty regarding the relevant WACC.

202. Any revision to the WACC would penalise commercially negotiated positions — which may not be consistent with State Aid rules or the spirit of ComReg 18/51.

Cost methodologies share the benefit with consumers

203. Existing costing allocation methodologies ensures that, where demand is realised for CEI, the revenues generated from the provision of those wholesale services directly reduces the allocation of cost for other wholesale services which shares that infrastructure. For example, as WLR and broadband services share some of this infrastructure the regulated price may reduce (all other things being equal). This may ultimately benefit customers through lower line rental and broadband charges.

204. As such, the benefit of CEI projects to the wider telecommunications market is embedded in the allocation of costs between the various wholesale services that share that infrastructure.

Company specific factors

205. If ComReg consider project specific risks then it must also consider company specific financing — by adjusting the WACC for the cost of equity and cost of debt. In this sense, project specific factors, in particular with CEI investment in NBP areas is lifting the veil of the hypothetically efficient operator and consequently ComReg must specifically consider the funding structure of eir.

206. For the revised WACC to be appropriate it needs to be appropriately adjusted to take into account, inter alia, the additional premium investors' demand for investing in private companies (referred to as the "illiquidity premium").

207. The illiquidity premium of investing in private companies is not theoretical as investments in private companies not listed on a stock exchange are usually harder

to divest from. This issue has been highlighted by the suspension of the largest fund held by Woodford Investment Management.[131]

208. Willis Towers Watson reports that the illiquidity premium could be as high as 150-250 basis points.[132]

[131] https://www.reuters.com/article/us-woodfordinv-suspension/explainer-how-the-door-slammed-shut-at-british-money-manager-woodfords-fund-idUSKCN1TB202

[132] Willis Towers Watson, "*Understanding and measuring the illiquidity risk premium*", March 2016.

Question 11: Are there any aspects that respondents consider important and that have not been covered under the previous questions? Please explain the reasons for your answer, clearly indicating the relevant paragraph numbers to which your comments refer, along with evidence and argumentation supporting your views.

209. Regulation 16 (2) (a) of the Framework Regulations provides that ComReg, in pursuit of its objectives shall apply good regulatory principles by, amongst other things, *"__promoting regulatory predictability__ by ensuring a consistent regulatory approach over appropriate review periods"*

210. In order to provide a stable economic environment for regulated companies the German Regulator (BNetzA) uses a combination of a point estimate (by calculating the relevant beta for the sector using 5 year daily data) and exponential smoothing.

211. The exponential smoothing effect alleviates the impact of financial shocks that may be present in historical data. This is particularly relevant where the regulated WACC is updated frequently and where the regulator wants to provide a consistent investment build/buy signal between regulatory review periods.

212. The exponential smoothing formula used by BNetzA is:

The revised WACC to be used in the next regulatory period = 0.3 * real WACC point estimate for the next period + 0.7*real WACC currently used

213. ComReg should consider the merits of this approach and the potential benefits of this methodology.

Question 12: Do you believe that the draft text of the proposed decision instrument for Mobile Telecommunications is from a legal, technical and practical perspective, sufficiently detailed, clear and precise with regards to the specifics proposed? Please explain your response and provide details of any specific amendments you believe are required.

214. eir has no specific comments.

Question 13: Do you believe that the draft text of the proposed decision instrument for Fixed Line Telecommunications is from a legal, technical and practical perspective, sufficiently detailed, clear and precise with regards to the specifics proposed? Please explain your response and provide details of any specific amendments you believe are required.

215. As a general observation, eir considers that separate applicable WACC decisions should be made as part of each market analysis decision (see eir's response to Question 7 and Question 9). The decision instrument is currently not drafted in this context and requires revision.

216. As set out in Annex 5 of the Consultation, the legal basis for the proposed decision instrument is stated to be Regulations 8 and 13 of the Access Regulation, and in particular Regulations 13(1) and (2). This is further confirmed in Section 1.2 of the draft decision instrument itself. However, eir considers that the relevant provisions do not entitle ComReg to impose a revised WACC on eir in isolation and without carrying out a market analysis decision. In particular, Regulation 13(1) of the Access Regulations provides that

"The Regulator may in accordance with Regulation 8 impose on an operator obligations relating to cost recovery and price controls….in situations where a market analysis indicates that a lack of effective competition means that the operator concerned may sustain prices at an excessively high level or may apply a price squeeze to the detriment of end-users."

217. In the Consultation, paragraph 2.3, ComReg makes it clear that it considers the imposition of a WACC as being *"a component of a 'cost oriented' price control"* and *"central to any price-setting process (as it is an input in determining the prices a regulated undertaking is allowed to charge)"*. Imposing a revised WACC is therefore an "obligation relating to…price controls". However, Regulation 13(1) is clear that such an obligation may only be imposed by a Regulator *"in situations where a market analysis indicates"* a lack of effective competition impacting prices. In other words, in order for the Regulator to comply with this requirement of Regulation 13, it is necessary for a market analysis to be carried out in parallel. eir does not consider that the fact that a market analysis may have been carried out in the market to be affected some years prior to the proposed WACC change is sufficient to meet this requirement. The language of Regulation 13(1) is in the present tense, indicating that the analysis must be of the market as it stands at the time of the proposed price control not as it was some years before. In that regard it should be noted that Regulation 13 is the only SMP related Regulation (as compared to regulations 9-12) which explicitly restricts the Regulator's entitlement to impose an obligation only to *"situations where a market analysis"* supports it. This further supports eir's contention that a WACC decision may only be made as part of a market analysis decision.

Definitions

218. The decision instrument lists Market 4 "Wholesale high-quality access provided at a fixed location" under the 2014 Recommendation heading. ComReg has not made any decision for this market under the 2014 Recommendation.

219. In fact, infringement proceedings commenced against Ireland, by the European Commission, for failure by ComReg to achieve the market analysis timelines for a number of markets including Market 4 (which should have been reviewed over 7 years ago).

220. Accordingly, the applicable leased line decision D06/08 should be listed under the 2007 Recommendation.

Section 4 WACC

221. Section 4.2 states that *"Eircom shall apply, in the on-going assessment of its compliance with cost recovery and price control obligations (including regulated wholesale prices) imposed prior to the Effective Date, the revised nominal pre-tax WACC rate of X% as set out in Section 4.1 of this Decision Instrument"*. However, this is ultra-vires to ComReg's powers. The Framework Directive is clear that in order for a revised WACC to be effective — for those price controls imposed prior to the effective date of a WACC decision —those price controls must first be fully re-consulted on.[133]

222. A number of pre-existing pricing decisions, which have been notified to the European Commission, such as D03/16, specifically impose the WACC per decision D15/14 (i.e., 8.18%). In other cases, such as D02/12, those price controls have not been revisited since the effective date of D15/14 — meaning pursuant to D15/14 the WACC pursuant to D01/08 remains in effect. While its language is not clear, Section 4.2 of the Consultation appears therefore to be intended to amend the WACC in these Decisions, as they apply to eir.

223. eir considers that ComReg has not established any proper legal basis for such a proposal, and that it gives rise to a number of serious legal concerns including:

   a. failure to consult on the proposed amendments;

   b. the apparent adoption by ComReg of an approach it has itself identified in this Consultation as legally problematic;

   c. discrimination between eir and other operators;

   d. failure to address eir's legitimate expectation that ComReg would continue to apply the pre-existing WACC during the price control period; and

   e. a significant lack of transparency and clarity as to the operation of the provision in practice, with potential retrospective effect.

[133] With the exception of those price controls which are based on aged-market analysis data. In those circumstances, an updated market analysis must first be completed to ensure that remedies remain appropriate and justified.

Failure to consult on the proposed changes to existing price controls

224. The Framework Directive is clear that in order for a revised WACC to be effective — for those price controls imposed prior to the effective date of a WACC decision — those price controls must first be fully re-consulted on. The consultation procedures referred to in Articles 6 and 7 of the Framework Directive must be followed by ComReg regardless of whether any revised rate (if any) results from a methodological change or simply an update of the data used in the calculation.

225. Further obligations to consult are set out in Regulation 12 of the Framework Regulations and more specifically in Regulation 8 (6)(c) of the Access Regulations which stipulates that *"Any obligations imposed in accordance with this Regulation shall…(c) only be imposed following consultation"*. However, neither the draft Decision Instrument nor the Consultation identify the relevant provisions of the existing price control Decision Instruments that ComReg is proposing to amend with Section 4.2, nor does it enter into any form of consultation as to whether an amendment to those Decisions by means of a change in the applicable WACC, is appropriate and proportionate, and complies with all of ComReg's other statutory obligations when amending Decisions.

226. Most significantly there is no assessment as to how this proposed change interacts with all of the other elements of these Decisions. This is highly problematic, as ComReg itself has recognised that a WACC is solely one component of these price controls. It is not applied in isolation, but rather is operated together with a number of other criteria in order to arrive at a price control. When these Decisions were consulted upon, it was on the basis that the applicable WACC for the duration of the Decision would be that prevailing at the time of the consultation and Decision. This influenced how eir responded to all aspects of the consultation and Decision, and whether or not it accepted or appealed that decision. For ComReg to now treat the WACC in those Decisions as an entirely standalone item that can be substituted with a new, significantly different figure without having any effect on the other elements of the Decision or the Decision overall is to act entirely contrary to how these Decisions were arrived at.

227. eir considers that any change to the WACC in these Decisions must be assessed in tandem with all the other parameters that went into the making of that Decision. Indeed this is recognised by ComReg in paragraph 8.15 of the Consultation, where it

specifically rejects applying the WACC to change existing tariffs, noting that *"this method may not be appropriate as arguably other parameter changes should be considered in tandem"*. However, as recognised in eir's response to Question 7 and Question 9, there are sound economic reasons for not revisiting existing price controls.

Application of an approach rejected by ComReg

228. The wording of Section 4.2 appears to envisage eir applying the revised WACC in calculating cost-oriented prices originally set by Decisions made prior to this Consultation. This would appear to be mandating an implementation in practice by eir of an approach rejected by ComReg in Option 1 (paragraph 8.15 of the Consultation), namely "*apply the revised WACC with immediate effect to all cost oriented prices*". However, in assessing Option 1, ComReg concluded that it should not be adopted as it "*may not be appropriate*". ComReg gives no explanation whether or how it considers the approach in Section 4.2 differs from that rejected by it in Option 1 as inappropriate.

Discrimination between eir and other operators

229. It should be noted that Section 4.2 of the Decision Instrument for the fixed line market is the only provision that requires an operator to implement the revised WACC in respect of existing price control obligations.

230. In the same Decision Instrument, Section 4.4. specifically provides that existing Decisions calculated using a previous WACC are not affected, stating "*Any obligations imposed on the Other SMP Fixed Service Providers relating to cost recovery and price controls (including regulated wholesale prices) imposed prior to the Effective Date and calculated using a previous WACC set by ComReg shall not be affected by this decision and shall continue to have full force and effect*". Identical wording is included in draft Decision Instrument for the Mobile Market. However, no such wording is included in respect of the provisions applicable to eir. This reinforces eir's concern that this provision is intended to alter eir's obligations under existing Decisions. However, the Consultation is silent as to why eir is being singled out in this manner; there is no explanation or assessment as to how or why this is being done, and no consultation on the issue. On its face, this appears to clearly constitute discrimination between eir and other operators, contrary to ComReg's legal obligations under the Communications Act 2002, the Framework and

the Access Regulations to carry out its functions in a non-discriminatory, proportionate and transparent manner, as well as to properly consult.

Legitimate expectation

231. eir further submits that it had a legitimate expectation that the WACC applicable to the various Decisions implementing price controls would not be changed until there was a full market analysis. This has been the practice to date. For example, as noted in paragraph 222, the WACC applicable to D02/12 is the WACC set pursuant to D01/08, not the more recent D15/14 because those price controls have not been revisited since D15/14 came into effect. Similarly, the WACC applicable to D03/16 is set pursuant to ComReg D15/14. This practice, taken together with the wording of Regulation 13 noted above, meant that eir had, and has a legitimate expectation that the price controls when set down by Decisions, will not subsequently be varied by means of a change in the WACC carried out in isolation. eir has relied on this practice by ComReg in making significant investment decisions and ComReg cannot now resile from this approach. As noted in paragraph 139, ComReg's proposed WACC will have the effect of extracting approximately €✂ million in investment capital over a five year price control period.

Lack of transparency and potential retrospective effect

232. ComReg is required, in regulating operators to do so in a transparent manner, such that it is possible for the operator to clearly know the law applied to them. However, there is a serious lack of clarity as to how the proposed section 4.2 is to operate.

233. In the first instance, as noted above, it does not clearly specify which particular Decisions and obligations of eir are now amended. Further the section does not specify the date from which, or the time periods during which, it should apply. In addition to creating a lack of clarity, this also means that it may potentially apply with retrospective effect. For example, eir's financial year runs from 1 July 2019 to 30 June 2020. The proposed Decision Instrument does not make clear whether the revised WACC is to be applied in any calculations being made by eir that run across the present financial year; in other words, with retrospective effect. ComReg will be aware that as a matter of administrative law there are restrictions on the extent to which it is possible to legislate with retrospective effect and that if a retrospective effect is intended, any such legislation must be explicit as to its operation.

Other considerations

234. Regulatory consistency is critical for providing certainty to market participants in the context of investment decisions whose pay-back period may be in excess of the current three year market review periods. ComReg has failed to consider what impact such a sudden change to the assessment of cost-orientation obligations would have on future investment in the Irish market. These changes will clearly have material impacts on stakeholders. Yet, ComReg does not include a Regulatory Impact Assessment ('RIA') in the document. A RIA might be expected to cover areas such as:

    i. Investment incentives;

    ii. Competitive effects;

    iii. Regulatory uncertainty; and

    iv. Effects on particular stakeholders.

235. This omission is clearly very serious, in that there is no indication that ComReg considered any or all the available alternative options, or what criteria they adopted in choosing their preferred options.

236. More specifically, eir considers that, for the reasons set out in paragraphs 166-171, Section 4.2 is not appropriate. Consequently, eir considers that Section 4.2 must be deleted.

Question 14: Do you believe that the draft text of the proposed decision instrument for Broadcasting - Market A is from a legal, technical and practical perspective, sufficiently detailed, clear and precise with regards to the specifics proposed? Please explain your response and provide details of any specific amendments you believe are required.

237. Not applicable to eir.

Question 15: Do you believe that the draft text of the proposed decision instrument for Broadcasting – Market B is from a legal, technical and practical perspective, sufficiently detailed, clear and precise with regards to the specifics proposed? Please explain your response and provide details of any specific amendments you believe are required.

238. Not applicable to eir.

REVIEW OF WEIGHTED AVERAGE COST OF CAPITAL

NBI'S RESPONSE TO COMREG CONSULTATION DOCUMENT NO. 19/54

AUGUST 2019

NON-CONFIDENTIAL VERSION FOR PUBLICATION

INTRODUCTION

National Broadband Ireland Infrastructure Limited ("NBI") welcomes the opportunity to respond to ComReg's Consultation Document No. 19/54 on the Weighted Average Cost of Capital ("WACC") in regulated mobile telecommunications, fixed telecommunications and broadcasting markets.

NBI has been appointed by the Department of Communications, Climate Action & Environment ("DCCAE") as the Preferred Bidder under the National Broadband Plan ("NBP"). NBI is an Authorised Undertaking in the Irish communications market and its NBP deployment plan provides for access at scale to Civil Engineering Infrastructure ("CEI") under the control of Open Eir ("OE"), the operator designated with Significant Market Power ("SMP") within the Wholesale Local Access ("WLA") market.

As such, NBI expects to be a significant user in the years ahead of regulated access products under OE's control. In particular, NBI plans to make extensive use of OE's duct and pole infrastructure and it is also seeking to avail of co-location services from OE to support its use of CEI under OE's control. NBI has for some time, as part of the ongoing NBP procurement process, been involved with bilateral discussions with OE on the terms for such access at scale to support the deployment of its NBP network.

Pricing of the regulated access products is obviously a key issue of concern to NBI, as the cost of such access is an important determinant in the overall cost of the NBP network deployment. The level at which OE's WACC is set is, in turn, a major input factor in the setting the overall level of pricing for OE's regulated services.

NBI's response to ComReg's Consultation Document focuses mainly on the issue ComReg has raised in Section 8 of the Document, where other points relating to the WACC are discussed, notably the question of whether or not there should be differentiated WACCs within the fixed line sector. In particular, NBI notes the suggestion put forward by ComReg in its Consultation Document that a different WACC might apply for the pricing of access to CEI services in the context of the NBP.

In this response, we set out a number of principles that ComReg might wish to bear in mind when considering the possibility of a different WACC for CEI services used to deliver the deployment of the NBP network.

The bulk of this consultation response is devoted to the above issue. For the sake of completeness, however, NBI also provides its comments, to the extent that it has any, in relation to all of the other specific questions posed by ComReg in its Consultation Document.

[✂]

RESPONSES TO CONSULTATION QUESTIONS

Q. 1	*Do you agree or disagree with the continued use of equilibrium concept for the estimation of the WACC? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.*

NBI agrees with ComReg's preliminary conclusion that it should continue to use the equilibrium concept in the estimation of the WACC. As ComReg notes (Para. 3.15 of the Consultation Document), the different estimates yielded by the equilibrium concept compared to the alternative observed asset approach are marginal. As a result, it makes sense for ComReg to continue with the method it has used to date.

Q. 2	*Where a company's effective tax rate is significantly different to the statutory tax rate should the WACC be estimated using the statutory corporation tax rate or the company's effective corporation tax rate? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.*

NBI takes the view that the WACC should be estimated using the statutory corporation tax rate rather than the company's effective tax rate. While the use of the latter may, in Eircom's case at the present time, indicate that a lower WACC might be set than would be the case where the statutory corporation tax rate is used, NBI takes the point made by ComReg (at Para. 4.29) that the WACC is being calculated on the basis of a hypothetical efficient operator employing an efficient capital structure.

Given the desirability for long-term stability in relation to the allowable WACC for an SMP operator it would appear to make most sense to continue setting the WACC on the basis of a hypothetical efficient operator. While ComReg notes (Para. 4.30) that the drawback of this approach is that an operator may be compensated via a higher WACC for tax charges that do not arise, shifting to an approach based on a company's effective tax rate would in all likelihood inject too much fluctuation into the WACC calculation at each review and could, in an extreme situation, lead to calls for the WACC to be reviewed purely to deal with significant shifts in the effective tax rate faced by the company in question. On balance, it would appear better to continue to estimate the WACC using the statutory corporation tax rate.

Q. 3	*Do you agree with ComReg's proposed approach to estimating the generic parameters for the respective WACCs and the preliminary point estimates chosen? Please explain the reasons for your answer, clearly indicating the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.*

NBI generally agrees with ComReg's proposed approach to estimating the generic parameters and the preliminary point estimates it has chosen except where a revised parameter appropriate to a specialised CEI operator would be more appropriate.

However, recent events, such as the publication on 8 August 2019 by the Central Statistics Office of the July Consumer Price Index ("CPI") figures for Ireland[1], showing annualised CPI in the year to July of 0.5%, and the proliferation of negative bond yields across the Euro area[2], even for bonds with long maturity dates, suggest the expected inflation figure of 1.3% assumed by ComReg could be over-estimated.

Q. 4	*Do you agree with ComReg's proposed approach to estimating the WACC specific to the mobile telecommunications sector? Please explain the reasons for your answer, in particular your views on the specific parameters used. Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.*

NBI has no comments to offer on the estimation of the WACC specific to the mobile telecommunications sector.

Q. 5	*Do you agree with ComReg's proposed approach to estimating the WACC specific to the fixed line telecommunications sector? Please explain the reasons for your answer, in particular your views on the specific parameters used. Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant evidence and argumentation supporting your views.*

NBI agrees with ComReg's proposed approach to estimating the WACC specific to the fixed line communications sector. That said, NBI notes the suggestion put forward in the Consultation Document (Paras. 8.34 to 8.51) that differentiated WACCs might be set within the fixed telecommunications sector and that, as part of such a move, a separate WACC may be put in place for assets relating to CEI owned by Eircom which NBI intends to use in its deployment of the NBP network.

NBI has provided its response to this proposal in the comments set out in relation to Q10 below. In summary, NBI believes that, were a separate WACC to be considered for CEI assets utilised by NBI in the context of its NBP network deployment, then a number of the parameters used to calculate the fixed line WACC would need to be re-assessed for both the

[1] See CSO website: https://www.cso.ie/en/releasesandpublications/er/cpi/consumerpriceindexjuly2019/

[2] See European Central Bank analysis of Euro area yield curves at: https://www.ecb.europa.eu/stats/financial_markets_and_interest_rates/euro_area_yield_curves/html/index.en.html

CEI-specific WACC and for the remaining activities of an efficient fixed line operator. These could include gearing (which might be higher for CEI than for the fixed line sector as a whole), the cost of debt (which would be likely to be significantly lower for CEI) and the cost of equity (where the Beta and the ERP could well be very different for CEI assets compared to the fixed line sector as a whole, as the CEI operator, with a single Government-backed customer, would face far less risk than the fixed telecommunications sector in general).

More generally, NBI is of the view that, on a forward-looking basis, the justification for considering a differentiated WACC for CEI assets will become stronger. This is because with the shift to fibre and the consequent reduction in most OAO usage of services such as local loop unbundling ('LLU') and line-share in favour of VUA and Bitstream, the vast bulk of CEI usage by Access Seekers will be NBI's use of Eircom's ducts and poles for its NBP network.

Given that ComReg is setting the WACC on a forward-looking basis, it is only right that it should take account of this likely future development within the market and, hence, what the appropriate WACC should be for CEI assets used for NBP in light of this.

One can think of a division of OE that is a CEI operator, or perhaps a subset of such a division that provides infrastructure only to NBP. In either case, the operator faces a very different risk profile than telecoms in general or fixed line telecoms in particular. The type and volume of products purchased by a CEI user depends on the required coverage. For NBP in particular, the customer (i.e. NBI) will be required by Government contract to have coverage to all premises in the Intervention Area ("IA"), and will have committed to do this primarily with FTTH.

The volume and nature of usage by NBI of Eir's CEI will be independent of end-user take-up, average throughput, peak speed (e.g. upgrades to NG-PON2 or subsequent standards), emergence of competitive broadband offerings from mobile, satellite or other technologies. All such risks are borne mostly by NBI (although partly shared by Government). There is no uncertainty of the scale or scope of the demand on OE, merely some limited risk about the timing of the initial fibre installation. So the CEI division serving NBI would face much less uncertainty or risk than even the CEI division serving Eir's own infrastructure needs.

Q. 6	*Do you agree with ComReg's proposed approach to estimating the WACC specific to Market A and Market B in the broadcasting sector? Please explain the reasons for your answer, in particular your views on the specific parameters used. Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.*

NBI has no comments to offer on the estimation of the WACC specific to the broadcasting sector.

Q. 7	*Do you agree or disagree with ComReg's preliminary view that WACC parameters could be updated more frequently and consulted on separately (as part of a pricing consultation) as opposed to conducting a full WACC methodology review and consultation? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.*

NBI takes the view that it is important to promote stability as an objective in setting the WACC for the various regulated sectors, including, as appropriate, the setting of differentiated WACCs within the fixed line sector. To that extent, NBI agrees with ComReg's preliminary view (Para. 8.4 of the Consultation Document) that WACC estimations should be based on the methodologies outlined in the Consultation Document, which should remain in force until a new methodology is put in place.

The period between WACC reviews is an issue and, as ComReg illustrates in Figure 1 of the Consultation Document, the indicative fixed line WACC has declined significantly – some 1.25% - since the last full WACC review was completed in 2014.

ComReg's proposal for dealing with this problem is by way of updating the WACC parameters more frequently, which could then be consulted on as part of a pricing consultation. Such an approach makes intuitive sense, though it is unlikely, given the time taken to complete pricing reviews generally, that such an updating exercise could be completed annually, as ComReg suggested.

A biennial review might work better in this context, as it would ensure greater stability in the prevailing WACC – which would be important in terms of promoting the correct investment incentives for the SMP operator – as well as dovetailing more neatly with ComReg's own timing for the conducting of pricing reviews for regulated services.

It is also important that ComReg's Decision Instrument on the WACC review is drafted in such a way that it allows for the updating of the WACC parameters in the manner envisaged by ComReg.

Q. 8 Do you consider that the risk free rate, asset beta and debt premium should be aimed up? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

NBI agrees with ComReg's preliminary conclusion that the risk free rate, asset beta and debt premium should not be aimed up in setting the revised WACCs for the fixed, mobile and broadcasting sectors.

Q. 9 Do you agree or disagree with ComReg's preliminary view that Option 3 is the most appropriate method to implement the revised WACC? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

NBI agrees with ComReg's preliminary conclusion (Consultation Document Paras. 8.18 to 8.20) that Option 3 is the most appropriate method to implement the revised WACC. As ComReg notes, such an approach aligns with ComReg's desire – one NBI agrees with – for more frequent WACC reviews to be undertaken.

As noted above in response to Q7, it is also important that ComReg's Decision Instrument on the WACC review is drafted in such a way that it allows for the updating of the WACC parameters in the manner envisaged by ComReg if it decides to proceed with Option 3.

Q. 10 What principles do you think should be adopted, if any, for differentiating WACCs? What principles should be adopted, if any, to decide if project specific risks need to be taken into account? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

In Paras. 8.34 to 8.51 of the Consultation Document, ComReg discusses the possibility of putting in place differentiated WACCs in the fixed line sector, specifically in relation to Fibre to the Home ("FTTH"), Fibre to the Cabinet ("FTTC") and CEI assets associated with the deployment of the NBP. NBI has a particular interest in the latter possibility.

NBI notes ComReg's position (Para. 8.48) that it has not yet come to any definitive conclusion as to whether or not a differentiated WACC for CEI assets in the context of the NBP is warranted. NBI welcomes ComReg's statement (Para. 8.49) that it may revisit the estimation of a WACC for CEI in the context of the NBP once the final structure of the NBP has been determined.

As ComReg is aware, NBI has been designated by DCCAE as the Preferred Bidder for the NBP. NBI is working constructively with DCCAE towards the completion of contract closing requirements, following which it anticipates being awarded the NBP contract later this year. As a result, ComReg will at that stage be in a position to see how the final structure of the NBP has been determined and so should be able to take account of this in its ongoing pricing review, which includes regulated pricing for CEI access. It is NBI's understanding that ComReg is already examining the possibility of NBP-specific CEI access pricing and the consideration of a differentiated WACC for CEI assets associated with the NBP should logically form part of any such consideration about the structure and level of such pricing.

As regards the principles that might be adopted for differentiated WACCs in the fixed line sector, NBI is of the view that the following aspects are relevant when considering the adoption of a differentiated WACC for CEI assets in the context of the NBP.

Active services and passive infrastructure

Up until now, all of the SMP operator's fixed access services have been priced using the estimated WACC for the fixed telecommunications sector. This means that both the active services and the underlying passive infrastructure access which OE is obliged to provide have been priced using the same WACC input figure, despite their very different characteristics.

As a fixed line SMP operator with an obligation to make such wholesale access available, OE is in a position to distinguish between capital and activities to support passive infrastructure, and capital and activities used to support active services such as Wholesale Line Rental ("WLR") and Broadband, i.e. Virtual Unbundled Access ("VUA") or current and next generation Bitstream.

Regulated wholesale active products are purchased by retail and wholesale OAOs who ultimately compete in the downstream retail market. These operators tend to compete mainly in areas where there is widespread platform competition from other fixed operators, for example where SIRO's FTTH network is deployed or within Virgin Media's DOCSIS 3.0 network footprint. To a lesser extent, such operators also compete more widely from a geographic point of view with the mobile operators, at least for voice and basic broadband. This latter trend has become more apparent since the widespread deployment of 4G networks by the mobile operators.

As fibre rollout proliferates and customer migration to next generation networks begins to gather pace, this will alter OAO demand for both active and passive wholesale services provided by the SMP operator. VUA and next generation Bitstream will supplant in their entirety current generation equivalents while, on the passive side, demand for Local Loop Unbundling ("LLU"), including line sharing, is expected to decline sharply.

Eventually, Copper Switch-off ("CSO") will ensure the complete migration from current to next generation services, both wholesale and retail. As CSO approaches and this migration nears completion it will also mean that the principal purchaser of passive access from OE will be NBI with its large-scale demand for CEI access for the rollout of the NBP network.

From the point of view of a theoretical CEI division within OE, rather than facing uncertain demand from a whole range of OAOs for different services in particular areas over specific timeframe, it will be providing service to a single large customer, one that will have by then committed to a 35-year contract. **[✂]**

Moreover, the scale and scope of the demand for CEI will be fixed: set by the contractual provisions for delivery time, coverage of the IA and the agreement to supply over 99% of the premises in the IA with an upgradeable FTTH solution. The nature and scale of the demand on OE CEI will not vary with end-user take-up, peak throughput or variations in wholesale price. This is because NBI must be able to serve every premises in the IA even if commercial alternatives emerge (whether mobile, wireless, satellite or just competing fibre services). Once the NBP network is built, the requirement for ongoing access to the underlying CEI is very unlikely to vary over the terms of the 35-year contract so is set to be extremely long-term in nature.

OE will enjoy no such certainty in relation to the rate of return it may be able to achieve from any other part of its regulated fixed line business. As a result, the risk profile that may be attached to its NBP-utilised CEI assets will be very different than that which OE faces in relation to its active wholesale products or even its own-use CEI outside the IA, thus supporting the argument for a differentiated WACC for CEI assets in the context of the NBP.

Were ComReg to proceed with a differentiated WACC for CEI in the context of the NBP it could calculate an appropriate WACC estimate for NBP CEI only, or a weighted average for all CEI. Typically ComReg would not calculate a WACC figure for one customer – but in this context, the CEI used by NBI will have a different WACC than even OE own-use CEI. The latter has a risk profile more like the fixed telecommunications sector overall rather than NBP-specific CEI.

Having a direct calculation for NBP-specific usage of CEI would avoid the need to come to a view on the proportion of OE's passive infrastructure access that this would encompass.

[✂]

WACC parameters for CEI access

Assuming that the CAPM is the appropriate model to determine a differentiated WACC for CEI assets relating to the deployment of the NBP network, it is worth considering how the various WACC parameters might (or might not) differ from those that apply to OE's fixed line business in general and/or its provision of active wholesale services.

At an overview level, differences are to be expected as the demand for CEI assets in the context of NBP would, unlike active services, be stable and predictable over the long-term **[✂]**. As such, the provision of CEI access would be more akin to the activities of a monopoly utility provider than it would with a vertically integrated fixed line operator selling access to a suite of active wholesale products and services to OAOs who compete with it at the downstream retail level.

What these differences mean for the various WACC parameters is considered below.

Gearing: in the same way that a fixed line operator can have a different gearing than a mobile operator, the OE's CEI division might be able to sustain a higher gearing than fixed line operator providing access to active wholesale services. While higher gearing of itself may not of itself cause a differentiated WACC for CEI to fall – as any decrease caused by cheaper debt should be expected to be offset by an increase in the cost of equity due to the financial risk – the risk profile for this increased debt will, by nature of the long-term relationship OE would enjoy with NBI, be much lower than it would be for any of OE's other fixed line activities.

Cost of debt: as noted above, the debt associated with OE's CEI assets would be expected to be lower, due to decreased uncertainty and greater long-term stability in relation to the provision of CEI access in the context of the NBP.

Cost of Equity: this comprises the risk-free rate plus equity beta and equity risk premium (ERP). While the risk free rate should be the same for CEI and competitive wholesale services, the equity beta and, possibly, the ERP may be considerably different. In fact the risk is so low for this particular activity that it is almost a Government bond. Any differences in the cost of equity for CEI activities vis-à-vis other fixed line activities would lead to a lower WACC for CEI compared to other fixed line activities.

Corporation tax treatment: there would be no change in such tax treatment for the CEI division vis-à-vis OE's other fixed line activities.

Taken together, changes in the above parameters (i.e. all bar corporation tax) would all exert downward pressure on the allowable differentiated WACC for CEI assets in the context of the NBP compared to the WACC for OE's other fixed line activities.

WACC parameters compared

To see what impact a differentiated WACC for CEI access in the context of the NBP might look like in practice, NBI has examined WACC determinations for other utility-type companies and organisations in Ireland and the UK (including Northern Ireland) and has looked at the relevant parameters underlying these WACC determinations. In particular, NBI has examined the figures used by other regulators for the cost of equity, cost and debt and gearing, to see how these compare with ComReg's proposed figures in estimating the WACC rate for OE specific to the fixed communications sector. In doing so, NBI has sought to check if the cost of both equity and debt for such utility-type companies would be lower than the figures proposed by ComReg for OE's fixed line business and if the allowable gearing ratio would be higher. The results of this analysis are set out in the Table below.

TABLE: WACC PARAMETERS FOR UTILITY-TYPE ORGANISATIONS IN IRELAND AND UK

Sector and regulatory authority	Cost of equity, post-tax (%)	Cost of debt, pre-tax (%)	Gearing (%)
Fixed telecoms (ComReg)	6.49	4.93	40.0
Electricity (CRU)	5.82	2.90	55.0
Water (CRU)	5.90	3.00	45.0
Air traffic control (IAA)	5.83	2.50	10.0
Airports, proposed (CAR)	5.38	0.85	50.0
Water and Sewage (Ofwat, UK)	4.01	1.33	60.0
Electricity (UR, Northern Ireland)	4.45	1.63	45.0
Gas (CMA, UK)	5.29	2.45	55.0
Gas (UR, Northern Ireland)	5.28	2.45	55.0
Water (CMA, UK)	5.70	2.60	62.5
Air traffic control (CAA, UK)	6.84	3.20	60.0
Rail network (ORR, UK)	6.50	3.00	62.5

Sources: ComReg (Document 19/54, Table 11); CRU - Electricity (Document CER/15/296, Table 7.1 and Europe Economics report for CRU, January 2015, Table 8.1); CRU - Water (Document CER/16/342); IAA (First Economics report for IAA, May 2019, Table 15, high data points in range used); CAR (Swiss Economics report for CAR, January 2019, Table 1). All NI and UK data from UKRN, Cost of Capital – Annual Update Report, 4 June 2018.

As the above table illustrates, with few exceptions utility-type companies and organisations in Ireland, Northern Ireland and the rest of the UK have lower costs of equity and debt and higher gearing than that proposed by ComReg in the Consultation Document for OE in the context of the fixed telecoms market.

Given the scale, scope and extended time period involved in the NBP and the fact that all the risks facing OE do not relate in any way to its provision of CEI access in the context of the NBP, it follows that the WACC parameters for a theoretical CEI-for-NBP division in OE would all be lower than those in the above table.

[✁]

[✁]

[✁]

Q. 11 Are there any aspects that respondents consider important and that have not been covered under the previous questions? Please explain the reasons for your answer, clearly indicating the relevant paragraph numbers to which your comments refer, along with evidence and argumentation supporting your views.

NBI is happy that all relevant issues have been covered within the consultation questions set out by ComReg.

Q. 12 Do you believe that the draft text of the proposed decision instrument for Mobile Telecommunications is from a legal, technical and practical perspective, sufficiently detailed, clear and precise with regards to the specifics proposed? Please explain your response and provide details of any specific amendments you believe are required.

NBI has no comments to offer on the draft text of the proposed Decision Instrument.

Q. 13 Do you believe that the draft text of the proposed decision instrument for Fixed Line Telecommunications is from a legal, technical and practical perspective, sufficiently detailed, clear and precise with regards to the specifics proposed? Please explain your response and provide details of any specific amendments you believe are required.

NBI has no specific comments to offer on the draft text of the proposed Decision Instrument, other than to re-iterate the point made earlier in this response, i.e. that ComReg needs to make provision within the Decision Instrument for the updating of the WACC parameters in the manner it has envisaged (i.e. in Paras. 8.13 to 8.20 of the Consultation Document). In finalising the Decision Instrument, ComReg needs to ensure that the proposed new procedures for updating the WACC parameters are explicitly catered for within the legal text of the Instrument.

Q. 14 Do you believe that the draft text of the proposed decision instrument for Broadcasting - Market A is from a legal, technical and practical perspective, sufficiently detailed, clear and precise with regards to the specifics proposed? Please explain your response and provide details of any specific amendments you believe are required.

NBI has no comments to offer on the draft text of the proposed Decision Instrument.

Q. 15 Do you believe that the draft text of the proposed decision instrument for Broadcasting – Market B is from a legal, technical and practical perspective, sufficiently detailed, clear and precise with regards to the specifics proposed? Please explain your response and provide details of any specific amendments you believe are required.

NBI has no comments to offer on the draft text of the proposed Decision Instrument.

Response to ComReg Consultation - ComReg 19/54

TO:	**Liam Burke ComReg**
FROM:	**Eamonn Reid**
REPRESENTING:	**RTÉ DTT Multiplex Management**
DATE:	**12 August 2019**
RE:	**Review of Weighted Average Cost of Capital Consultation Response**

RTÉ DTT Multiplex Management (RTÉ DMM) welcomes the opportunity to comment on the consultation on the Weighted Average Cost of Capital ("WACC") (the "Consultation") issued by the Commission for Communications Regulation ("ComReg") reference ComReg 19/54. RTÉ is the license owner of two Digital Terrestrial Transmission (DTT) Multiplex Licenses in the ComReg designated DTT broadcast market Market B and RTÉ DTT Multiplex Management is the manager of this activity within RTÉ.

A separate response to this Consultation will be provided by 2rn, a service provider in the ComReg designated DTT broadcast market Market A.

For clarity, RTÉ The Broadcaster who is a customer to RTÉ DMM in Market B will not be responding to this consultation.

Overview

ComReg raises issues relevant to the broadcasting sector in sections 3, 4, 7 and 8 of the Consultation. The majority of the questions raised in the Consultation are related to ComReg's methodology for estimating specific parameters for calculating the WACC. In this response, however, RTÉ DMM will not comment on specific WACC parameters, except for the question on tax rates. Instead, in response to Question 11, at Section 8 of the Consultation RTÉ DMM have provide views on the limitations of using WACC to set regulated prices in Market B.

Generic WACC parameters

ComReg asks*:*

Q 2 Where a company's effective tax rate is significantly different to the statutory tax rate should the WACC be estimated using the statutory corporation tax rate or the company's effective corporation tax rate? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

The Consultation states that "the broadcasting WACCs are estimated for a hypothetical efficient broadcaster". RTÉ DMM therefore agrees with ComReg's approach of using the statutory corporation tax rate in Ireland of 12.5% to estimate the pre-tax WACC. The use of the statutory tax rate is appropriate because this is the tax rate that an efficient standalone operator would expect to pay. It should not be influenced by the aspects of the operator's business outside the scope of the regulated activity.

Other issues regarding the WACC

ComReg asks:

Q. 11 Are there any aspects that respondents consider important and that have not been covered under the previous questions? Please explain the reasons for your answer, clearly indicating the relevant paragraph numbers to which your comments refer, along with evidence and argumentation supporting your views.

RTÉ considers a framework based on a WACC return on a regulated asset base is not the most appropriate approach to regulated prices in Market B. In contrast to many regulated businesses in the sector, Market B is characterised by relatively low levels of assets. As shown in the Market B Regulated Accounts for 2018, the value of plant and equipment was only €184,000 and mean capital employed amounted to only €216,000. Operating costs were €11.5 million of which €10.4 million represented the cost of services supplied from Market A. The capital employed does not reflect the nature of the operation or the business risks faced by the Marker B operator. The situation will deteriorate further as the plant and equipment depreciates.

Over the 5 year period 2014 to 2019, RTÉ DMM earned an average annual return of less than €100,000. RTÉ DMM considers this return to be extremely low compared to the average annual operating costs of €11.5 million and is not commensurate to the risks borne by RTÉ DMM in Market B.

The forecasted capital investment in Market B for the next 5 year period is low in comparison to the first 5 year period so the return will be even less or possible negligible.

In the current WACC return on a regulated asset base model:

- RTÉ DMM's ability to earn a return in excess of costs is severely limited
- RTÉ DMM carries risks in its Market B operations and should be able to earn a return commensurate with those risks
- alternative regulatory frameworks exist that would allow RTÉ DMM to earn a reasonable return in Market B.

We address each of these points in turn in our response below.

RTÉ's ability to earn a return in excess of costs is severely limited

ComReg regulates prices in Market B by allowing RTÉ DMM to charge prices that covers its costs plus a return on capital employed. This is a typical approach to setting regulated prices in markets where regulated firms have large asset bases.

However, as noted above Market B does not have a large asset base in proportion to the costs of operation and this small asset base is being eroded further by depreciation. RTÉ DMM's capacity to earn a return over costs is therefore severely limited.

RTÉ carries risks in its Market B operations and should be able to earn a return commensurate with those risks

ComReg states:

"Cost oriented prices use the WACC to estimate costs of wholesale inputs that would occur in a competitive market. The WACCs in this consultation are an estimation of the rate of return expected by investors."

ComReg's statement implies that it is seeking to set prices for the provision of DTT multiplexing services that would prevail in a competitive market. RTÉ DMM considers it is reasonable to expect that providers of DTT multiplexing services in a competitive market would expect to earn a return which reflects the risks to which they are exposed as operators in the market.

Firstly, even under a hypothetical model of 'perfect competition', firms are still predicted to earn a 'normal profit' in the long term, which includes a rate of return that compensates firms for their opportunity cost of running the business. Standard economic theory also shows that even investors in a hypothetical business with no risk still require a return, to account for the time value of money and to incentivise them to engage in the business.

Secondly, RTÉ DMM's multiplexing service is not a risk free business. In providing these services, RTÉ DMM is exposed to inter alia the following risks:

- Advertising market risk. The broadcasting sector depends to a large extent on the advertising market for funding. Advertising is a highly cyclical industry and broadcast advertising competes with numerous other advertising channels, such as social media and the internet. This risk to the funding of many of RTÉ DMM's customers in turn creates risk and uncertainty in RTÉ DMM's DTT multiplexing business. Where broadcasters are reliant on advertisement revenue, the cyclical nature of the advertising market deters broadcasters from committing to longer term contracts and can contribute to cash flow pressures.
- Customer contract risk. A number of RTÉ DMM's customers are channels which are subject to 'must-carry' regulations. As a result, many of RTÉ DMM's customers believe they have significant bargaining power in contractual negotiations with RTÉ DMM and seek to secure contractual terms that would expose RTÉ DMM to additional commercial risk, without the risk of the channel being taken off RTÉ DMM's DTT platform. RTÉ is mandated to maximise the utilisation of the platform.
- Competition from other content platforms. Whilst ComReg has found RTÉ to have Significant Market Power ("SMP") in Market B, RTÉ DMM considers that DTT is one of many competing platforms for providing broadcast content available to broadcasters. Other such platforms may include satellite and internet-based platforms ("IPTV"), many of which are subject to little or no regulation. In addition, linear TV content is increasingly in competition with other audio-visual content platforms, such as streaming services like Netflix. As such, RTÉ DMM is exposed to the risks of RTÉ DMM's direct customers switching to other content platforms and of their business models being undermined by their viewers moving to other sources of content.

In summary, RTÉ DMM does not consider that regulation should restrict it to earn a very limited asset based return in Market B, because DTT multiplexing is an inherently risky business which, in a competitive market, would be expected to earn a corresponding return.

Potential alternative regulatory regimes for Market B

A possible alternative would be margin regulation where the regulated price could allow RTÉ DMM to earn a margin on its costs. An appropriate margin might be assessed by reference to firms undertaking comparable activities and with comparable risks.

Sky Response to Review of Weighted Average Cost of Capital (WACC) consultation, ComReg 19/54 issued on 31 May 2019

1. Before going into the detail on the WACC constituents we consider it is important to take stock of whether the important purpose of ComReg setting a cost of capital, which effectively equates to setting a "reasonable rate of return" on investment, is achieving that purpose with respect to regulated entities. In this regard Sky's comments are focussed on the outcomes associated with fixed incumbent and SMP provider, Eircom Ltd ("Eircom").

2. Based on available evidence Eircom is currently one of the most profitable fixed line incumbents in the world. In fact Sky has been unable to find evidence of a more profitable comparator. Eircom's current fixed line EBITDA margin is in excess of 50%[1]. This compares with typical fixed and wireless EBITDA margins in North America and Western Europe of just 35% according to S&P Global Ratings[2].

3. This is an extraordinary fact when one considers that Eircom continues to be dominant (in a legal sense through SMP designations) in the upstream markets which are core to its business. This means that Eircom, is subject to *ex-ante* regulation in those upstream markets and as such, in most cases, is subject to a cost orientation obligation that ought to limit the extent to which it can earn excessive profits. While Eircom are not regulated in all markets reflected in its 51% fixed line profit margin, it is reasonable to assume excessive returns in unregulated markets are constrained by effective competition and indeed there is general consensus that in the Irish retail broadband market, for example, competition is intense.

4. The problem therefore lies not in excessive returns to Eircom in unregulated fixed line sectors (which we expect ComReg agrees with or alternatively should be intervening to address such market failures) but in excessive returns being earned on regulated services where Eircom ought to be restricted to earning no more than (or at least close to) a reasonable rate of return i.e. its cost of capital. This disconnect is best highlighted by a review of returns recorded in Eircom's published regulatory accounts and in particular when focussed on the key component therein of "*wholesale access*".

ROCE (regulated @ **8.18%**)	**2018**	**2107**	**2016**	**2015**
Wholesale Access	11%	13%	13%	14%

5. The decline to 11% in 2018 provides no comfort that ComReg is getting on top of the problem given that Mean Captal Employed ("**MCE**") increased by 18% in this period as Eircom focused on the roll-out of FTTH network in rural areas in this period and a return on this investment has naturally not yet begun to materialise. If costs and revenues associated with FTTH roll-out were excluded it is probable[3] that returns on wholesale access would be in excess of 2015 and 2016 levels.

[1] With fixed + wireless business in excess of 45%
[2] S&P Global Ratings - Industry Top Trends 2019 - November 15 2018
[3] In the interest of governance and transparency FTTH expenditure and revenue ought to be separated in further publications of the separated accounts. Sky are concerned that the amalgamating FTTH cost oriented

Confidential

6. The persistence of this over-recovery should be a source of considerable concern to ComReg. This concrete evidence coupled with the anecdotal evidence of Eircom's overall profitability in excess of 50% presents a compelling argument that ComReg has given Eircom what can only be described as an "easy ride" in a regulatory context for a number of years now. While one may argue that imposing cost orientation obligations is an intrusive regulatory remedy, this is only true to the extent that prices that are regulated are actually oriented to cost. The evidence suggests this has not been the case for both services subject to and not subject to cost orientation obligations.

7. While some degree of regulatory forbearance was understandable, albeit not strictly appropriate, following Eircom's exit from receivership in 2013 a serious question now arises as to whether ComReg's ongoing forbearance (even in the presence of cost orientation obligations) is an invitation to investors to focus on the short to medium term financing strategies to the long-term detriment of the market and consumers in particular.

8. The problem of significant over-recovery against a existing regulated rate of return of 8.18% is further exacerbated by the extent to which this rate in itself is already very generous when considered against Eircom's actual cost of financing. The problem is therefore two-fold (i) the existing regulated rate of return in significantly inflated above the true cost of financing and (ii) ComReg's approach to modelling eircom's costs is excessively deferential to Eircom's risks which is leading to over-recovery beyond the inflated regulated rate of return.

9. In this regard it is notable that capital investment by Eircom in the last 5 years has come entirely from free cash-flow. While Sky and other operators pay well above the purported regulated rate of return to Eircom for services that are supposed to be cost oriented, Eircom has not had to raise a single cent of equity or debt to finance the "investments" it has made since coming out of receivership. On the contrary, net of investments Eircom has been able to pay significant dividends to shareholders[4] and exceptional bonuses to its senior management[5]. The reality is that OAOs have been funding many of these "investments" for the SMP providers that is reaping excessive returns. These excessive prices as defined by an above reasonable rate of return on wholesale services as such has resulted in an unjustified wealth transfer from OAOs (and consumers) to Eircom.

10. Eircom's free cash flow has increased by more than €50m in 2017/18[6] (and this looks set to increase by a further €50m this year) due in the main to extensive cost cutting exercise across the entire business and via (an unevenly but unquestionably) downward trend in Eircom's capital intensity ratio (see Chart 1 below). Despite this Eircom recently converted a significant portion of equity to debt through a refinancing deal that sees an additional c€400m of debt placed on the company's balance sheet.

11. This decision which ensures Eircom's credit worthiness will continue to rate below "'*investment grade*" at the major rating agencies for the foreseeable raises questions about

services is masking trends that the wider industry and ComReg should be observing from a sanity check perspective.

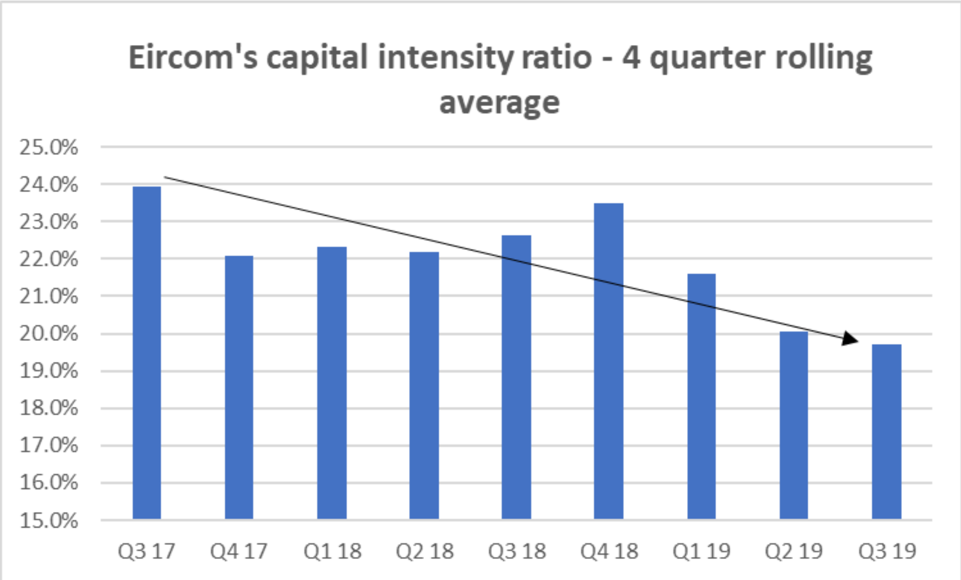
[4] "Eir ramps up debt to fund bigger dividend" - April 2019

[5] Eir managers to share 100m through french takeover- December 2017

[6] This was despite exceptional redundancy payments of €32 and payment provisions of €20m.

the long term strategy of Eircom's owners. As a short to medium term strategy the move is not surprising, if that is the investor horizon Eircom's owners are working to, as it allows them to exploit a significant gap between the true cost of financing – even for low grade debt – by comparison to the permissible level inherent in the current (and even proposed) regulated rate of return. Short term gains are being banked with apparently less focus on the long-term fiscal status of the company.

Chart 1 – Eircom's Capital Intensity Ratio (source: eircom accounts)



12. In this regard it is worth noting that Eircom average cost of debt currently stands at **3.63%**[7] and this compares with a proposed cost of debt range by ComReg in the consultation of between **4.27%** and **5.69%**. With the majority of Eircom's debt secured out to 2026 following its recent refinancing there is simply no justification for this level of premium and that is before we get into an assessment of an inflated nominal risk-free rate range being proposed by ComReg.

13. This "*bonus premium*" on the cost of debt, which is additional to the risk-free rate plus the debt premium being proposed by ComReg amounts to between **0.64%** and **2.06%**. Based on a 40% gearing assumption being proposed by ComReg this will equate to up to **c€11.9m**[8] p.a. (known) over recovery of costs being sanctioned by ComReg on cost of debt alone. Furthermore, as ComReg is aware Eircom are operating with total disregard for what ComReg and others assess to be the optional notional gearing ratio (discussed below).

14. If 40% is perceived as an optimal gearing level then it begs the question why Eircom's owner do not appear to agree with that view of optimality or alternatively is it knowingly and

[7] Eircom quarterly presentations
[8] Using MCE from 2017/18 Eircom Regulated Separated Accounts of €1.44bn

Correspondence Address: Sky Ireland, One Burlington Plaza, Dublin 4, Ireland
Sky Subscribers Services Limited (Irish branch), Grant Way, Isleworth, Middlesex TW7 5QD Registered in England No. 02340150

deliberately pursuing a sub-optimal capitalisation strategy that will deliver in terms of short term gains to the long term detriment of the company? It would not be the first time this occurred at Eircom. ComReg talk about gearing in the context of not rewarding historical errors but if the regulated entity is very recently pursuing a strategy that on its face seems counterintuitive from an efficiency point of view, it simply means, not that it is behaving irrationally, but rather it is pursuing an alternative strategy that has little to do with the optimal capital structures. In this regard it is incumbent on ComReg to explore this anomaly in terms of policymaking.

15. It is critical that ComReg's future approach to WACC takes on board lessons learned from Eircom's past and current behaviour. If Eircom's majority shareholders regard WACC to "locked-in" for a period of up to 5 years following conclusion to this consultation it is likely to exploit the type of arbitrage opportunities already referred to above on the cost of debt and this may ultimately undermine the financial health of the company. In such a scenario ComReg would bear some responsibility for that outcome if it ignored Eircom's corporate history in determining how WACC is derived and applied in a regulatory context.

Risk Free Rate

16. ComReg considers that the estimate of the real risk-free rate to be used in WACC calculations needs to take account of expected future economic conditions, both in the Eurozone and in Ireland. In addition, it states, due to the global financial crisis that started in 2008 current Eurozone bond rates may not be fully representative of the risk-free rate over the period that the proposed WACCs will be used. If ComReg had arrived at this conclusion 3 years ago or 3 years prior that and indeed 3 years prior to that, history would have shown on each occasion that it was wrong.

17. It's unclear why what ComReg is saying is appropriate therefore, or if it has considered the most up to date information. The Europe Economics report appended to the consultation document notes for instance that the 'n*ominal yields on the Irish government bonds over the last few months has been fairly stable at around 0.9 per cent*.' It also notes that '*the ECB data on forward minus spot curves suggest a range of 0.7 to 0.9 for 3 to 4 years ahead*'.

18. It is now clear the Europe Economics assumptions in this respect will almost certainly be wrong based on more recent information.

19. Crucially, the situation has since changed with ECB President, Mario Draghi stating on June 18th, at the ECB's annual conference that the ECB would consider further stimulus through additional bond purchases if inflation did not pick up. 5-year Euro swaps are now at negative yields with the overnight deposit rate set to be cut to lower than the current -0.4% at the next ECB meeting in September[9]. Last month Irish 10 year bonds were yielding just 0.2% and at time of writing in early August had in fact entered negative territory. We believe that in light of these <u>material</u> developments the models used should therefore be updated accordingly as a point estimate risk free rate of 3.43% is simply not justified based on any objective analysis and consequently is significantly overstated.

Gearing and Equity Beta

[9] Bond Market entering danger zone - Irish times 9 August 2019

20. As an initial comment we note that ComReg's figures quoted in paragraph 6.6 of the consultation are incorrect. The 2018 Eircom Holdings Limited report shows negative total equity to be €724m and not €902m as stated in the consultation which is the figure relevant to the 2017 accounts.

21. It is worth noting that ComReg suggest at paragraph A 6.4 that notional gearing "*does not reward the regulated entity for an inefficient capital structure or for sub-optimal decisions made in the past*". It is difficult to reconcile this statement with the mathematical fact that if a companies actual gearing is higher than its notational level of gearing it is going to benefit from being permitted to recover a higher return on investment than its true cost of capital. This is because the cost of equity is greater than the cost of debt so assuming a company's capital structure incorporates a higher portion of debt than equity than is notionally the case, this does in fact reward an operator for so-called "*inefficient capital structure*".

22. Indeed, Eircom are today benefitting from exploiting the inefficient incentives created by the notional gearing assumption underpinning its current regulated rate of 8.18% which is grounded in a gearing assumption that is completely out of kilter with its actual situation. It is critical that ComReg observe the actual implications of what is happening and has happened in Eircom as opposed to wedding itself to some pro-forma proposal that is replicated from one jurisdiction to the next without actually assessing what is happening in particular cases. It is not a response to continue to take this approach of notional gearing because it is grounded in some theory about what a "*hypothetically*" efficient operator would do if it easy to demonstrate that the regulated entity not only disregards this but in fact is banking higher profits while pursuing an inefficient capital structure.

23. How does ComReg provide for incentives to Eircom to pursue a hypothetically efficient capital structure is the issue that should be at the heart of its thinking if it continues to observe behaviour from Eircom that suggests it has no such incentive but rather than being penalised is actually benefitting from the disconnect between its strategy and that of the hypothetically efficient operator.

24. While in "theory" Eircom's equity beta is increasing as its gearing increases, Eircom's behaviour indicates that this is not the case. Its owner's response to a significant increase in cash flow has to been to raise debt significantly above the theoretically efficient capital structure. Eircom's owner are not concerned about their own equities exposure to debt in the way described by the asset to equity beta conversion formula. In this regard adopting an equity beta for Eircom based on a comparator set that does not have comparable gearing levels may not be appropriate and result in an outcome divorced from reality.

25. Eircom's historical debt holders learned to their cost of the implications of a disconnect between theory and reality with a €1.4bn[10] debt write down in 2013. While Eircom has made much of the fact that its current "net debt/EBITDA ratio" is sustainable[11], it is a ratio that is being propped up by significant over-recovery of costs for services that are supposed to be cost oriented. In this regard Eircom are banking on ComReg continuing to allow for this sort of over-recovery to continue and for the significant cost cutting that has occurred over the

[10] At the time almost equivalent to 1% of Irish GDP.
[11] "Eir defends bond issue that saw €400m payout" - Irish Independent, 30 May 2019

Correspondence Address: Sky Ireland, One Burlington Plaza, Dublin 4, Ireland
Sky Subscribers Services Limited (Irish branch), Grant Way, Isleworth, Middlesex TW7 5QD Registered in England No. 02340150

past 2 years[12] not to filter down into cost-oriented prices. The concern for industry and Irish consumers is that ComReg in turn end up feeling pressurised/captured about the implications for a deterioration in Eircom's financial ratios and facilitate ongoing over recovery by either making overly generous assumptions in modelling exercises or by setting WACC itself too high. There is evidence to suggest this may already occurring.

26. Therefore, while ComReg suggest notional gearing ensures that inefficient capital structures are not rewarded, Eircom are being rewarded by this very approach. It is loading up on relatively cheap debt but is earning a return that is more heavily weighted to its cost of equity.

27. One mechanism that ComReg could employ to drive efficient incentives would be to set apply Eircom's actual gearing ratio to fixed estimates of the cost of equity and debt that are derived based on an optimal notional gearing level. By way of a numerical example this would mean if the cost of equity was 6% at notional gearing ratio of 40% and the of cost debt is 4% (implying a WACC of 5.2%) but Eircom subsequently choose an actual gearing ratio of 80%, its cost of equity and debt remains unchanged at 6% and 4% respectively generating a WACC reflecting actual gearing of 4.4%. This would incentivise Eircom to bring its gearing back into line with an efficient capital structure and the attraction of burdening the company with more and more debt would be deterred by the counter-balance of a lower effective cost of capital being enjoyed on regulated prices.

28. The flexibility that the current approach incorporates was what contributed to the Eircom's entering receivership in 2013 and risks doing the same again judged by recent events. OAOs and consumers should not face a "profligacy tax" on Eircom's inefficient capital structure either through an inflated WACC (v Eircom's actual cost of capital) or through overly generous modelling assumptions being adopted by ComReg that effectively forgives such inefficiency through the sanction of artificially inflated cost-oriented prices.

29. In this regard it is worth recalling the following evidence presented by ex-ComReg Commissioner to an Oireachtas Committee in January 2013:

> *"It is important to appreciate that Eircom has always been a* ***very profitable company***[13]*. The examinership process it went through last year was because it took* ***on a huge amount of debt under a series of private ownerships****. Its operating profitability has remained very respectable and comparable to other incumbent operators throughout Europe. As a result of the examinership… a figure of €1.4 billion of debt was written off, which was approximately one third of the total debt it had. This is what it was thought necessary to get the company to a* ***manageable level of debt given its profitability****."* [emphasis added]

30. Identifying the "*manageable level of debt*" was key to the settlement that saw Eircom exit receivership. Eircom's current level of debt may well be "*manageable*" given its current profitability. However, its profitability is to a large extent being sustained by ComReg's regulatory forbearance in terms of the application to and the enforcement of Eircom's cost orientation obligations. This in turn is contributing to the inefficient capital structure the

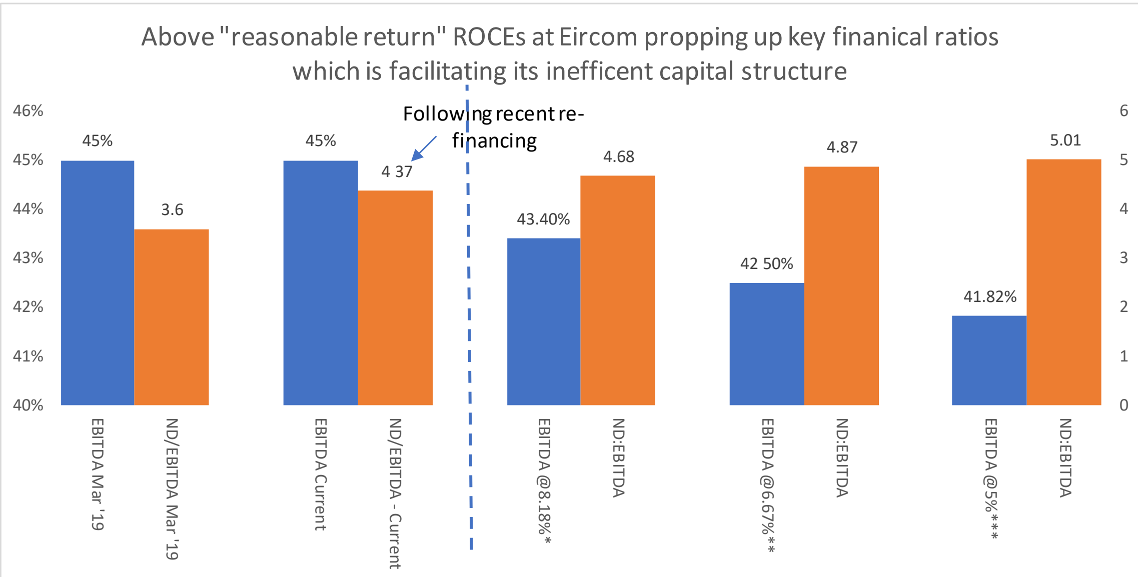
[12] Without prejudice to Sky's position in legal proceedings outside this consultation these significant savings are clearly occurring right across Eircom's cost-oriented services despite suggestions to the contrary. This is clear from both Eircom's group and regulatory accounts.
[13] Eircom's EBITDA is significantly higher today than in mid-2012/2013

business has adopted because it is allowing Eircom to raise debt on the basis of flattering financial ratios underpinned by the associated excessive profit margins (as noted above 51% fixed line EBITDA margin appears unprecedented internationally).

31. There is little doubt were Eircom's debt to become "unmanageable" because ComReg succeeded in bringing down returns on regulated services to be in line (or close to in-line) with regulated rates of return – **and that surely should be ComReg's objective** - Eircom would be calling for regulatory relief to account for the precarious fiscal situation that it deliberately pursued.

32. To highlight the extent to which the inefficient capital structure being pursued by Eircom is dependent on excessive profits we can see from Chart 2 below that were Eircom's Return on Capital Employed (ROCE) to fall in line with the currently proposed WACC against the existing Mean Capital Employed as stated in its latest regulatory accounts, its "net debt to EBITDA" ratio would increase to **X 4.87** which is well above the "*manageable*" level of debt (**X 4.2**) it inherited following its exit from receivership. Critically, just as identified by Mr. Chisholm in 2013, Eircom would continue to be exceptionally profitable at this level, all else being equal, with a margin (including mobile) in excess of 40% (and a fixed line EBITDA of c45%). This analysis highlights not just Eircom's willingness to pursue an inefficient capital structure focussed on short to medium term gains but the extent to which that strategy's relies on ComReg's approach to enforcing cost orientation obligations that results in ROCEs well above a "*reasonable rate of return*".

Chart 2



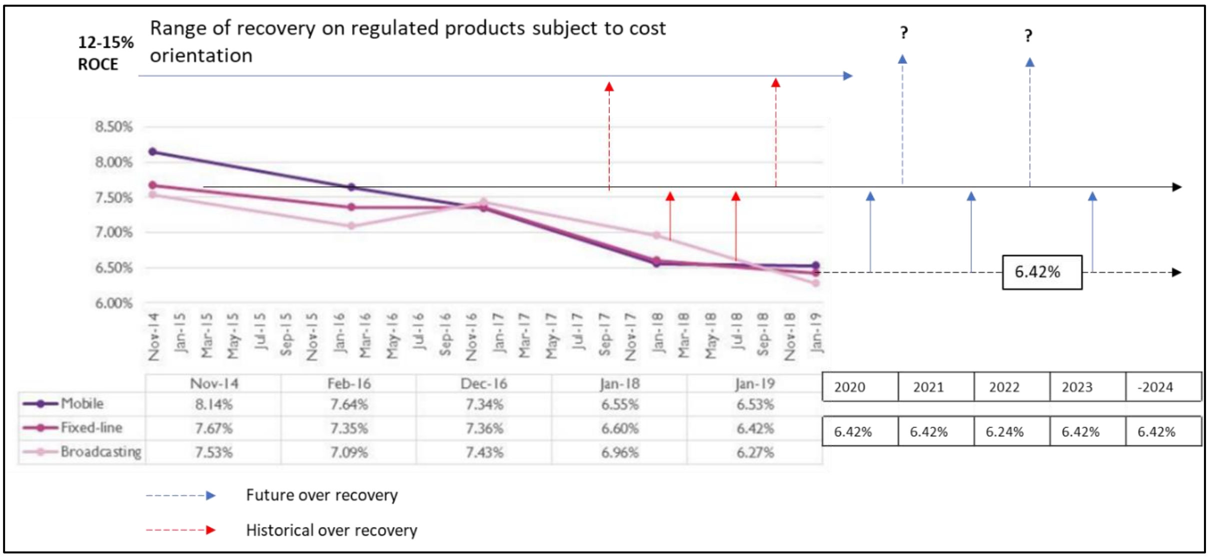
* Results in a €37m reduction from 2017/18 HCA MCE of €155m
**Results in a €58m reduction from 2017/18 HCA MCE of €155m
***Results in a €72m reduction from 2017/18 HCA MCE of €155m
Source: Eircom company reports and regulatory seperated account reports

33. As such ComReg must give serious consideration as to how it can incentivise Eircom to pursue a more stable and efficient capital structure now and very clearly call out to investors at this time that they cannot rely on a regulatory forbearance to underwrite the pursuit of inefficient capital structures going forward. Sky are extremely concerned by ComReg's suggestion that a more appropriate lower WACC would only be deployed in cost modelling exercises when new market reviews are conducted (*discussed next*). If that were to happen, notwithstanding it would amount to a failure by ComReg to enforce regulatory obligations, it would also fail to promote efficient "build or buy" signals and further signal to Eircom that it is free to continue pursuing an inefficient capital structure policy in return for short term gains.

Options for Implementing the WACC in Price Controls

34. Sky are of the view that the revised WACC should be applied with immediate effect to all cost-oriented prices. ComReg note that this approach "*may not be appropriate as arguably, other parameter changes should be considered in tandem*". This is simply an assertion not supported with any argument presented by ComReg. WACC is a variable that is exogenous to all other inputs in the various cost models and so there is no case to suggest other variables need necessarily be looked at[14] simply to reflect a more appropriate and efficient cost of capital. Eircom by comparison will not be delaying exploiting the opportunities of disconnect between the existing regulated cost of capital and its considerably lower actual financing costs. To give some context to what this would mean it is worth reproducing ComReg's own Figure 1 from the consultation and consider the implications of what this proposal could mean in terms of delivering excessive profits to Eircom:

Chart 3



35. We can see that Eircom has already banked considerable "*fair bet*" returns above actual costs in terms of having a cost of capital that is considerably above what Europe Economics

[14] Again, this comment is without prejudice to Sky's view in legal proceedings that ComReg should have used up to date accounting information in setting Eircom's FTTC prices and remain of the view that this should still occur.

considers to be an efficient cost of capital since 2014. On top of that it has earned returns considerably above this inflated level over the same period for reasons already discussed. By delaying implementation of an updated cost of capital certain markets e.g. WLA and WCA would remain untouched **until potentially 2024** with acost of capital by this point that is well out of kilter with efficient costs for almost a full decade. This is unacceptable by any objective measure and there is simply no justification for this level of regulatory forbearance. Such a move will have strayed significantly beyond an argument for a "*fair bet*" on investment to one more into realms of one that is "*rigged*".

36. If it was the case that Eircom's profitability was not so (excessively) out of kilter with its global peers and its actual ROCE was not so far above the recommended rate (which itself is inflated for reasons already outlined) there may be a weak basis for delaying the application of the same. The fact that this is not the case renders any suggestion it should not be applied to existing regulated prices would be a significant error on ComReg's part.

37. Furthermore, it is difficult to see how Eircom could remain compliant with their cost orientation obligations and not adopt the new cost of capital reflected in a regulatory decision. The WACC parameter would constitute a material and sustainable change that must be reflected in Eircom's cost models and in particular where annual reconciliation of accounts proving cost orientation is required.

38. Sky do not consider it open to ComReg in a legal sense to allow for such an arbitrary deferral of imposing an efficient cost of capital on Eircom. This decision on its own would render Eircom's cost-oriented prices, by definition, above cost. There is certainly no convincing argument that can be made around principles of "*regulatory certainty*" that can be used to justify the deferral given that Eircom's cost of capital has not been amended for more than 5 years and this has already resulted in a financial windfall to Eircom based on Europe Economics report.

39. Equally, there could be no legitimate expectation that the cost of capital would not be reviewed and amended beyond a 5 year period and in particular that the WLA/WCA cost models would not be amended accordingly. It was well signalled, as appropriate to Eircom and the wider industry that the pricing in D11/18 was susceptible to change where a new cost of a capital was determined. This is clear from paragraph 8.22 of the consultation. Indeed the only basis for considering "*regulatory certainty*" in the context of this issue is the certainty ComReg should be promoting in terms of assuring the market that "cost orientation" means cost orientation.

40. We note that ComReg states that '*it is for Eircom to ensure that it adheres to its cost orientation obligation. Where it considers it is either under recovering or over recovering its costs it should inform ComReg of this fact so that tariffs can be adjusted where considered necessary*'. We do not see this as having any relationship to reality and would be an abdication of responsibility by ComReg if it did not actively seek to update pricing reflecting the newly determined cost of capital. In practical terms there is no material implications for Eircom not informing ComReg if its prices are above cost[15] while the downside for doing so is real and measurable.

[15] If ComReg disagrees we would welcome clarification as to what the implications are and in particular how OAOs would recoup over recovery of costs were Eircom to be found in breach based on an *ex-post* assessment

41. Sky strongly suggest that in the event that ComReg are minded to determine that cost oriented pricing does not need to be updated until the next market reviews that ComReg call out specifically to the European Commission during the notification process that this would result in the cost of capital applicable to WLA/WCA pricing being retained that is significantly above the determined appropriate cost of capital and that this situation is likely to apply until at least 2024. In this regard ComReg ought to seek specific approval and comment from the Commission and BEREC on allowing for such over-recovery of costs and justify its reasons for doing so which have not been outlined in this consultation. Sky proposal in this regard is entirely without prejudice to its own view that such approval cannot legitimately be granted in any event and would note that ComReg has offered no reasons for the proposal in the consultation other than an unqualified assertion.

42. Sky also agree that one potential sensible response to the challenges faced by ComReg would be to update the parameters underpinning the WACC calculations more frequently than has been the practice up to now, ideally annually, using the methodologies ultimately decided upon as part of the consultation. By doing so, it would also obviously be less necessary for ComReg to 'aim up' (*discussed next*) on its central WACC estimates.

Aiming up

43. For reasons already outlined it is difficult to reconcile ComReg's reasoning for "*aiming up*" if the parameters in the WACC in the first instance are already effectively "aimed up" e.g. the risk-free rate is significantly above the true risk free rate as highlighted above. Sky is cognisant that on a clean-slate approach to determining WACC the regulator should consider the "*consequences between setting the WACC too low and setting it too high*". However, given ComReg's approach to choosing individual WACC variables is already guided by the same principle and given its approach to cost modelling is similarly informed the cumulative effect of this "*aiming up*" policy is that not only are returns "*too high*" they are too high to point that cost oriented prices are ultimately not cost oriented. In this regard there appears no justification for a further iteration of "*aiming up*" by ComReg once it has settled on the final inputs to WACC.

Conclusion:

44. ComReg, (in line with a number of other regulators around the world, it is fair to say) have consistently allowed a return on capital that is excessively generous to a regulated company with SMP[16]. This has occurred for several reasons, most obviously due to an inability to adjust to a world where a decade of extremely low interest rates (by long term historical standards) has been the norm. This has meant that Eir have been allowed a regulated return of return in excess of their actual cost of capital. In addition, they have consistently earned well above even this overstated rate, with no clawback.

45. As is clear from Eircom's own actions, together with the clear position the ECB have taken on forward looking interest rates, without significant intervention in this area, this situation is

given ComReg's well established principle that *ex ante* regulatory is necessary because *ex post* remedies are likely to be ineffective.

[16] In this regard we would invite ComReg to review "Estimating the cost of capital for implementation of price controls by UK Regulators" – An update on Mason, Miles and Wright (2003) by Wright, Burns, Mason and Pickford (2018)

Correspondence Address: Sky Ireland, One Burlington Plaza, Dublin 4, Ireland

Sky Subscribers Services Limited (Irish branch), Grant Way, Isleworth, Middlesex TW7 5QD Registered in England No. 02340150

likely to continue. That ought to be a source of concern to ComReg and should be central to its decision-making on WACC. We therefore encourage ComReg to focus on 4 issues in particular:

1. **ComReg should revisit their risk-free rate calculations in light of the most up to date information and given Eircom financing is now secured out to 2026 at very advantageous costs of debt that is far more efficient than the proposed hypothetically efficient cost of debt ComReg proposes.**

2. **ComReg need to consider solutions to address the perverse incentives that Eircom's notional gearing has created for an investor that appears motivated by short to medium term gains as opposed to the optimal long-term capital structure of the business. Repeating the approaches previously adopted could contribute to a "fiscal crisis" at the incumbent particularly if it is restricted to earning a fair return on capital (as it ought to be) as opposed to being allowed the excessive returns it currently enjoys.**

3. **ComReg should apply the revised WACC with immediate effect to all cost-oriented prices in order to ensure Eircom are complaint with its cost orientation obligations. Having consulted on whether pricing should be updated to reflect a new WACC, ComReg must confirm this will be required. In Sky's view failure by ComReg to confirm that it will do so pursuant to the decision coming out of this consultation would constitute a serious error on ComReg's part.**

4. **Finally ComReg should commit to updating the parameters underpinning the WACC calculations more frequently (ideally annually).**

Sky

18 August 2019

Review of Weighted Average Cost of Capital (WACC)

Response to ComReg Consultation Document No. 19/54 from Three Ireland

13 August 2019

1. Introduction

On 31 May 2019 ComReg published a consultation on a review of the weighted average cost of capital (WACC) ComReg Document No. 19/54. The enclosed is Three Ireland's response to this consultation.

2. Summary

Three Ireland (Three) welcomes the opportunity to comment on ComReg's WACC consultation.

In general, Three would welcome more frequent WACC reviews going forward. Three also considers that aiming up should be used for the mobile WACC, given there is more risk with getting this figure too low rather than too high.

3. Consultation Questions

Q. 1 Do you agree or disagree with the continued use of equilibrium concept for the estimation of the WACC? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

Three has no comments on this question.

Q. 2 Where a company's effective tax rate is significantly different to the statutory tax rate should the WACC be estimated using the statutory corporation tax rate or the company's effective corporation tax rate? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

Three is in agreement with ComReg's position as set out in paragraph 4.32.

Q. 3 Do you agree with ComReg's proposed approach to estimating the generic parameters for the respective WACCs and the preliminary point estimates chosen? Please explain the reasons for your answer, clearly indicating the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

The equity risk premium appears low at 4.6%. The reduction in the equity risk premium used in the calculation from 5% to 4.6% seems at odds with international trends, for example, Duff & Phelps has increased its U.S. Equity Risk Premium recommendation from 5.0% to 5.5% as of December 31st 2018 (Valuation Insights, First Quarter 2019[1)]. KPMG Netherlands recommends the use of an equity market risk premium of 5.75% as per 31 March 2019[2]. We also note that ComReg's selected Eurozone comparator (Italy) has recently determined an equity risk premium of 6.07%.

[1] https://www.duffandphelps.com/insights/publications/valuation-insights/valuation-insights-first-quarter-2019

[2] Equity Market Risk Premium – Research Summary – dated 31 March 2019 at https://assets.kpmg/content/dam/kpmg/nl/pdf/2019/advisory/equity-market-risk-premium-research-summary-31032019.pdf

Q. 4 Do you agree with ComReg's proposed approach to estimating the WACC specific to the mobile telecommunications sector? Please explain the reasons for your answer, in particular your views on the specific parameters used. Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

Three would support a higher WACC for mobile.

For aiming up, in relation to the fixed network, given the relative stability of demand and technology and the lesser impact of usage on network configuration and cost, ComReg's position at paragraph 8.12 may be appropriate for fixed but not for mobile.

In Three's view, ComReg's original position from 2014, that the negative consequences of setting the WACC too low are potentially greater than the negative consequences of setting it too high, certainly still applies to investment in mobile networks. Three would accordingly support aiming up for the mobile WACC.

Q. 5 Do you agree with ComReg's proposed approach to estimating the WACC specific to the fixed line telecommunications sector? Please explain the reasons for your answer, in particular your views on the specific parameters used. Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant evidence and argumentation supporting your views.

Three would support a lower WACC for fixed. Aiming up my not be appropriate for fixed, for the reasons set out in Three's response to question 4 above.

Q. 6 Do you agree with ComReg's proposed approach to estimating the WACC specific to Market A and Market B in the broadcasting sector? Please explain the reasons for your answer, in particular your views on the specific parameters used. Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

Thee has no comment on this question.

Q. 7 Do you agree or disagree with ComReg's preliminary view that WACC parameters could be updated more frequently and consulted on separately (as part of a pricing consultation) as opposed to conducting a full WACC methodology review and consultation? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

In paragraph 8.4, ComReg expresses a preference for updating the WACC more frequently, Three would welcome a regular WACC review to be included in ComReg's work plan.

Q. 8 Do you consider that the risk free rate, asset beta and debt premium should be aimed up? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

Please see our response to Question 4 above in support of aiming up for mobile networks.

Q. 9 Do you agree or disagree with ComReg's preliminary view that Option 3 is the most appropriate method to implement the revised WACC? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

Three agrees with Option 3 as being the most appropriate method to implement the revised WACC.

Q. 10 What principles do you think should be adopted, if any, for differentiating WACCs? What principles should be adopted, if any, to decide if project specific risks need to be taken into account? Please clearly indicate the relevant paragraph numbers to which your comments refer, along with all relevant factual evidence supporting your views.

Three has no comments on this question**.**

Q. 11 Are there any aspects that respondents consider important and that have not been covered under the previous questions? Please explain the reasons for your answer, clearly indicating the relevant paragraph numbers to which your comments refer, along with evidence and argumentation supporting your views.

Three has no comments on this question.

Q. 12 Do you believe that the draft text of the proposed decision instrument for Mobile Telecommunications is from a legal, technical and practical perspective, sufficiently detailed, clear and precise with regards to the specifics proposed? Please explain your response and provide details of any specific amendments you believe are required.

It is well drafted and sufficiently detailed. It is also clear and precise with regards to the specifics proposed**.**

Q. 13 Do you believe that the draft text of the proposed decision instrument for Fixed Line Telecommunications is from a legal, technical and practical perspective, sufficiently detailed, clear and precise with regards to the specifics proposed? Please explain your response and provide details of any specific amendments you believe are required.

Three has no comments on this draft text other than to note that it is well drafted.

Q. 14 Do you believe that the draft text of the proposed decision instrument for Broadcasting - Market A is from a legal, technical and practical perspective, sufficiently detailed, clear and precise with regards to the specifics proposed? Please explain your response and provide details of any specific amendments you believe are required.

Q. 15 Do you believe that the draft text of the proposed decision instrument for Broadcasting – Market B is from a legal, technical and practical perspective, sufficiently detailed, clear and precise with regards to the specifics proposed? Please explain your response and provide details of any specific amendments you believe are required.

Three has no comments on these draft decision instruments other than to note that they are well drafted.

Non - Confidential

Review of Weighted Average Cost of Capital (WACC)

Response to Consultation

Response to Consultation

1. Vodafone welcomes the opportunity to respond to the ComReg Review of the Weighted Average Cost of Capital (WACC) review for the Mobile and Fixed line telecommunications sectors and for the Broadcasting markets A and B.
2. In general, Vodafone support the methodologies adopted by ComReg in this review and in this regard, we have limited commentary to specific aspects of the paper. The key concern arising is when a revised lower WACC shall become effective in regulated SMP markets in particular fixed markets.

Over Recovery

3. It is critical that investing companies should be permitted to achieve a reasonable rate of return on the capital that they employ in SMP markets.

4. It is however also a concern that in the fixed telecommunications market Eircom continuously achieve profits well in excess of the regulatory WACC. This in our view could be a symptom of inadequate regulatory control and raises serious concerns around the level of the current fixed WACC, the price control mechanisms in place and of particular relevance to this consultation the need to ensure application of the revised WACC sooner in fixed markets.

5. It is accepted that an important objective for ComReg in setting the WACC is the avoidance of risk of underinvestment. It is indeed a requirement under Access regulations that ComReg take into account the investments made and allow an operator the chance to realise a reasonable rate of Return on Capital Employed.

6. The concern in fixed markets is that the level of Eircom's profitability, across those markets in which they are designated as having SMP, indicate higher wholesale prices have been charged

than would have been the case if returns had been closer to the WACC. This has impacted consumer welfare, adoption rates and competition in the fixed sector.

7. It points to the absolute need for application of the WACC sooner rather than later. In paragraph 2.13 of the consultation ComReg recognise that setting of the WACC too high 'would allow the regulated company to earn excessive returns at the expense of its wholesale and retail customers while also potentially distorting pricing signals to investors'. This seems wholly inconsistent with the proposal to implement the WACC to price controls that come into effect after the WACC review. Having just completed the review of markets 3a and 3b this will mean a further review may not take place for a number of years, which in effect leads to the unacceptable situation which ComReg state they are looking to avoid, where regulated process based on the 2014 WACC remain in place until 2022-2024. This is counterintuitive to ComReg's stated objective.

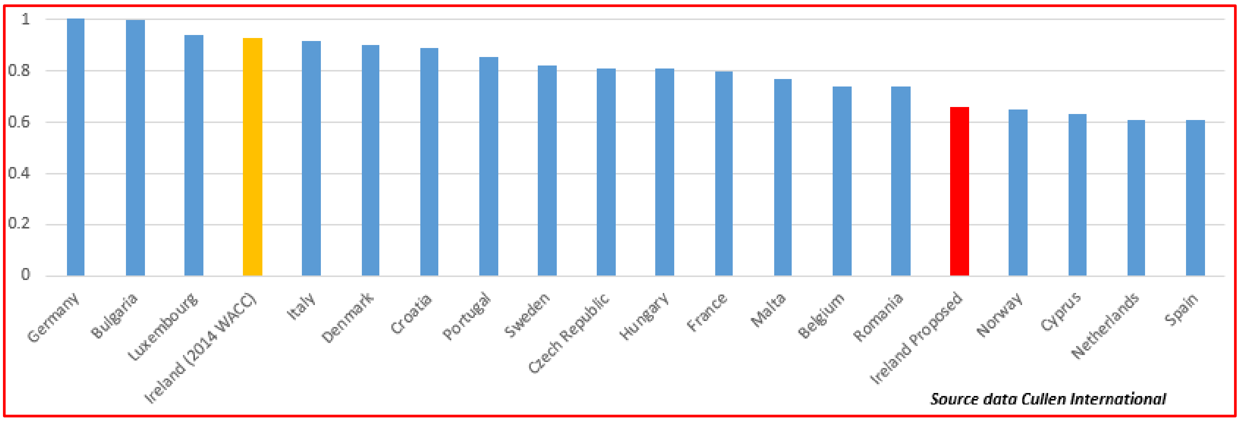
Answers to consultation questions raised

Question 2: Should the effective tax rate be used where a company's effective rate is significantly different to the statutory rate.

8. ComReg advise that the tax rate used in the 2014 WACC review was the statutory tax rate, which leads to a higher WACC in fixed markets. The question arises as to why consumers should pay for taxes that the incumbent does not actually need to pay. In this regard, it seems appropriate to limit the rate used to the effective rate. ComReg also need to consider however, the effective rate paid by efficient entrants, as they will not be able to compete in the market if the Eircom statutory rate is used and the effective rate of new more efficient entrants is closer to the statutory rate. If this situation does not arise, then as above the effective rate should be used.

Question 4: Do we agree with approach to estimation of WACC in the mobile sector?

9. Whilst in general agreement with the overall methodology the Equity beta estimates adopted on mobile seem especially low. We note ComReg concern around data availability as referred to in paragraph 5.12.



10. The main concern for Vodafone relates to the estimates put forward on equity beta, which raise questions around the reliability of data supporting this estimate. Ireland should not be so low compared to other European countries and it is our view that that further analysis and revision of the equity beta for mobile is appropriate.

Question 9: Do you agree or disagree with ComReg's preliminary view that Option 3 is the most appropriate method to implement the revised WACC?

11. Vodafone refers to the comments above on over recovery. It is our view that the WACC should apply now.

12. Vodafone has made its concerns clear to ComReg for a number of years around over recovery in the fixed sector. The absence of effective price control have led to negative wholesale pricing behaviours and Eircom is at the top of the list of EU telecommunications operators for levels of profit which we believe is wholly driven by high prices for wholesale services.

Weighted Average Cost of Capital

- Additional comments and observations

- Non-confidential
- 17/10/2019

let's make possible...

Overview of issues in 19 / 54

1) Methodology to calculate WACC

- The evidence ComReg has presented does not support the proposed unlevered asset beta for the mobile or fixed line markets
- Lack of transparency and justification of how the unlevered asset betas are calculated by Europe Economics
- Current market volatility undermines 2 yr timeframe for beta calculation

New
This presentation quantifies short-term fluctuations evident in 2 yr estimation windows

New
New evidence that NRA methodologies supports eir's view that the Equity Risk Premium calculation should be supported by additional data sources

New
Snapshot of recent pre-tax nominal WACC rates submitted by NRAs

2) How frequently the WACC is updated

- ComReg's proposed annual update of the WACC increases the regulatory uncertainty and unpredictability of available fair returns to all operators – in particular infrastructure-based operators

New
This presentation highlights inconsistency of ComReg's proposed annual update of WACC to the notional investor and the long-term payback investment decisions made by telecom operators

Overview of issues in 19 / 54

3) Implementation of updated WACC

- eir considers that it is not appropriate to apply a revised WACC to pre-existing cost-oriented price controls when assessing compliance with cost-orientation

- When price controls were set using specific assumptions including the WACC for the forthcoming price control period, it set appropriate build/buy signals for that price control period. The telecommunications market is highly capital intensive and is categorised by large sunk capital investments, whose deployment may span multiple price control periods. Consequently, there are sound economic and policy reasons for not reviewing existing price controls within price control periods

New

This presentation demonstrates the annual revolving implementation obligations (and uncertainty) of ComReg's proposal. eir's proposal allows for a more frequent update of WACC while achieving appropriate build/buy signals per market

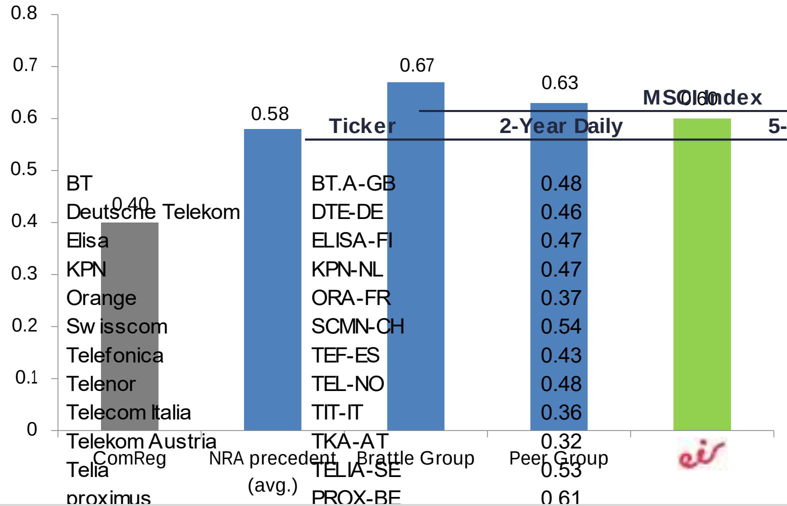
4) Final Observations

- Shortfalls in ComReg's methodology and evidence to calculate WACC also evident in mobile equity beta
- Implications of WACC for FTTH (FTTC anchor pricing and FTTH connection charges) and CEI pricing have not been recognised by ComReg. Encourages "wait and see" strategy from operators

Fixed Unlevered Asset Beta

Eircom, Comments post submission deadline, 17 October 2019, Non-confidential

Unlevered asset beta



NRA precedent

	Unlevered asset beta	
Belgium (2019)	0.63 *	2 yrs
Portugal (2019)	0.46 *	5 yrs
Italy (2019)	0.53 *	5 yrs
UK (2018)	0.78	2 yrs
Sweden (2018)	0.55 *	5 yrs
France (2017)	0.48	2 yrs
Average	**0.57**	

0.48 (2018)

* *Blume adjusted*

BEREC reports that that the majority of NRAs use a Bayesian/Blume adjustment when calculating the unlevered asset beta

ComReg's unlevered asset beta of 0.40 would be the lowest used by telecommunications NRAs in Europe and is out of kilter with recent NRA precedent, independent expert estimates and peer group analysis

Peer Group

		MSCI Index		Blume Adjusted	
	Ticker	2-Year Daily	5-Year Weekly	2-Year Daily	5-Year Weekly
BT	BT.A-GB	0.48	0.49	0.54	0.55
Deutsche Telekom	DTE-DE	0.46	0.71	0.52	0.69
Elisa	ELISA-FI	0.47	0.55	0.61	0.66
KPN	KPN-NL	0.47	0.61	0.54	0.65
Orange	ORA-FR	0.37	0.59	0.44	0.58
Swisscom	SCMN-CH	0.54	0.52	0.62	0.61
Telefonica	TEF-ES	0.43	0.57	[illegible]	[illegible]
Telenor	TEL-NO	0.48	0.69	0.61	0.75
Telecom Italia	TIT-IT	0.36	0.45	0.35	0.42
Telekom Austria	TKA-AT	0.32	0.35	0.45	0.46
Telia	TELIA-SE	0.53	0.61	0.61	0.66
proximus	PROX-BE	0.61	0.62	0.69	0.70
[illegible]	[illegible]	[illegible]	[illegible]	0.45	0.46
[illegible]	[illegible]	[illegible]	[illegible]	0.58	0.71
Tele2	TEL2.B-SE	0.75	0.65	0.77	0.70
Hellenic Teleco	HTO-GR	0.58	0.90	0.69	0.90

		MSCI Index		Blume Adjusted	
	Ticker	2-Year Daily	5-Year Weekly	2-Year Daily	5-Year Weekly
Average - All		**0.48**	**0.59**	**0.56**	**0.63**
Average - ComReg 2019		**0.46**	**0.57**	**0.52**	**0.59**
Median - All		**0.48**	**0.60**	**0.56**	**0.65**
Median - ComReg 2019		**0.47**	**0.59**	**0.54**	**0.61**

Deutsche Telekom DTE-DE 0.46 0.71 0.52 0.69
Orange ORA-FR 0.37 0.59 0.44 0.58

Sources: FactSet, KPMG

Unlevered Asset Beta

Unlevered asset beta

	Ticker	MSCI Index 2-Year Daily	MSCI Index 5-Year Weekly	Blume Adjusted 2-Year Daily	Blume Adjusted 5-Year Weekly
BT	BT.A-GB	0.45	0.49	0.51	0.54
Deutsche Telekom	DTE-DE	0.43	0.69	0.50	0.68
Elisa	ELISA-FI	0.42	0.52	0.58	0.65
KPN	KPN-NL	0.42	0.62	0.52	0.65
Orange	ORA-FR	0.37	0.60	0.44	0.59
Swisscom	SCMN-CH	0.53	0.52	0.62	0.61
Telefonica	TEF-ES	0.41	0.56	0.42	0.52
Telenor	TEL-NO	0.41	0.65	0.56	0.72
Telecom Italia	TIT-IT	0.38	0.47	0.37	0.43
Telekom Austria	TKA-AT	0.30	0.36	0.43	0.47
Telia	TELIA-SE	0.53	0.62	0.60	0.66
proximus	PROX-BE	0.58	0.64	0.67	0.71
Telenet	TNET-BE	0.34	0.38	0.41	0.44
NOS	NOS-PT	0.47	0.65	0.56	0.68
Tele2	TEL2.B-SE	0.70	0.64	0.74	0.70
Hellenic Teleco	HTO-GR	0.55	0.83	0.67	0.86
Average - All		**0.46**	**0.58**	**0.54**	**0.62**
Average - ComReg 2019		**0.44**	**0.57**	**0.51**	**0.59**
Median - All		**0.43**	**0.61**	**0.54**	**0.65**
Median - ComReg 2019		**0.43**	**0.60**	**0.51**	**0.61**

Sources: FactSet, KPMG

Presentation of Europe Economics analysis difficult to analyse, interpret and lacks transparency

NRA consultations and decisions typically include similar presentation of data – as included in eir's submission to 19/54 (as included here)

eir encourages ComReg to consider change in presentation of information

Short term fluctuations

	14 July 2019		3 October 2019	
	MSCI Index		MSCI Index	
Ticker	2-Year Daily	5-Year Weekly	2-Year Daily	5-Year Weekly
Average - All	**0.48**	**0.59**	**0.46**	**0.58**
Average - ComReg 2019	**0.46**	**0.57**	**0.44**	**0.57**
Median - All	**0.48**	**0.60**	**0.43**	**0.61**
Median - ComReg 2019	**0.47**	**0.59**	**0.43**	**0.60**

2yr median change indicates significant market fluctuation

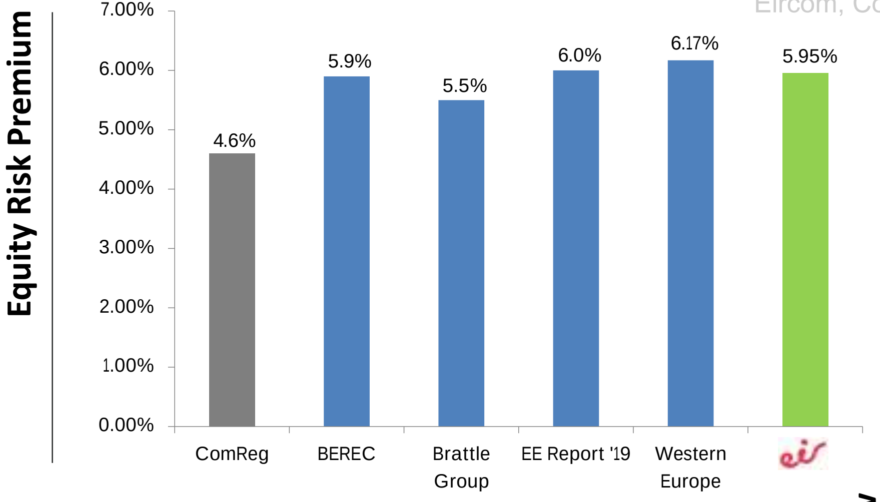
- Drop in 2yr unlevered asset beta in less than 3 months (0.48 vs 0.46) equates to a decrease in regulated return of over €6m (of three regulated products only). There are no technology developments which could support a view that the medium/long-term riskiness of the telecommunications market relative to the market has declined within this time horizon

- Highlights eir's concerns of using 2 yr time horizon – as set out in detail in eir's response to ComReg 19/54 – including in particular the market instability expected from Brexit (31 October 2019)

- Misunderstanding of Smithers & Co 2003 analysis. Not clear why or what time period has been considered by Europe Economics. The continued use of ComReg of a 2yr timeframe is hard to defend

- A 5 yr window is preferred by both EC and BEREC

Equity Risk Premium (ERP)



NRA precedent of ERP methodology supports eir's view that ComReg's estimation must be supplemented by other data sources

The WACC should be "forward-looking" and thereby anticipate future developments not reflected in the historic averages

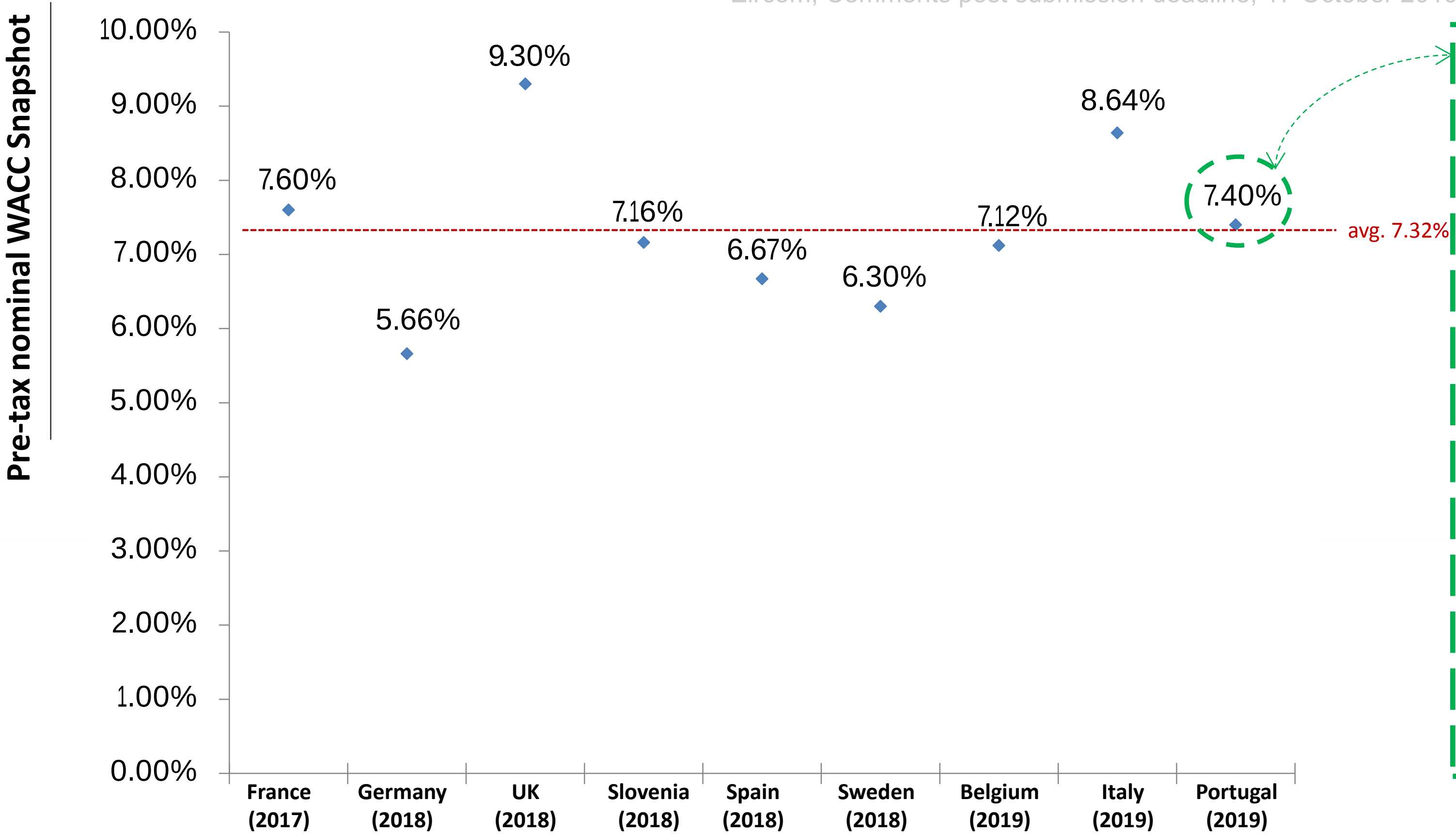
Based on the TMR method (undertaken by ComReg's consultants) the nominal ERP is in the range of 7.11%-9.6% (real ERP 7.0%-9.4%)

The wider source of equity risk premium information, as proposed by eir, which includes country specific risk, is recognised by the European Commission and has been included (and approved) as part of other NRA WACC notifications.

ERP Overview

	ERP Methodology
Portugal (2019)	DMS, Damodaran, Fernandez
Italy (2019)	DMS but also assessed against Damodaran Italy and Western Europe
Belgium (2019)	DMS, Fernandez, Fairness Finance
Sweden (2018)	DMS, Damodaran, Fernandez, PwC
Spain (2018)	DMS, Fernandez
Slovenia (2018)	Damodaran
UK (2018)	Historical premia over UK gilts & treasury bills, Academia survey, DGM, Reg. precedent
Germany (2018)	4 year market premium over US, UK & Germany gilts & treasury bills
France (2017)	5% long standing rate

Recent WACC notifications



Deconstructed

- 5 yr – Blume adjusted unlevered beta*:-
  - same peers: 0.57
  - eir peers: 0.60
  - ComReg peers: 0.59
- ERP: DMS, Damodaran, Fernandez:-
  - Irish value: 5.95%
- Gearing: 40% debt
- Irish tax rate
- Change to debt premium & RfR as per Europe Economics

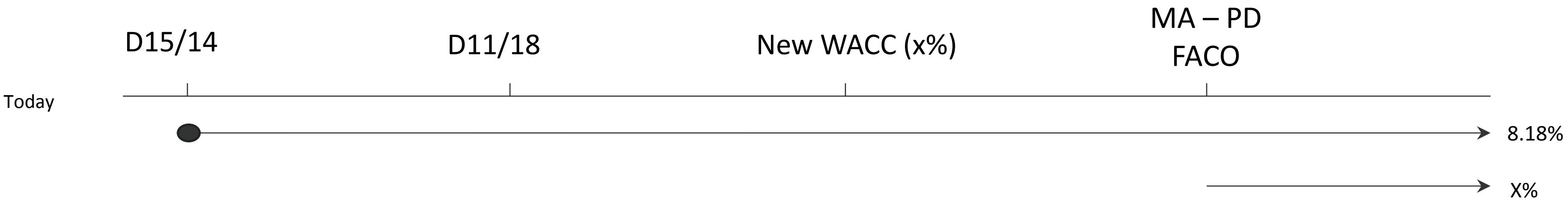
WACC:
- same peers: 8.20%
- eir peers: 8.40%

** Cut-off 14 July 2019*

Applying updated annual WACC

Today

- *ComReg D15/14: “The fixed line nominal pre-tax WACC of 10.21%, as per ComReg Decision 08/35, will remain in place as an input to existing price controls until these are reviewed”*
- eir has a legitimate expectation that the price controls when set down by Decisions, will not subsequently be varied by means of a change in the WACC carried out in isolation



ComReg consultation:

- The WACC decision will only apply to new pricing decisions…but
- eir must assess its cost-orientation obligations on an annual basis with an annually updated WACC

- ComReg is proposing to retrospectively change pricing decisions. ComReg must respect the ‘fair bet’ assumptions relative to the investment risk as it presented itself to eir as well as to other operators when ComReg set cost-oriented tariffs or margin squeeze obligations

Investment signals

- Updating the WACC on a regular basis and applying such updates to assess eir's compliance with it cost-orientation obligation **guarantees** that the true expected return over the period will never be attained. From a cost modelling perspective this is akin to updating the model every year which as a result of the tilted annuity means that eir's total cost recovery is never achieved – as this approach will be time inconsistent and will effectively truncate the future recovery of capital that is embodied in the current pricing decision. This issue has already been acknowledged by ComReg D03/16 in paragraph 5.27

- As recognised by the European Commission, it is more important that the parameters of the WACC *"reflects the financial conditions over the life of the investment rather than at any specific point in time over the life of that investment"*

- Updating the WACC on a regular basis (as suggested by ComReg) directly goes against BEREC's guidance that NRAs must recognise that the WACC is *"not merely applying a fully-defined formula"*

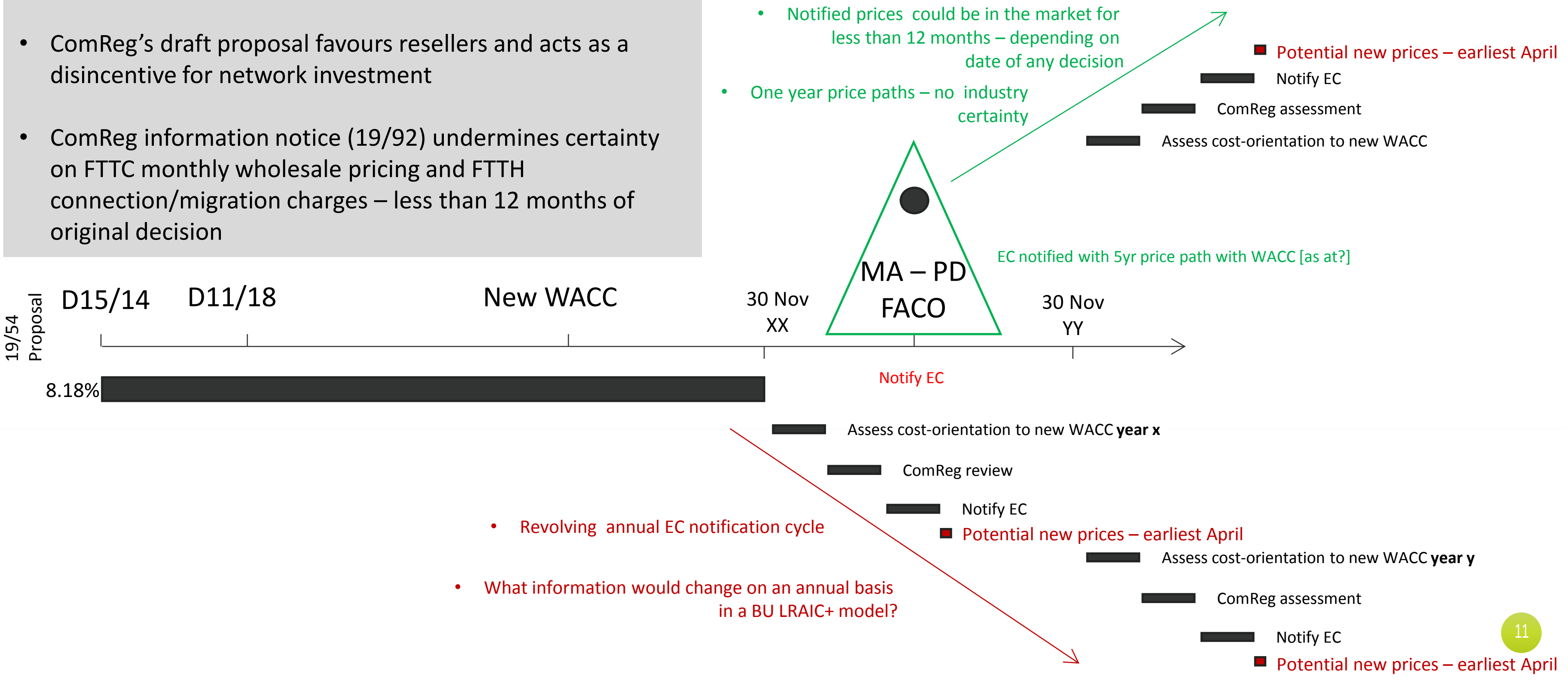
- Frequent updates to the WACC confuses the time horizons of the (notional) investor and the expected life of the telecommunications assets employed. Effectively such updates implies that the notional investor could annually liquidise their assets including unwinding debt obligations and re-capitalise and invest in telecommunications infrastructure each year. This is not a credible. In particular, as there is a difference between the actual cost of capital of a company and the theoretical weighted average cost of capital

- Similarly, the systematic risk at longer horizons for companies differs from systematic risk at very short horizons. Consistent with ComReg's regulatory objectives which are focussed on the long-term benefits of the market implies that ComReg must estimate the long-run, rather than short-run values of asset betas

19 / 54 Creates lack of certainty

Creating uncertainty and a poor investment environment

- ComReg's draft proposal favours resellers and acts as a disincentive for network investment
- ComReg information notice (19/92) undermines certainty on FTTC monthly wholesale pricing and FTTH connection/migration charges – less than 12 months of original decision



Revolving EC notifications

Annual WACC updates

- Portugal, C(2018) 5876, "Need to notify all WACC updates…the Commission considers that any new calculation of the WACC should be subject to the consultation procedures referred to in Articles 6 and 7 of the Framework Directive, regardless of whether the new WACC value results from a methodological change or simply an update of the data used in the calculation. The Commission therefore calls on ANACOM to consult interested parties and the Commission before adopting any measure related to the WACC in the future either as a stand-alone decision or as part of a market analysis or decision on remedies." [emphasis added]

- This suggests that at least two separate rounds of consultation needed for each [annual] update before ComReg could notify an update or new decision: 1) WACC and 2) Potential update of wholesale prices. This makes April implementation, which - in any event - eir does not agree is the correct economic policy, timeline from previous page highly unlikely

- Would the absence of wholesale pricing change when updated inputs offset each other still require a consultation and new EC notification?

- EC has already raised this issue as part of Article 7 notification *"Given that ComReg reserves the right to require prices to be updated depending on the new WACC value, please explain how ComReg will ensure price predictability"*

Creating certainty

- Set individual WACC as part of each market analysis. The individual WACCs are then reviewed as part of any new market analysis decision

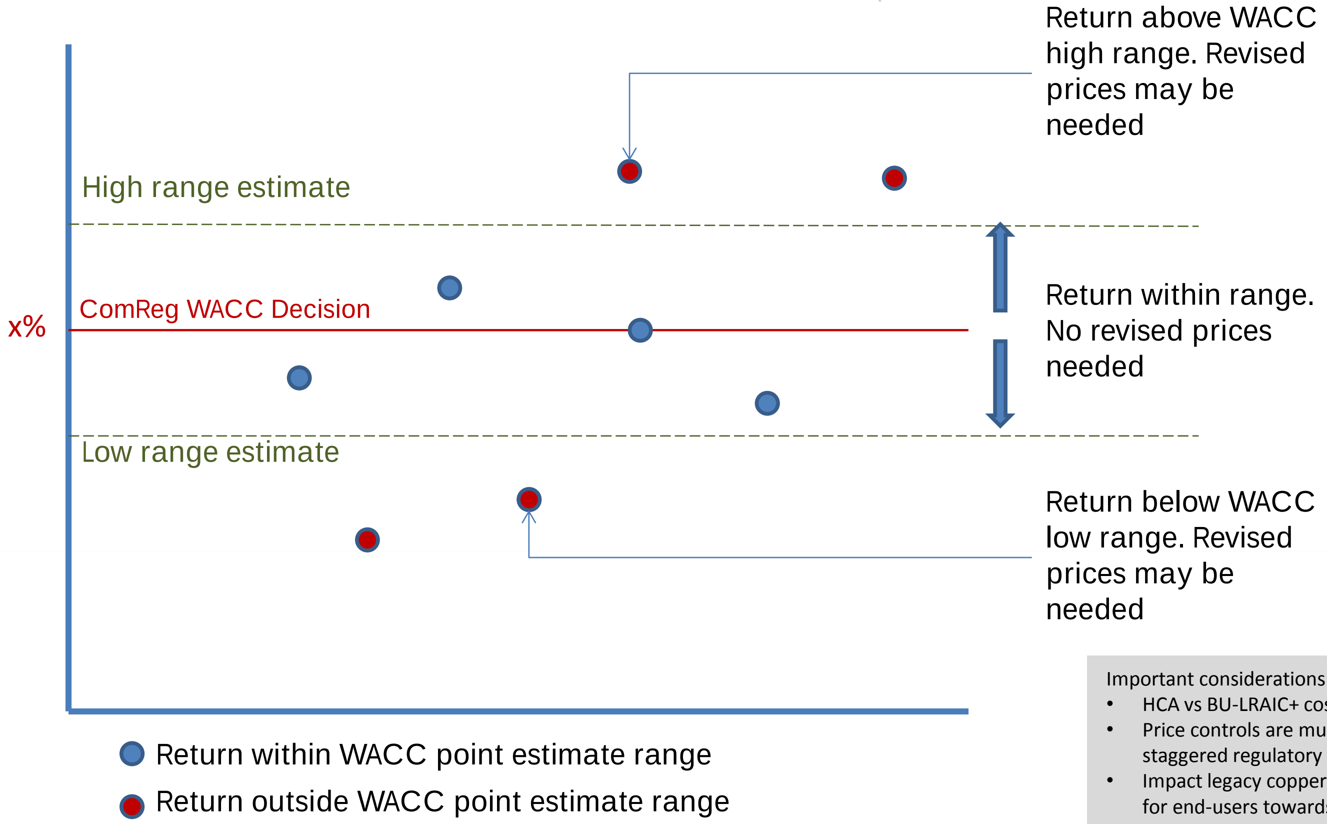
- As recognised by the European Commission, it is more important that the parameters of the WACC *"reflects the financial conditions over the life of the investment rather than at any specific point in time over the life of that investment"*

- Sets appropriate investment signals and pricing certainty for each market

- Consistent with regulatory objectives of price certainty, stability and predictability

- Assessment of cost-orientation relative to high-low WACC point estimate decision for each market (see overleaf)

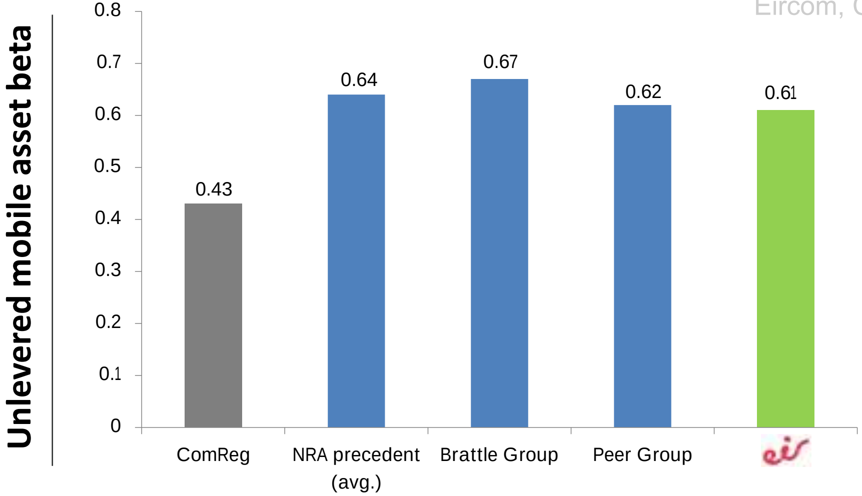
Fair returns and pricing signals

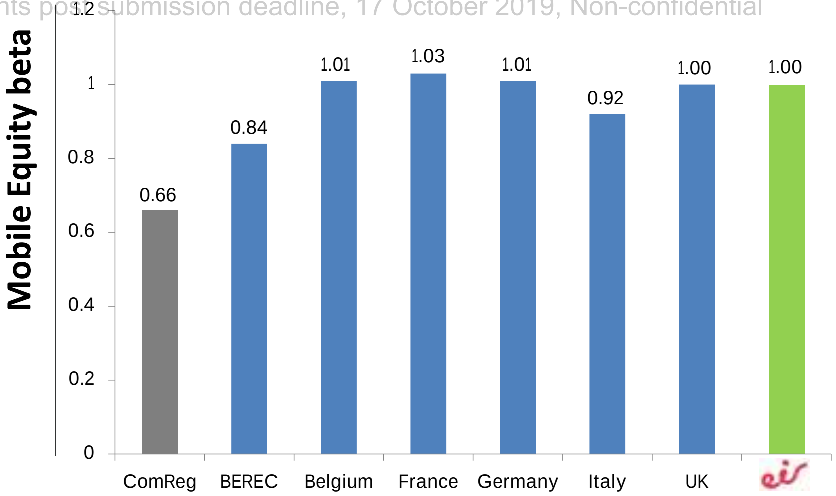


Important considerations:

- HCA vs BU-LRAIC+ cost models
- Price controls are multi-year and impacted by related and staggered regulatory pricing decisions
- Impact legacy copper prices have on the migration incentives for end-users towards future technologies including FTTH

Final observations





Equity beta = unlevered asset beta / (1- Gearing)

- Issues identified in calculation of fixed line WACC also prevalent in ComReg's draft mobile WACC

Other uses of WACC

- FTTH connection charges – informed by cost-orientation. As currently drafted there is no consideration of a WACC premium for FTTH – this is contrary to the EC recommendation. Issue of FTTC pricing as an anchor to FTTH prices and potential returns has not been considered

- CEI and NBI - providing duct and pole access to NBI is not without risk. eir cannot be in a situation where we are potentially agreeing to a project and spend of this magnitude for the parameters of any agreed deal to be later changed by regulation

Thank you

eir.ie

eir

Review of Weighted Average Cost of Capital (WACC)

- Mobile Telecommunications
- Fixed Line Telecommunications
- Broadcasting (Market A and Market B)

Supplemental Response to Consultation and Draft Decision 19/54

23 January 2020

DOCUMENT CONTROL

Document name	eir supplemental response to ComReg Consultation & Draft Decision 19/54 Review of Weighted Average Cost of Capital
Document Owner	Eir
Status	Non-Confidential

The comments submitted in response to this consultation document are those of Eircom Limited and Meteor Mobile Communications Limited (trading as 'eir' and 'open eir'), collectively referred to as 'eir Group' or 'eir'.

Please note that, for the purposes of the Freedom of Information Act 2014 and the Communications Regulation Act 2002 (as amended) and in the context of the eir Group's general rights and obligations, information supplied by the eir Group to you may contain confidential, commercially sensitive or price sensitive information consisting of financial, commercial, technical or other information, whose disclosure to a third party could result in financial loss to the eir Group, could prejudice the competitive position of the eir Group in the conduct of its business, or could otherwise prejudice the conduct or outcome of contractual or other negotiations to which the eir Group is a party.

Accordingly, you are requested to contact a member of eir Group's Regulatory Strategy Team where there is a request by any party to have access to records which may contain any of the information herein and not to furnish any information before the eir Group has had an opportunity to consider the matter.

Introduction

1. *"A cost of capital, which is too low, is unlikely to encourage efficient investment in infrastructure or the promotion of innovation as regulated entities are unlikely to invest if they consider that the regulated returns are insufficient to address their funding requirements. As a consequence, consumers, while paying lower prices, will not derive maximum choice or quality in the longer term".*[1]

2. For the reasons set out in eir's submissions on the 13 August 2019 ('Original submission') and 17 October 2019 ('Additional submission'), the applicable Weighted Average Cost of Capital ('WACC') in Ireland should be higher than ComReg's preliminary estimate and when compared against international precedent (appropriately adjusted for Irish parameters) should be materially so.

3. eir's submissions to ComReg's consultation on the WACC ('ComReg 19/54') extensively cited recommended guidance and precedent on the both the methodological approaches to the calculation of the WACC and the relevant range within which the individual parameters should reasonably fall. Based on the significant financial and regulatory precedent, available at the time, indicated that ComReg's preliminary WACC estimate would erroneously extract over €✂ million of eir's available investment capital to the detriment of end-users and competition in the Irish market.

4. As identified in eir's Original submission, the European Commission was expected to issue guidance on the calculation of the WACC later in 2019. On 6 November 2019 the European Commission published a Notice on the calculation of the cost of capital[2] (the 'Notice'). While on the 5 November 2019 it published a document (the 'Staff Working Paper')[3] which sets out in detail the methodology provided for in the Notice. eir's Original submission requested ComReg to consider whether, given the impeding publication by the European Commission, further rounds of consultation would be beneficial to allow interested parties to consider the position of ComReg, the

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[1] ComReg, Cost of Capital, ComReg Document 14/136, ComReg D15/14.

[2] European Commission, "*Commission Notice on the calculation of the cost of capital for legacy infrastructure in the context of the Commission's review of national notifications in the EU electronic communications sector*", C375/1, 6 November 2019."

[3] European Commission, "*Commission Notice on the calculation of the cost of capital for legacy infrastructure in the context of the Commission's review of national notifications in the EU electronic communications sector*", Commission Staff Working Document, SWD(2019)397final, 5 November 2019.

European Commission and BEREC on the recommended guidance for the calculation of the WACC.

5. The purpose of the European Commission's publication is to increase the consistency of the methodologies applied across Europe to calculate the WACC. The Staff Working Paper states that "*[t]he prevailing view was that methodological differences, are, at least in part, likely to distort investment decisions and create inefficiencies affecting the Digital Single Market*". This view is shared by eir: "*[t]here is a real investment flight risk from the Irish economy towards higher returns available internationally. Consequently, any misjudgement in determining the WACC for the mobile and fixed line telecommunication sectors will have significant adverse impacts on the Irish economy to the detriment of end-users*".[4] This is particularly relevant when ComReg has proposed to deviate from international best practice — resulting in a lower Irish WACC. Importantly, the European Commission's position on the calculation of the WACC (including in some instances, the likely range) is supported by BEREC[5] (of which ComReg is a member).

6. As is evident from the Staff Working Paper and European Commission's Notice, and as identified in eir's submissions, both the unlevered asset beta and the equity risk premium — as estimated on a preliminary basis by ComReg — are distinctly out of kilter with the methodologies, precedent values and proposed range now confirmed as appropriate by the European Commission. These material errors by ComReg, without correction, will wrongly lower the allowable available returns of regulated telecommunications services in Ireland by at least €✂ million.[6]

7. Furthermore, when using the regulatory objectives guiding the European Commission's publication of the appropriate WACC methodology, as identified in eir's submissions — in addition to ComReg's methodological error in calculating the unlevered asset beta — the transparency of how ComReg and its consultants have arrived at its preliminary view on the unlevered asset beta is also unclear.

8. Finally, the regulatory objectives set out in the Staff Working Paper favour the update of WACC from a consistency, predictability, efficiency and transparency objective in setting the WACC "*in parallel with (and for a period encompassing) the regulatory*

[4] eir, Original submission, paragraph 3, 13 August 2019.

[5] The Body of European Regulators for Electronic Communication.

[6] All other parameters being equal.

review period" and reviewing the WACC *"at, or close to, the time of the new pricing decision"*. This is directly counter to ComReg's preliminary proposal to require eir to retrospectively apply an annually updated WACC into extant price control decisions to assess its cost-orientation obligations — as if those future WACC rates existed at the time when setting the various regulated wholesale prices. As identified in eir's Original submission, *"The regulatory uncertainty created by ComReg's proposal to retrospectively apply the WACC to existing price-controls and/or the proposal to update the WACC annually will have a chilling effect on investment by eir and by other operators (considering or already investing in alternative infrastructures). Such outcomes are inconsistent with ComReg's objectives — as set out in Regulation 6(1) of the Access Regulations — in that ComReg's proposal fails to promote efficiency, competition, efficient investment and innovation, or to maximise benefit to end-users"*. In eir's Additional submission, the complexity and continued revolving Article 7 notifications which would result from the implementation of ComReg's preliminary view is highlighted.

9. The uncertainty and poor investment signals of this proposed approach at a practical and economic level are incorrect even on a theoretical level. As ComReg's proposal confuses the time horizons of the (notional) investor and the expected life of the telecommunications assets employed. Effectively such updates imply (updating the WACC retrospectively into existing pricing decisions) that the investor could annually liquidise their assets including unwinding debt obligations and re-capitalise and invest in telecommunications infrastructure afresh each year (as if previous price paths and build/buy decisions were just artificial and without consequence).[7] This is not credible or consistent with ComReg's regulatory objectives. In particular, as there is a difference between the actual cost of capital and the theoretical WACC proposed for regulatory purposes. See also paragraph 207 of eir's Original submission.[8]

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[7] This is also particularly relevant to associated investment in FTTH by operators including Siro and eir where the recent price path set for FTTC by ComReg act as a signal to undertake riskier full-fibre network investment. See also paragraphs 10 and 176 of eir's Original submission.

[8] eir is a privately-owned company. Its share ownership is not traded publicly. To off-set the lack of liquidity in private companies investors typically seek an investment premium (or return) for their equity stake. In financial theory this is referred to as an illiquidity premium. See paragraph 208 of eir's Original submission. Similarly, the debt premium for private companies is typically higher than those of its listed peers. Consequently, the actual cost of equity and cost of debt is higher than the notional hypothetical operator proposed by ComReg. A funding gap could result from available returns from potential investment in regulated services being lower than the actual cost of financing.

10. Finally, as set out in eir's Original submission paragraphs 223-236, ComReg has not established or consulted on the legal basis for such a change. Put simply *"For ComReg to now treat the WACC in those Decisions as an entirely standalone item that can be substituted with a new, significantly different figure without having any effect on the other elements of the Decision or the Decision overall is to act entirely contrary to how these Decisions were arrived at".*[9]

11. This paper evaluates the parameters of the WACC as proposed in ComReg 19/54 against the methodologies, or, in some cases values, as recommended by the European Commission.

12. eir remains of the view, as set out in its Original submission, that *"[c]onsistent with the equilibrium concept, ComReg must exercise its judgement in a way that properly reflects its regulatory objectives and recognise that the WACC is 'not merely applying a fully-defined formula'"*. However, as recognised in ComReg's current WACC decision (ComReg D15/14), the implications of setting the WACC too low, through lower investment and innovation, outweigh the impact of the WACC being set too high. Consequently, in forming a final decision on the individual components of the WACC formula in part or in full should not lead to a lower total WACC for Irish companies than would have occurred had the European Commission's recommended approach (in methodology or expected value) been adopted.[10]

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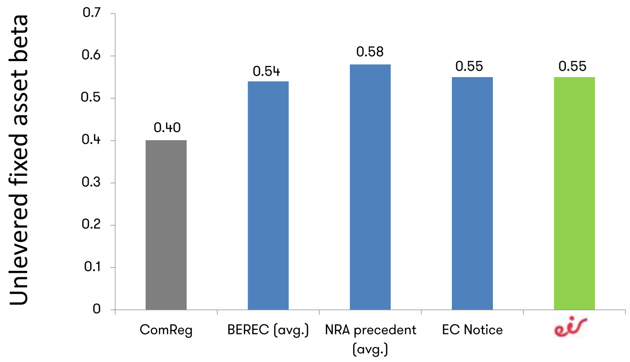
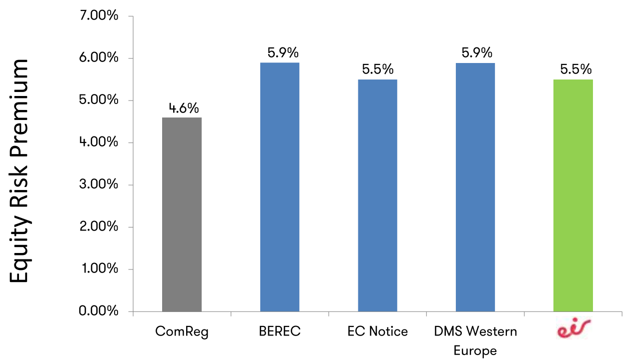
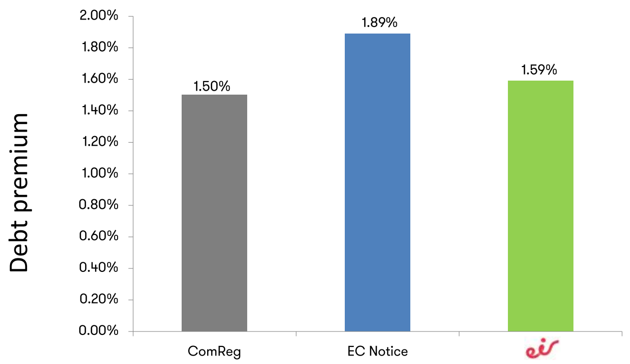
[9] eir, Original submission, paragraph 226, 13 August 2019.

[10] As set out in Table 3 and Annex 1, strictly following the European Commission's published approach suggests a range of 6.73%-6.92% for Ireland.

eir supplemental response to 19/54







WACC comparison: correcting for errors

ComReg 19/54	EC Notice	Revised WACC
6.42%	6.92%	7.94%

WACC comparison: European NRAs vs ComReg

NRA avg.*	NRA median*	ComReg 19/54
7.71%	7.96%	6.42%

Regulatory investment return incentives

- Ireland vs European average ~€✂ million lower
- Ireland vs European median ~€✂ million lower

** Source: BEREC 2019*

Section 1: Unlevered asset beta

13. ComReg's preliminary view in ComReg 19/54 appears to be that the unlevered asset beta should be calculated using a two-year average period. However, this position, as identified in eir's Original submission[11], may have been as a result of a misunderstanding of Smithers & Co (2003) findings that the stability of beta improved with the frequency of observations over which that data was observed. However, Smithers & Co (2003) does not make a specific recommendation as to the length of time that data is to be observed over. In fact, Smithers & Co (2003) uses a five-year window to demonstrate the volatility of results, depending on the frequency of observations chosen.

14. eir's Original submission discusses at length in paragraphs 69-71 and 105-111 why the appropriate time period to determine the unlevered asset beta is over 5 years. Even at the time of ComReg's consultation, both the European Commission's and BEREC's preliminary position was that a 5-year averaging period was the most appropriate period to use. However, no reasoning was provided by ComReg as to why such deviation from the European Commission and BEREC position is warranted or appropriate. In that regard, eir notes ComReg's obligation to act transparently, and provide reasons for its decisions.

15. More significantly, as evident in the Staff Working Paper and European Commission Notice the 5-year averaging period continues to be their recommended position. There are two particular extracts from the Staff Working Paper which are worth repeating here in full, to demonstrate how the regulatory objectives are met using the 5-year averaging period:

    "a methodology that provides stable parameter values (such as one that uses longer averaging periods) may somewhat reduce the pressure on regulators to change their methodology with the aim to limit market variability and shield the regulated company from market fluctuations (as it has been observed in the past with regulators' approach to the riskfree rate). In this sense, longer averaging periods would help regulators maintain a stable calculation methodology over time and thereby support regulatory predictability" and

[11] eir, Original submission, paragraph 106, 13 August 2019.

"Infrastructure investments in electronic communications networks have long lifetimes of up to 20-30 years. Regulators review periodically the allowed return on capital; this has been done at least every 3 years but the maximum review period has been extended to 5 years. In this context, the issue of whether (i) the allowed regulated return reflects the exact financial conditions at any given point in time seems of lesser importance than the objective of ensuring that (ii) the allowed return reflects the financial conditions over the lifetime of the investment. In this sense, the use of a longer averaging period implies that when set the allowed return reflects less closely the existing market conditions than the use a shorter averaging period. However, a longer averaging period is likely to broadly reflect the financial conditions existing over the lifetime of the investment, as long as the regulator maintains the same averaging period in sequential market review periods. In this regard, rather than achieving greater static efficiency by using shorter averaging periods, <u>it is relatively more important, from a regulatory policy perspective, to ensure that over the lifetime of the investment the regulated company is appropriately rewarded according to the financial conditions existing over the lifetime of its investment</u>. The use of a longer averaging period is likely to achieve this objective, as long as the regulator commits to using the same averaging period over the lifetime of the investment in its periodical market reviews [emphasis added]."

16. Of specific consideration here is that the Staff Working Paper assessed both a shorter period (including the 2-year period as proposed by ComReg) and a longer period (5-year period) and concluded that "*a 5-year averaging period strikes the right balance between predictability/stability and efficiency*". Therefore, ComReg's preliminary proposal of using a 2-year averaging period is unjustified and inconsistent with its regulatory objectives and obligations.[12]

17. While the choice of averaging period is unlikely to affect the European Commission's transparency objective, as noted in eir's Original submission to ComReg 19/54 it is not apparent from the EE Report 2019[13] how the unlevered asset beta has been derived. In that regard eir notes ComReg's obligations of transparency and to provide reasons for its decisions, which eir submits must include giving reasons where it proposes deviating from the European Commission's position. eir encourages ComReg to

[12] As set out in eir's original submission to ComReg 19/54, ComReg's shortcomings in calculating the unlevered asset beta are also evident for the mobile market.

[13] Europe Economics, EE 2019 Report, ComReg 19/54a.

improve the transparency of its unlevered asset beta calculation when publishing its final decision.

18. Finally, as evident in Table 1, the 5-year arithmetic average of the peers identified by eir (see paragraphs 112-124 of eir's Original submission) is 0.55 compared to 0.50 for the two-year period (for those peers identified by ComReg in 19/54). The comparative gap (between 0.55 and 0.50) represents a difference of ~ €✂ million (all other parameters remaining equal) in the return of efficiently incurred costs of eir and an erroneous extraction of re-investment capital from the Irish economy.

19. Consequently, ComReg must correct this material methodology error and revert — as published by the European Commission — to the use of a 5-year averaging period for the calculation of the unlevered asset beta for both the fixed and mobile sectors.

Table 1: Unlevered fixed asset beta values

		MSCI Index	
	Ticker	**2-Year Weekly**	**5-Year Weekly**
BT	BT.A-GB	0.64	0.51
Deutsche Telekom	DTE-DE	0.42	0.63
Elisa	ELISA-FI	0.15	0.48
KPN	KPN-NL	0.47	0.54
Orange	ORA-FR	0.38	0.52
Swisscom	SCMN-CH	0.47	0.53
Telefonica	TEF-ES	0.45	0.53
Telenor	TEL-NO	0.35	0.59
Telecom Italia	TIT-IT	0.54	0.51
Telekom Austria	TKA-AT	0.23	0.37
Telia	TELIA-SE	0.59	0.61
Proximus	PROX-BE	0.43	0.58
Telenet	TNET-BE	0.20	0.37
NOS	NOS-PT	0.67	0.61
Tele2	TEL2.B-SE	0.52	0.63
Hellenic Teleco	HTO-GR	0.71	0.75
Average - All		**0.45**	**0.55**
Average - ComReg 2019		**0.50**	**0.55**
Median - All		**0.46**	**0.54**
Median - ComReg 2019		**0.47**	**0.53**

Source: FactSet, cut-off date 6 January 2020, KPMG Corporate Tax Table

20. As evident in Table 1, the arithmetic average on a 5 year weekly range is 0.55 (for both sets of peer groups).

Section 2: Equity Risk Premium ('ERP')

21. ComReg's preliminary view was the ERP should be derived from the historical data estimate by Dimson Marsh Staunton ('DMS'). ComReg's consultants Europe Economics applied a downward adjustment to the DMS methodology to reflect their desire to capture the economic contraction (in Europe Economics' view) of the Irish market between 1960Q2 and 2018Q3. However, as identified in eir's Original submission, no such downward adjustment was proposed by Europe Economics in 2014, even though the data series is largely the same. In fact, using approximately the same data, Europe Economics recommended an upward adjustment to the Irish ERP in ComReg D15/14. No reasons have been provided for this change in approach.

22. eir's submissions recommended a wider source of historical and survey information to determine an Irish ERP. eir proposed the further sources (including DMS) of Damodaran and Fernandez which are both recognised by the European Commission and have been included (and approved) as part of other NRA WACC notifications. Specifically, eir's Additional submission detailed those other additional sources. This Additional submission demonstrated that recent NRA precedent decisions on ERP include a wider source of information than solely using DMS as proposed by ComReg.

23. The Staff Working Paper states that the recommended approach is to use a European Union-wide ERP, as opposed to a domestic parameter value. The European Commission states that a Union-wide ERP *"will ensure greater practicability and stability of the value"* and *"the evidence on the strong correlation between EU equity markets and the limited 'home bias' in the ownership of EU electronic communication companies suggests that it may be more efficient to rely on a notional Union-wide parameter"*. Therefore, an Irish specific ERP as proposed by both ComReg and eir (although differing in methodologies) is not considered appropriate by the European Commission. However, the resulting value from the European Commission's approach is closer to that proposed by eir.

24. The Staff Working Paper does not conclude on the specific source of the historical ERP. However, it is likely, given the European Commission's previous acknowledgment to their validity,[14] that such potential sources could include DMS, Damodaran and Duarte in part or in combination.

[14] eir, Original submission, paragraph 44, 13 August 2019.

25. More interestingly and applicable, for ComReg's potential imminent decision on the WACC, the Staff Working Paper states the ERP will be published by BEREC and categorically that *"[t]he single Union-wide equity risk premium estimated by BEREC will likely be similar to the values described above [i.e., 5%-5.5% as recommended by the Brattle Group and 5.8% being the average of the ERP notified by NRAs in 2017]".*

26. The likely ERP range, as indicated by the European Commission, is above the rate proposed in ComReg 19/54 of 4.6% and significantly above the rate of 4.2% identified as a possible appropriate European-wide rate in the EE 2019 Report. However, as identified by Europe Economics, the 4.2% DMS rate includes an estimate for Russia. Therefore, it is likely that some adjustment may need to be made even on a standalone DMS basis to get a more accurate estimate of an appropriate European wide rate[15] — noting also in particular, Stehle's recommendation that *"due to the importance of data quality when calculating ERP, only DMS data from the United States, United Kingdom and Germany should be used".*[16] eir notes that the DMS for Western European countries is 5.89%[17] which is also comparable to the BEREC 2019 benchmark of 5.93%.[18] This suggests that European Commission's guidance to the appropriate likely range is highly achievable.

27. eir considers the publication by the European Commission of the appropriate likely range of the ERP of 5.0%-5.8% is particularly relevant in an Irish context where the difference of using the European rate per DMS (2017) of 4.3% compared to 5.0%-5.8% (European Commission's likely lower and higher bounds) is a reduction of available returns of €✂ million - €✂ million respectively.

28. For prudence, ComReg's final decision should at least use the low-high range of 5.0%-5.5% to derive an appropriate point estimate of the WACC. The impact on the WACC of using the lower bound range is set out in Table 3.

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[15] The DMS European rate is also only based on 16 countries. Some of those countries like Russia are not part of the European Union.

[16] The Body of European Regulators for Electronic Communication, BoR (19) 240.

[17] Western Europe is defined as: Spain, Germany, UK, Italy, France, Sweden, Belgium, Norway, Denmark, Portugal, Finland and Ireland.

[18] The Body of European Regulators for Electronic Communication, BoR (18) 215.

Section 3: Gearing

29. As the gearing in the WACC formula is based on a notional hypothetical operator, ComReg is approximating the debt to equity capital structure of the regulated firm.

30. As such, it is appropriate to use a notional industry-wide gearing. The use of a generic notional operator is also consistent with the methodology applied by the majority of NRAs. Neither the Staff Working Paper nor European Commission's Notice suggests that this approach is unreasonable.

31. As set out in eir's Original submission, eir considers that the point estimate of 40% appears reasonable for the debt profile of a fixed line operator and is in line with the median value used by other NRAs.[19]

32. However, for the mobile sector, ComReg's proposed debt profile of 35% is low in comparison to the average gearing of relevant mobile peers. Using the gearing data as published in Table 5.3 of the EE 2019 Report[20] and removing less relevant peers[21] suggests that a gearing of 39% is more appropriate and reflective of the hypothetical efficient operator.

	Gearing Dec 2018
Deutsche Telekom	38.2%
Orange	41.6%
Telefonica	48.8%
Telia	11.7%
Telecom Italia	61.3%
Vodafone	33.6%
Average	**39.2%**

33. In order to replicate the gearing of a hypothetically efficient operator, it should be reflective of current industry-wide gearing, which ComReg's proposed debt profile is not.

34. Consequently, the gearing ratio used by ComReg in updating the mobile WACC should be amended to reflect a debt ratio of 39%.

[19] The Body of European Regulators for Electronic Communication, BoR (18) 215.
[20] Europe Economics, EE 2019 Report, ComReg 19/54a
[21] See paragraphs 76-77, eir Original submission, 13 August 2019.

Inflation

35. ComReg 19/54 proposed an inflation rate of 1.3% based on a 2-year forecast for Ireland. eir's Original submission proposed 1.8%, based on the long term inflation rate to match the period of bonds maturity and potential inflationary impact of Brexit on Irish prices.

36. The Staff Working Paper states that *"it would be more appropriate to use a notional EU-wide inflation rather than a domestic one"* and while it would best to use a 10-year forecasting period that *"[a]s there are rarely such long-term inflation forecasts, using the ECB's long-term (5 years) inflation forecast would be appropriate"*. Consequently, the European Commission does not favour ComReg's approach.

37. The 5-year forecast rate as published by the European Central Bank for the EU is 1.7% as at 18 December 2019.[22] Consequently, ComReg's preliminary value is not consistent with European Commission's expectations.

38. The preliminary value proposed by ComReg of 1.3% compared to the recommended inflation rate of 1.7% results in an under-recovery of eir's costs of ca. €✂ million.

39. eir submits that the appropriate inflation rate to use is 1.7% as published by the European Central Bank and as recommended by the European Commission.

Taxes

40. ComReg 19/54 proposed that the statutory tax rate should be used. eir continues to agree with that view.

41. The European Commission Notice states that *"The Commission considers it appropriate to use the relevant domestic corporate tax rate, which is the common approach adopted by NRAs, to estimate the pre-tax WACC"*.

42. Consequently, ComReg's proposed approach is consistent with that recommended by the European Commission.

[22] https://www.ecb.europa.eu/stats/ecb_surveys/survey_of_professional_forecasters/html/table_hist_hicp.en.html

Section 4: Debt premium

43. ComReg 19/54 proposed a debt premium of 1.5% based on the average spread of peer's corporate bonds versus the appropriate government bond benchmark which for European companies was a 10-year German government bond.

44. eir's Original submission noted that while the peer group should be enlarged for reasons identified in paragraphs 112-115 that the range appeared appropriate based on average value used by NRAs.

45. The Staff Working Paper states that the "*most appropriate approach is to estimate a range of debt premiums for a peer group of EU benchmarks from which the NRAs can select the appropriate value for their SMP operator (having regard to its characteristics) and add this to the estimated risk-free rate to derive the cost of debt*".

46. eir considers that "*having regard to its characteristics*" means that not all peers are appropriate relative to Ireland or eir as the SMP operator. Standard & Poor's BBB rating "*corresponds to obligations with adequate capacity to meet financial commitments* <u>*but more subject to adverse economic conditions*</u> *[emphasis added]*". For the reasons set out in eir's Original submission, with the foreboding uncertainties of the Irish economy as a result of Brexit it would seem prudent "*having regard to its characteristics*" to only consider peers with credit ratings of BBB. This excludes Swisscom, Proximus and Telenor from the peer group relevant for calculating the debt premium. This also suggests that more weight should be given to BT, as the SMP operator which is most likely to face similar economic conditions as eir in the near term future.

47. As evident in Table 2, having regard to the characteristics of eir (see paragraph 46) whose returns are solely based on the Irish economy, the average corporate bond yields with remaining maturity of between 9 and 13 years is 1.85%.[23] More specifically, the corporate bond yield of BT is 3.16%.

[23] As required by the European Commission Notice, "*as close as possible to the 10-year maturity for the RFR*", eir has used corporate bond with remaining maturities between 9 and 13 years issued since 1 January 2015 (providing a 5-year averaging window — as required by the European Commission Notice).

Table 2: Corporate bond yields

Company	Average Bond Yield
BTGroup	3.16%
DeutscheTelekom	1.12%
Orange	1.54%
Telefonica	0.79%
Telia	2.67%
Average	1.85%

Source: Bloomberg, 6 January 2020

48. As the corporate bonds are issued in multiple currencies, eir considers the 5-year average on 10-year German bond yields provide an appropriate benchmark for the Eurozone to determine the approximate debt premium required by notional investors. This generates a debt premium of 1.59% (1.85% minus 0.26%).

49. The equivalent debt premium for BT corporate bond yields versus 5-year average on 10-year UK government bond yields is 1.89% (3.16% minus 1.3%).

50. eir considers that a debt premium range of 1.59% - 1.89% appears reasonable. On balance, a debt premium of 1.59% appears appropriate in circumstances where ComReg, correctly in eir's view, continue to use the forward looking Risk-free rate of 2.10% (see paragraphs 52 and 56) to recognise the relationship of the risk free rate and cost of debt in calculating the debt premium. Similarly, if ComReg uses the lower risk-free rate of 0.78% (Factset, 6 January 2020, see also paragraph 57) then the higher debt premium of 1.89% is appropriate.

Section 5: Risk-free rate

51. In ComReg 19/54 ComReg states that *"due to the global financial crisis that started in 2008 current Eurozone bond rates may not be fully representative of the risk-free rate over the period that the proposed WACCs will be used"* and consequently with the assistance of their consultants estimate a point estimate of 2.1% for the Irish risk-free rate.

52. eir's Original submission agreed with ComReg's view that *"to base the risk-free rate on current yields on government bonds would lead to an artificially low estimated risk-free rate for forward-looking WACC estimates"* and that a normalised risk-free rate for Ireland of 2.1% appears appropriate.

53. The Staff Working Paper states that *"A risk-free rate based on yields on national government bonds is more likely to appropriately reflect a true risk-free rate for a specific country"*. As such, ComReg's proposed approach to use Irish government bonds is correct.

54. The Brattle Group estimate that *"the impact of QE on 10-year government bond yields has been between 16 and 80 basis points, with an average of 40 basis points"*. The Brattle Report states that *"[i]n this case it is reasonable for NRA's to make an upward adjustment to observed yields when estimating the risk-free rate, while the QE program is in place. An upward adjustment of up to 1 percentage point seems reasonable, taking into account both the credit rating of each MS, and the overall duration and scale of the monetary program"*. However, the Staff Working Paper states that *"adjustments to the risk-free rate estimate (in order to account for QE programmes…are considered unnecessary"*. Based on the fact that the methodology proposed by Europe Economics is the same as the approach used in setting the risk-free rate in D15/14 which the BEREC summary describes as "Aiming up", it unclear whether a QE adjustment is proposed in ComReg 19/54.[24]

55. However, ComReg's consultants have made an adjustment to the Irish risk-free rate based on an assessment of the appropriate future risk-free rate of Ireland using an econometric model providing *"a judgement as to the underlying equilibrium value of the risk-free rate for the Eurozone, treating the Eurozone as by-and-large one capital market (though we shall argue that Ireland's strong macroeconomic performance*

[24] The Body of European Regulators for Electronic Communication, BoR (19) 240.

justifies placing it above the mid-point of the plausible equilibrium risk-free rate range for the Eurozone). We form this judgement based on a review of the macroeconomic outlook, bond yields across the Eurozone and regulatory precedent".[25] Subject to ComReg moving to a final decision on the WACC, any comments received from the European Commission following Article 7 notification should provide greater guidance as to the validity of ComReg's proposed methodology in respect to this parameter.

56. eir maintains its view that basing the risk free rate on current government bonds would lead to an artificially low estimated risk-free rate for the forward-looking WACC rate and therefore it is appropriate that regulatory policy can mitigate the effect of this distortion through the use of adjustments using the equilibrium concept. In particular, consideration should be given by ComReg that the recently notified WACC rate by the UK (Ireland's nearest trading partner) is 7.9% and 8.9% depending on the regulated wholesale service. Annex 2 sets out the average and median WACC rates currently in force throughout Europe and the rates most recently notified by other NRAs. Annex 3 compares ComReg's proposed WACC rate against the average parameter values currently used by NRAs and the Irish rates derived from the European Commission Notice and Staff Working Paper. This benchmark view of comparative WACC rates across Europe again highlights the downgraded Irish WACC rate proposed by ComReg.

57. For comparative purposes, in Table 3, eir has included the 5-year average yield on 10-year Irish government bonds (without adjustment (see paragraph 55)) to determine the risk-free rate and resulting Irish WACC. As evident in that analysis the resulting WACC is higher than that originally proposed by ComReg using both the lower and upper ERP range.

58. Annex 1 of this submission also recalculates the Irish WACC using the same ERP estimate as the Staff Working Paper of 5.2% (see paragraph 65). This analysis derives an Irish WACC of 6.73%.

59. As set out in paragraph 12, these are important points of reference as the resulting range of 6.73% (as set out in Annex 1) and 6.92% (as set out in Table 3) represents the minimum rate that ComReg's WACC decision could justifiably fall to. Any adjustment to ComReg's original proposal using an equilibrium approach (used by ComReg to

[25] Europe Economics, EE 2019 Report, ComReg 19/54a

deviate away from the European Commission's methodology) must only result in an overall range which is a premium to that rate. See also paragraph 65.

Section 6: Corrected ComReg WACC estimate and comparable EC approach

60. Table 3 corrects the WACC parameters proposed by ComReg in 19/54, in light of appropriate European Commission methodologies and/or values.

61. For comparison purposes the high-low range of strictly following the European Commission methodology is also presented.

62. As set out in paragraph 11, in forming a final decision on the individual components of the WACC formula in part or in full should not lead to a lower WACC for Ireland than would have occurred had the European Commission's recommended approach (in methodology or expected value) been adopted.

63. Greater weight should be given to the higher ERP range of 5.5% as the Staff Working Paper notes that it expects a similar range to that already published which includes the NRA average of 5.8% (see paragraph 27).

64. However, even in using the lower bound ERP rate of 5% and correcting ComReg's unlevered asset beta calculations, inflation rate and updating the cost of debt results in an Irish WACC of 7.94%.

65. For illustrative purposes Annex 1, replicates the comparison undertaken in the Staff Working Paper of the minimum and maximum WACC value estimated for Ireland based on a mixture of values set by ComReg in 2014 and European Commission proxy values. Using that initial high-level comparative exercise undertaken by the European Commission, eir has updated all historic parameters to current values or those values deemed likely by the Staff Working Paper. The resulting WACC rate is also higher than proposed by ComReg in 19/54. The difference, even in this illustrative example, between the proposed rate of ComReg in 19/54 of 6.42% and the updated European Commission rate of 6.73% estimate using the Adjusted Staff Working Paper comparison represents an under-recovery of eir's efficiently incurred costs of ~€✂ million.

66. For the reasons set out in paragraph 28, and as set out in paragraphs 57 and 58, the minimum justifiable rate in strictly following the European Commission's approach for Ireland is 6.73% to 6.92%.

Table 3 Arriving at an appropriate Irish WACC

Parameter	Draft ComReg (2019)	EC low-range	EC high-range	Corrected ComReg low-range (2019)	Comment
Unlevered Beta Telecom Sector	0.40	0.55	0.55	0.55	Corrected: use of 5-year unlevered asset beta per EC Notice
Gearing (D/E)	40.00%	40.00%	40.00%	40.00%	
Leverage (D/(D+E))	28.6%	28.6%	28.6%	28.6%	
Tax Rate	12.5%	12.5%	12.5%	12.5%	
Equity beta	0.67	0.92	0.92	0.92	
Risk Free Rate	2.10%	0.78%	0.78%	2.10%	Risk-free rate depending on EC interpration
Inflation	1.3%	1.7%	1.7%	1.7%	Corrected: use of 5-year forecast ECB inflation rate per EC Notice
Nominal Risk Free Rate	3.43%	2.49%	2.49%	3.84%	
Equity Risk Premium	4.60%	5.00%	5.50%	5.00%	Corrected: ERP range as proposed likely by Staff Working Paper
Cost of Equity (EUR)	6.49%	7.08%	7.53%	8.42%	
Pre-Tax Cost of Equity (EUR)	7.42%	8.09%	8.61%	9.62%	
Debt premium	1.50%	1.89%	1.89%	1.59%	Corrected: Now reflects peers "having regard to characteristics" of eir per EC Notice
Cost of Debt (Pre-Tax)	4.93%	4.38%	4.38%	5.43%	
Tax Rate	12.5%	12.5%	12.5%	12.5%	
Cost of Debt (EUR) - Post Tax	4.3%	3.8%	3.8%	4.7%	
Pre-tax WACC	6.42%	6.61%	6.92%	7.94%	Corrected: Even low range using ComReg approach above originally proposed in 19/54

Section 7: Implementing a revised WACC

67. ComReg 19/54 has two distinct proposals regarding an updated WACC. The first is that the WACC could be updated annually. The second is that eir should use that annually updated WACC to assess its cost-orientation compliance with extant pricing decisions.

68. eir's Original submission agreed that the WACC could be updated more frequently. However, that there are sound economic, legal and policy reasons for not reviewing existing price controls with updated WACC assumptions within price control periods.

69. It is clear from the Staff Working Paper that the European Commission's views are aligned with the submitted position of eir.

70. The Staff Working Paper suggests that the WACC could be updated at least once per year. However, in the application of a new WACC that in order to meet its regulatory objectives of:

    i. Predictability: that it "*suggests adopting a predictable approach when estimating the WACC, for example, one that foresees that the WACC will be estimated at each relevant regulatory decision or at a point sufficiently close in time to that decision*";

    ii. Efficiently: that "*it would be preferable to estimate the WACC in parallel with (and for a period encompassing) the regulatory review period*"; *and*

    iii. Transparency: by "*Reviewing WACC estimates at, or close to, the time of the new pricing decision*".

71. Consequently, there is a clear delineation by the European Commission between calculating the WACC annually and the application of that updated WACC rate. The concluding sentence in the Staff Working Paper on this topic surmises the European Commission position very succinctly, by encouraging NRAs to make preparations on the update of the WACC to "*ensure synchronicity between the WACC estimation and the regulatory decision*". This view is shared by eir, as stated in the Original submission, "*[t]his sequencing of relevant decisions*[26] *ensures that any further specifications of pricing remedies, to which the forward looking WACC applies, is also*

[26] Including that the revised WACC is only applicable to those specific market analysis pricing remedies.

consistent with the time horizon considered as part of the market analysis in determining that such pricing remedies are warranted".[27]

72. Finally, as set out in eir's Original submission, from a legal perspective, ComReg cannot simply introduce a new, significantly different WACC figure into a pre-existing Decision without fully assessing the impact on the other elements of the Decision or the Decision overall. To do so would be to act entirely contrary to how these Decisions were arrived at.

73. Consistent with the European Commission's Staff Working Paper, ComReg should undertake a WACC consultation and decision at the same time as a market analysis consultation/decision. The resulting point estimate WACC decision can then be applied to any new pricing decisions which are further specifications of that market analysis decision.[28]

[27] eir, Original submission, paragraph 151, 13 August 2019.

[28] However, this could only be in circumstances of a new price control, subject to appropriate consultation after the market analysis decision has been made. This does not apply to pre-existing price controls made under previous market analysis decisions which are simply being rolled-over and carried into new market analysis decisions. For those circumstances, the specific pre-existing WACC should continue to apply.

Annex 1: Comparison of the approx. pre-tax nominal WACC values estimated in the Staff Working Paper and updated values[29]

Parameter	ComReg (2014)	Staff Working Paper, Page 92: Staff Working Paper estimate (low)	Staff Working Paper, Page 92: Staff Working Paper estimate (high)	Adjusted Staff Working Paper low range 2020	Comment
Unlevered Beta Telecom Sector	0.60	0.50	0.67	0.55	Updated: EC high-low estimate and 6 January 2020 5-year unlevered asset beta
Gearing (D/E)	40.00%	40.00%	40.00%	40.00%	
Leverage (D/(D+E))	28.6%	28.6%	28.6%	28.6%	
Tax Rate	12.5%	12.5%	12.5%	12.5%	
Equity beta	1.00	0.83	1.12	0.92	
Risk Free Rate	2.20%	0.78%	0.78%	0.78%	Updated: 6 January 2020, Non-adjusted, 5-year avg. on 10 year Irish govt. bonds
Inflation	1.5%	1.5%	1.5%	1.7%	Updated: 6 January 2020, 5-year forecast ECB inflation rate
Nominal Risk Free Rate	3.73%	2.29%	2.29%	2.49%	
Equity Risk Premium	5.00%	5.20%	5.20%	5.20%	Updated: Staff Working Paper Estimate
Cost of Equity (EUR)	8.73%	6.63%	8.10%	7.26%	
Pre-Tax Cost of Equity (EUR)	9.98%	7.57%	9.26%	8.30%	
Debt premium	1.75%	1.75%	1.75%	1.89%	Updated: 6 January 2020, values and peers "having regard to characteristics"
Cost of Debt (Pre-Tax)	5.48%	4.04%	4.04%	4.38%	
Tax Rate	12.5%	12.5%	12.5%	12.5%	
Cost of Debt (EUR) - Post Tax	4.8%	3.5%	3.5%	3.8%	
Pre-tax WACC	8.18%	6.16%	7.17%	6.73%	Updated: Adjusted WACC point estimate in Staff Working Paper also above ComReg proposal

[29] The Staff Working Paper low-high estimate is based on: The low-high unlevered asset beta of 0.50 to 0.67 as derived by the Brattle Group, an updated 5-year avg. on 10-year Irish Govt. Bonds to estimate risk-free rate, an equity risk premium of 5.2% per Staff Working Paper, gearing and debt premiums as derived by ComReg in 2014. In order to replicate the approximate values in the Staff Working Paper (page 92) the inflation rate as determined by ComReg in 2014 is also held constant. When these values are updated it results in an Irish WACC of 6.73%.

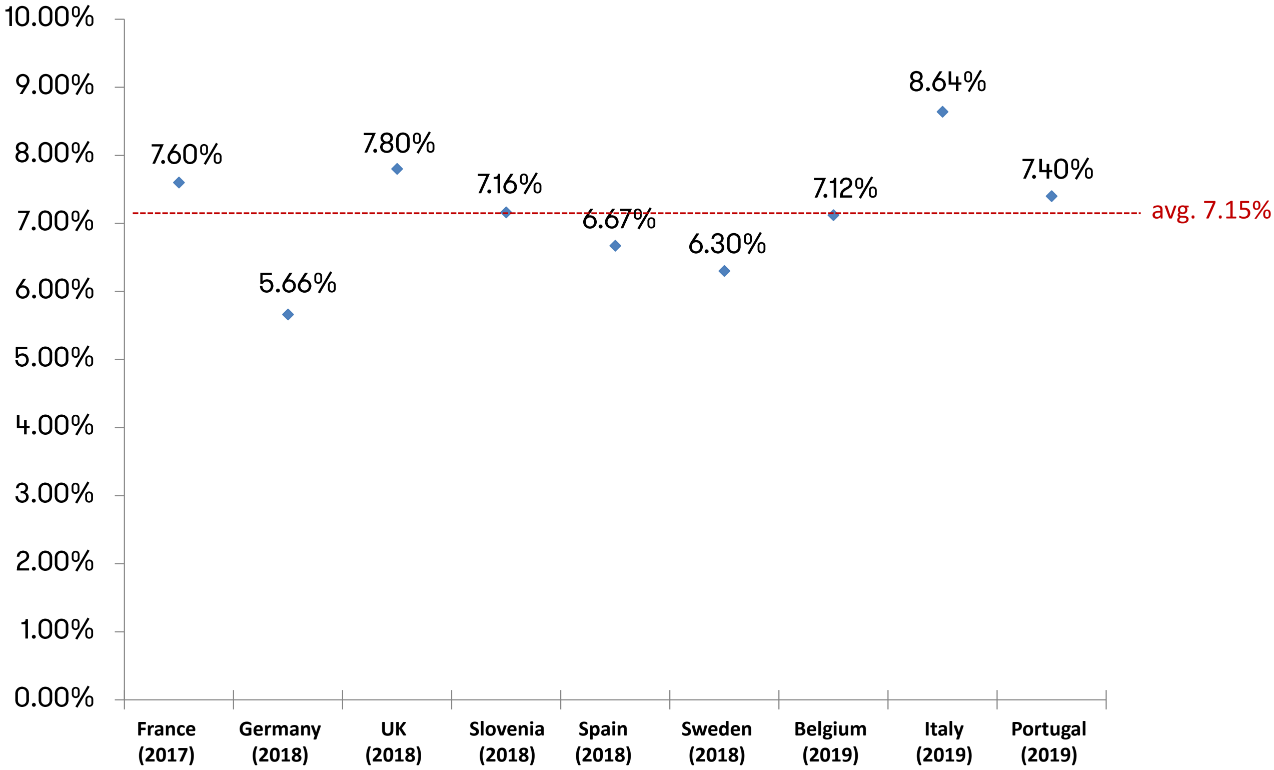
Annex 2: WACC rates across Europe

WACC rates currently in force in Europe

	Average	Median
WACC fixed Nominal Pre-tax; 32 NRAs (2018)	7.71% (7.96%)	7.28% (7.73%)
WACC mobile Nominal Pre-tax; 26 NRAs (2018)	8.59% (8.73%)	8.11% (8.11%)
WACC fixed Nominal Pre-tax; 26 EU NRAs (2018)[8]	7.60% (7.86%)	7.28% (7.73%)
Wacc mobile Nominal Pre-tax; 23 EU NRAs (2018)	8.22% (8.34%)	7.63% (7.89%)

Source: BEREC RA database 2019

Recently notified fixed WACC rates



Annex 3: Comparison of ComReg proposal to published NRA average values[30] and EC Notice

Parameter	Draft ComReg (2019)	NRA average benchmark (2019)	EC high-range	Comment
Unlevered Beta Telecom Sector	0.40	0.54	0.55	Updated: 6 January 2020, 5-year unlevered asset beta
Gearing (D/E)	40.00%	37.70%	40.00%	
Leverage (D/(D+E))	28.6%	27.4%	28.6%	
Tax Rate	12.5%	12.5%	12.5%	
Equity beta	**0.67**	**0.87**	**0.92**	
Risk Free Rate	2.10%		0.78%	Updated: 6 January 2020, Non-adjusted, 5-year avg. on 10 year Irish govt. bonds
Inflation	1.3%		1.7%	Updated: 6 January 2020, 5-year forecast ECB inflation rate
Nominal Risk Free Rate	3.43%	2.70%	2.49%	
Equity Risk Premium	4.60%	5.93%	5.50%	Updated: Staff Working Paper Estimate
Cost of Equity (EUR)	6.49%	7.84%	7.53%	
Pre-Tax Cost of Equity (EUR)	**7.42%**	**8.96%**	**8.61%**	
Debt premium	1.50%		1.89%	Updated: 6 January 2020, values and peers "having regard to characteristics"
Cost of Debt (Pre-Tax)	4.93%	4.00%	4.38%	
Tax Rate	12.5%	12.5%	12.5%	
Cost of Debt (EUR) - Post Tax	**4.3%**	**3.5%**	**3.8%**	
Pre-tax WACC	6.42%	7.09%	6.92%	Updated: Adjusted WACC point estimate in Staff Working Paper also above ComReg proposal

[30] Individual parameters per NRA averages as published in BEREC (2019) 240. For calculation purposes the Irish tax rate is used in the NRA benchmark analysis.

From: [redacted]
Sent: Wednesday 19 February 2020 12:10
To: [redacted]
Cc: [redacted]
Subject: Ofcom WACC proposal

[redacted]

I am not sure if you have seen Ofcom's recent publication which includes in Annex 21 an update on the proposed WACC - consistent with its methodology to only review the WACC as part of its Market review cycles.

It is interesting to see the relative stability of Ofcom's proposed WACC rate over time including that dating back to 2018. There is also some apparent transferable key objectives in the framework used by Ofcom in determining an appropriate rate of return.

I have attached the consultation for ease of reference.

[redacted]

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From: ✂
Sent: Monday 25 May 2020 17:40
To: ✂
Subject: non-confidential WACC

✂

I refer to the update of ComReg's work programme and the anticipated decision on the weighted average cost of capital ('weighted average cost of capital') in Q2 2020. As set out in eir's submission to ComReg 19/54, ComReg has failed to consult on the appropriate WACC for NGA services. This means any pending decision from ComReg on the appropriate WACC cannot apply to FTTC or FTTH services.

There is no economic assessment undertaken in ComReg's consultation (ComReg 19/54) on the WACC to allow ComReg to suitably determine (or industry to consider) whether a risk premium is appropriate for investment in NGA. In fact, the full consideration of ComReg's "consultation" on whether a risk premium is appropriate for FTTC refers only to a previous ComReg Decision (ComReg D11/18) which, as identified in eir's submission to ComReg consultation 19/54, does not adequately address the issues identified by the 2010 NGA Recommendation nor does ComReg D11/18 take the utmost account of the European Commission's expressed concerns of that notified measure.

In addition, in respect to FTTH connection/migration charge, as identified in eir's submission to ComReg 19/54, ComReg's consultation fails to consider the appropriate WACC premium for FTTH. As submitted by eir *"✂."*

Notwithstanding ComReg's procedural failure to consult as required pursuant Article 6, Article 7 and Article 8 of the Framework Directive, the extant decision on WACC (ComReg D15/14) is categorically clear the new rate would only apply to new pricing decisions made prospectively *"In the fixed line telecommunications sector, the tariffs will be applied prospectively. The fixed line nominal pre-tax WACC of 10.21%, as per ComReg Decision 08/35, will remain in place as an input to existing price controls until these are reviewed, at which point it is anticipated that the most recent estimated fixed line WACC value will be required as an input to price controls in this sector".* As such, the FTTC price path set by ComReg from 1 March 2019 to 30 June 2024 is bound by the existing WACC of 8.18%. Similarly, the maximum migration/connection charge nationally for FTTH at €100 per event cannot be amended based on a change to the extant WACC rate.

In respect to ComReg D11/18, as the European Commission correctly highlighted in Question 8 of its Request for Information on 18 September 2018 *"Given that ComReg reserves the right to require prices to be updated depending on the new WACC value, please explain how ComReg will ensure price predictability and briefly summarise, if any, the views of the operators in this respect?".* The fact that this was not consulted on was tacitly acknowledged by ComReg in its response to the Commission. In fact, a revised FTTC based on an updated WACC was only introduced as a footnote in the Response to Consultation at the final decision stage. Second, the positioning of the footnotes in which ComReg's reserves its rights regarding any potential update on the WACC is in respect to explaining the underlying model(s) only. When read in conjunction with the extant WACC decision and practice to date it is reasonable to interpret their reserved right could only be exercised following further and separate consultation(s) of further specification of the pricing remedy under the meaning of Article 7. This would also involve a fresh consultation on the pricing remedies notified and also a full separate consultation on whether a risk-premium is required for FTTC services — which as submitted by eir is not currently met by simply referring to a ComReg decision which also did not consider the matter.

In this context eir is also aware of ComReg's information notice (19/92) which set out a summary of the settlement agreement reached between ComReg and Sky. I would be obliged if ComReg could confirm that future WACC decisions will consult on and provide interested parties the opportunity to submit views on whether a risk premium is appropriate for NGA services and that the pending WACC decision is not a methodology decision which is only updated from time to time without further consultation on the appropriate methodology — noting in particular, that the EC categorically identified, in C(2018) 5876, of the *"[n]eed to notify all WACC updates…the Commission considers that <u>any new calculation of the WACC should be subject to the consultation procedures referred to in Articles 6 and 7 of the Framework Directive, regardless of whether the new WACC value results from a methodological change or simply an update of the data used in the calculation</u>. The Commission therefore calls on ANACOM to consult interested parties and the Commission before adopting any measure related to the WACC in the future either as a stand-alone decision or as part of a market analysis or decision on remedies."* [emphasis added].

I look forward to hearing from you.

✂

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✂

✂

2022 Bianconi Avenue, Citywest Business Campus, Dublin 24

Further comments by Sky on WACC by reference to Mason Pickford Wright Burns paper updated 2018.

1. We would first point to the observation in the Mason Pickford Wright ("MPW") paper that focusses on the excessive returns being earned by regulated entities (which ComReg has regularly benchmarked from) in the UK:

> *"Regulated companies have undoubtedly achieved efficiency gains, to the benefit of the consumer. But in our judgement, the returns that they have earned for achieving these gains have not been commensurate with the risks they face, or with the incentives required to persuade them to invest. The magnitude of bid premia suggests strongly that markets agree, and furthermore that they expect this situation to persist.[1]" (page 68)*

2. In the context of Sky's submission of 18 August with respect to the extent to which ComReg has allowed Ericom to earn substantially above the defined regulated rate of return/allowable WACC (or the RAR in MPW paper) for many years we would strongly urge ComReg to review chapter 8 of the MPW paper. While the analysis carried out by MPW in this section includes some observations specific to price cap regulation the reality is that Eircom's cost orientation obligations in Ireland have operated in manner not dissimilar to price cap regulation. For example for WLR pricing, notwithstanding the fact that Eircom are supposed to carry out an annual reconciliation of its costs to ensure ongoing compliance with its cost orientation obligation, the reality is that Eircom simply don't do this and merely bank excess returns in a manner akin to incentive based price cap regulation. The outcome of ComReg's approach to enforcing Eircom's cost orientation obligations in this regard has resulted in outcomes similar to those identified by MPW in chapter 8.

3. MPW argues that regulators should take account of "*historic outperformance*" and call out a specific level of outperformance (RER) anticipated against the regulated WACC in the price control period. While this may be a novel approach, the authors, which it should be noted were commissioned to carry out this work by UK regulators, are seeking to address years of a failed approach that has consistently seen equity investors over recovering at the expense of consumers. Indeed, there is a strong case to be made for the need for a new approach given the evidence on the failure of the prevailing approach. MPW found that in the evidence considered the "*true RER set by UK regulators since privatisation has been distinctly higher than the RAR*". It

[1] With respect to Eircom this is probably best exemplified by its statement in its most recent accounts published on 3 September, 2019 with respect to the National Broadband Plan – "*A roll-out by NBI is likely to result in a lower utilisation of our copper network within the intervention area, as customers migrate to fibre broadband. We, however, would expect additional rental income from NBI for access to our pole and duct infrastructure to **largely compensate for revenue losses**".* This is extraordinary claim to make to bondholders given they are comparing unregulated retail prices for an active service that incurs significant last mile costs with a cost oriented partial wholesale (passive) services that excludes significant last mile costs – yet Eircom expects one to "largely" compensate the other. This could only occur with very generous cost modelling assumptions in Eircom's favour.

Correspondence Address: Sky Ireland, One Burlington Plaza, Dublin 4, Ireland

Sky Subscribers Services Limited (Irish branch), Grant Way, Isleworth, Middlesex TW7 5QD Registered in England No. 02340150

further noted that it is gap that is "*increasing in recent years*". As per Sky's response on 18 August similar conclusions can be drawn with respect to Eircom.

4. The novel approach proposed by MPW i.e. setting an explicit value for RER, would highlight whether regulators have been making "*systematic forecasting errors (i.e. errors that could have been predicted) for the average company, then this would represent a failure of their statutory obligations, for which they should be held accountable*". Whether or not ComReg or any other regulator is held accountable is not the important point here (although relevant authorities should seek to hold themselves to account), what is important is that a mechanism is adopted that seeks to address the problem of systematic forecasting errors at the earliest opportunity. In this regard, ComReg could adopt a more rigorous internal approach to assessing its own performance by monitoring Eircom's WACC "outperformance" – which as highlighted in Sky's submission is extraordinary by global standards (as of 30 June, 2019, fixed line EBITDA is in excess of 51%).

5. In this regard, and in the context of Comreg's legal remit in terms of promoting efficiency, it may be a good discipline for ComReg to set an RER informed by historical over performance and approach cost modelling exercises underpinned by such an explicit reference point. An explicit RER approach could also be used as a trigger for interim intervention (between market reviews) to relook at Eircom's cost models and assess whether significant and sustainable changes has occurred in Eircom's underlying cost base where returns are significantly above the RER target.

6. Without prejudice to Sky's position in on-going litigation, for example it is clear that Eircom's cost base across the business is considerably lower than that currently assumed in the Revised CAM and NGA cost models. Eircom's operating costs have fallen by more than c20% in the last 18 months and if Eircom separated out (and ComReg ought to require this) the FTTC ROCE in the regulatory accounts Sky consider a figure well in excess of 8.18% and indeed well into double figures would be observed. In such a scenario having set a reasonable RER (which by definition should not have a significant gap to the RAR) would prompt ComReg to intervene and revise Eircom's cost models. Eircom are certainly not going to volunteer this.

7. As noted, Sky greatest concern is not just that WACC is currently significantly overestimated (which is a material concern in its own right) but that the effective RER being enjoyed by Eircom represents what the MPW paper refers to as the "*information wedge*" (Wi) that is being exploited by its investors.

8. In this regard it is worth noting from the paper that "*any difference between [RER and WACC] implies benefits that accrue* ***only to the equity holders****, the implied gap between the expected return on regulatory equity and the true market cost of equity* ***must be distinctly larger*** *(i.e. must scale up by a factor of 1/(1-g) where g is leverage (gearing)*".

Confidential

9. The manner in which Eircom is currently regulated from a cost orientation perspective is therefore very attractive to equity investors because ComReg's regulation of Eircom mirrors perfectly with MPW observations in the UK that "*RAR has systemically exceeded the CAPM-WACC*" and "*the RER has in turn systemically exceeded the RAR because regulated companies have systemically exceeded their cost targets*".

10. MPW note that regardless of which is the source of bid premia[2] i.e. "*be it an allowed cost of capital that is too high, or outperformance payments*" they argue again "*that regulators need to be clear what the overall expected return (RER) they are aiming for"*. Crucially, they conclude, which is entirely in line with what Sky are proposing ComReg focus on is that "*the endpoint [between expected and realised returns] should be a much tighter, and more transparent link between the returns regulated companies can expect to earn and our best estimates of their cost of capital*". This goes to the heart of the point Sky has made at paragraph 1 of its submission on 18 August. It boils down to what is the purpose of setting a cost of capital in the first instance and can ComReg better ensure that purpose is being achieved.

11. Sky would further draw ComReg's attention to the MPW-Burns paper with respect to Recommendation 7 of the paper:

"Regulators should exercise care in allowing for the impact of leverage, in deriving asset beta estimates and in "re-gearing" to derive equity betas based on assumed levels of regulatory gearing"

12. While MPW and Burns cannot fully agree on the how this recommendation is interpreted what is clear is that both have concerns about the manner in which equity beta is re-geared. MPW found that that "*in recent decisions UK regulators have set equity beta assumptions at values well above the range of estimates derived directly from estimation*" [p.56-57]. In the scenarios looked at by MPW they found that using a notional gearing level that was out of kilter with the actual gearing level using standard re-gearing formulae resulted in regulated equity betas that were well above the directly estimated betas for listed companies.

13. In this scenario we have a situation where the marginal cost of equity is being deliberately overestimated for the purpose of setting the WACC. In addition, MPW

[2] We would encourage ComReg to carry out an assessment of Eircom's ratio of market valuation to the Regulatory Asset Base (excluding unregulated activities) against the price paid by Iliad in 2017 to examine the scale of the bid premia. With a market value of circa €3.5bn and a RAB of just €1.44bn, notwithstanding that unregulated activity has not been removed from the former, on the face of it would suggest a very substantial bid premia is evident given the extent to which Eircom's core activities are regulated. Investors are essentially counting on a significant disconnect between RER and RAR to continue.

argue that given it can be shown it is inappropriate to apply this re-gearing approach for listed companies it is clearly not a good idea for unlisted companies (e.g. Eircom). They then go on to point out that given that the majority of UK regulated companies are unlisted this is "potentially" an important issue. However, that classification of "potentially" does not apply to ComReg in the context of the mitigation considered by MPW where re-gearing is applied. This is because ComReg does not apply a "pure" WACC approach where the focus is on calculating a correct asset beta and where the equity beta does not come into play and so no re-gearing is required. As such the concern raised by MPW is not just "potentially" an issue in the context of the ComReg's proposed approach but is unquestionably so.

14. While Burns takes issue with MPW on their objections to notional gearing, crucially he acknowledges a key exception to adoption of notional gearing and states "*in particular, in situations **where there is a material difference between actual and notional gearing**, regulators **should carefully consider the specific method of re-levering**, for example through consideration of the appropriate debt beta to apply to de-levering and re-leaving.*"

15. This goes to the heart of the concern raised by Sky in our submission at paragraph 24 where we note that from observed behaviour "*Eircom's owners are not concerned about their own equities*[3] *exposure to debt in the way described by the asset to equity* [beta] *conversion formula*". ComReg's explicitly support the adoption of "notional gearing" level because it allows Eircom flexibility in tweaking its capital structure. In doing so ComReg are ignoring what is happening in practice and instead relying on what it thinks should happen in theory. ComReg's approach to the equity beta estimation (in terms of how it is impacted by gearing) is one of reliance on a theoretical framework that ignores Eircom's recent corporate history and behaviour of its equity shareholders.

16. Sky see no basis for ComReg being forced to adopt a position grounded in theory that is known to fail in practice. As noted by Burns (at F-126) "*there is no single truth that pertains for the beta, but rather a body of evidence that regulators should draw upon to inform their judgement*". Sky would ask to what extent Comreg is relying on evidence that is either specific or relevant to Eircom in making its judgments? The notional gearing approach and associated beta re-gearing recommendations while well-reasoned in an academic vacuum that considers the general/average regulated company, can no longer be justified against the specific case of Eircom with an established history of behaviour that is diametrically opposed to idea of optimal notional gearing.

17. As we noted in our submission it is not the case that Eircom are behaving irrationally by moving further and further from the notional gearing level (as it did recently), it is because it is pursuing a strategy not underpinned by "optimal gearing" but is rather

[3] [sic] should be "Equity's"

exploiting the initial disconnect between notional and actual gearing and in doing so potentially undermining the long term fiscal health of the company.

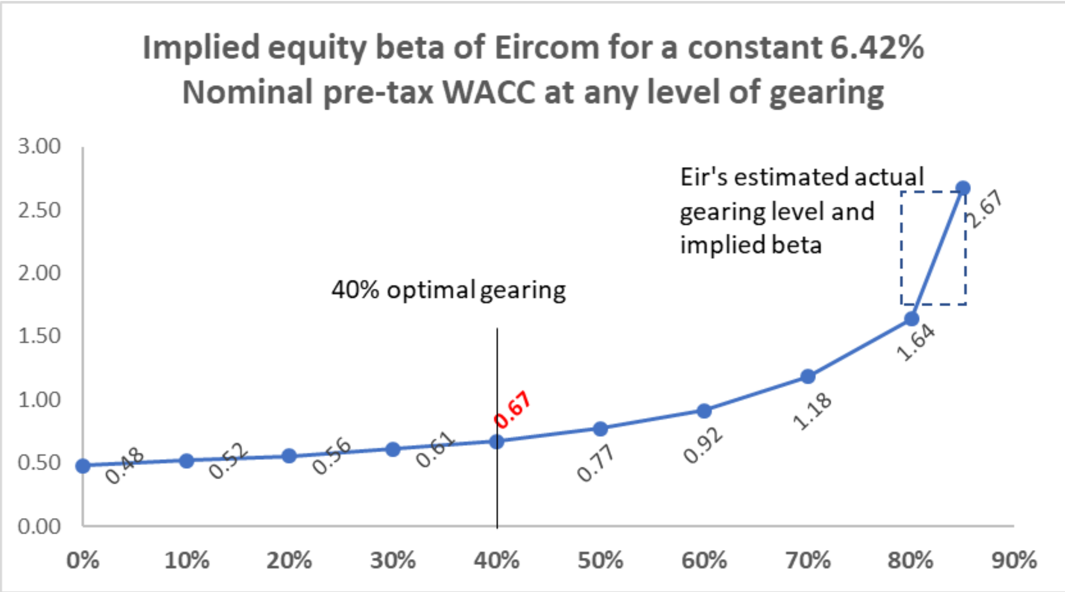
18. In the most recent financial year Eircom paid a €400m dividend to shareholders which again has significantly reduced equity investors exposure to the downside of pursuing a theoretically inefficient capital structure. In doing so it has also theoretically increased the marginal cost of equity based on the approach to WACC ComReg is proposing because the dividend has been financed through debt. It simply does not stand to reason that upon reducing the share of equity in a business, the marginal cost of equity is rising substantially.

19. Eircom are not engaging in "tweaking" actual gearing around the notional optimal gearing level. Loading up on cheap debt (by effectively swapping equity for debt) while being allowed to earn a return that assumes a capital structure moving in the opposite direction also means it can earn substantially above the RAR described in the MPW paper and indeed well above any reasonable level of an assumed RER.

20. To highlight the problem implicit in ComReg's approach, as discussed, it is assuming that Eircom's marginal cost of equity increases every time it takes on more debt. Firstly, if that were true then the spiral of taking on more and more debt becomes self-perpetuating especially when the actual cost of debt remains unaltered or falling (as has happened as is likely to remain the case over at least the medium term). Secondly, and more importantly implicit in the approach taken by ComReg in setting a notional gearing level of 40% and an associated equity beta of 0.67 is that if gearing increases slightly above or below that level the equity beta will increase and decrease accordingly. What happens however, when the starting point of actual gearing is so far removed from the notional level?

Correspondence Address: Sky Ireland, One Burlington Plaza, Dublin 4, Ireland

Sky Subscribers Services Limited (Irish branch), Grant Way, Isleworth, Middlesex TW7 5QD Registered in England No. 02340150



21. We can see from the above chart that if Eircom's equity beta is in fact increasing in the manner described by the conversion equation used by ComReg then by the time gearing reaches 90% it would have an equity beta in excess of 3. In the top end of the 80-85%[4] gearing zone, the zone Eircom have been operating in recent years we are still considerably above an equity beta of 1 in a range of 1.64 to 2.67. Such equity beta's bear no relationship to reality in the sector being considerd (i.e. fixed line telecoms) and equally there is no incentive for Eircom to come back to what is supposedly the optimal gearing level because the implied marginal cost of equity is so high. This example highlights the weakness of the theoretical approach being adopted.

22. ComReg must consider some mechanism for driving incentives towards a more efficient capital structure for <u>the long run</u> in Eircom or as previously noted bear some of the responsibility if a 2012-type fiscal crisis in the company arises again. It must also take action to address the fact that like many other regulators (as identified in the MPW paper), ComReg has facilitated massive over recovery at Eircom by either failing to account for or anticipate significant "out performance" in Eircom by comparison to assumed performance inherent in regulatory cost models and assumed performance inherent in a theoretical cost of capital. This has resulted in returns significantly above Eircom's RAR and RER as defined by the MPW paper.

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[4] Eir press release with Enterprise value of "approximately €3.5bn" against liabilities of €3bn (as per 2018 accounts). Where there is negative book value of equity then market value of company should be used to calculate actual gearing.

2 September 2019

Confidential

[redacted]

From: [redacted]
[redacted]
To: 12 September 2019 14:25
Subject: 10 Government Bond

https://www.ntma.ie/news/ireland-sells-1-billion-of-bonds

[redacted]

Further to our submissions on WACC we would note a material development this week that 10 year Irish Government bonds are selling at negative yields.

Regards
[redacted]

[redacted]

From: [redacted]
Sent: Thursday 19 March 2020 17:19
To: [redacted]
Subject: RE: 10 Government Bond

[redacted]

Further to ComReg's intention to publish a decision on WACC this month we have no doubt some consideration would have been given to the current crisis around the Covid 19. In this regard we expect you are aware of the ECB's announcement of a €750m stimulus package to the EU that has significantly eased rising (yet low) yields on Italian debt. This approach has been consistent with the EU's approach to sovereign bond intervention since the "Draghi put" in 2012 with no policy change evident under the reign of Ms. Lagarde.

Sky would further add that with the outbreak of the current crisis account should be taken that Eircom will be assured a rate of return on its investment and this safe haven factor ought to negate any suggestion of a need for aiming up when coupled with the fact Eircom has consistently enjoyed rates of return well in excess its ROCE. Its most recent statutory accounts revealed a fixed line EBITDA margin of 52% which is extraordinary by European and global standards – this now higher than when Sky made its original submission to the cost of capital consultation. Sky are of the view, and will be providing evidence to that effect imminently, that many of Eircom's current cost oriented price are significantly above cost. This is evident from the latest regulatory accounts – as identified by ComReg's consultants, Eircom's actual cost of capital is significantly lower than the 8.18% it is currently enjoying (and has been for some time) and non-SMP operators are in need of relief from this over-recovery now more than ever.

Regards
[redacted]

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Sent: 12 September 2019 14:25
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https://www.ntma.ie/news/ireland-sells-1-billion-of-bonds

[redacted]

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Regards
[redacted]

[redacted]

From: [redacted]
Sent: Thursday 9 April 2020 08:18
To: [redacted]
Subject: RE: [EXTERNAL] RE: [Confidential] 10 Government Bond

[redacted]

We would welcome up an update on the anticipated publication of this decision.

Furthermore I'm sure you have seen this weeks announcement that the NTMA raised €6bn in 7 year bonds just this week at a yield of 0.24%.

https://www.rte.ie/news/business/2020/0407/1129023-ntma-bond-auction/

regards
[redacted]

From: [redacted]
Sent: 20 March 2020 11:48
To: [redacted]
Subject: RE: [EXTERNAL] RE: [Confidential] 10 Government Bond

Many Thanks [redacted]

Can you advise if the decision will be published this month – which is our current understanding.

Regards
[redacted]

From: [redacted]
Sent: 20 March 2020 11:46
To: [redacted]
Subject: [EXTERNAL] RE: [Confidential] 10 Government Bond

[redacted]

Many thanks for yesterday's email. In respect of the WACC Consultation, ComReg's decision-making and deliberative process, that will lead to the adoption of its final decision, is ongoing. ComReg is aware of, and is currently assessing the implications for the WACC Consultation as a result of changes to the financial markets caused by the current crisis.

ComReg will include your recent communication as a submission to the Consultation and will be published according to our guidelines.

Regards

[redacted]

From: [redacted]
Sent: Thursday 19 March 2020 17:19

To: [redacted]
Subject: RE: 10 Government Bond

[redacted]

Further to ComReg's intention to publish a decision on WACC this month we have no doubt some consideration would have been given to the current crisis around the Covid 19. In this regard we expect you are aware of the ECB's announcement of a €750m stimulus package to the EU that has significantly eased rising (yet low) yields on Italian debt. This approach has been consistent with the EU's approach to sovereign bond intervention since the "Draghi put" in 2012 with no policy change evident under the reign of Ms. Lagarde.

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Further to our submissions on WACC we would note a material development this week that 10 year Irish Government bonds are selling at negative yields.

Regards
[redacted]

CONSULTING

Report for Sky Ireland Limited

Analysis of Eircom's wholesale fixed access regulated prices, costs and returns

Ian Streule, Andrew Daly, Audrey Bellis

7 May 2020

Ref: 2016045-194

Contents

analysys mason

Analysys Mason Limited
St Giles Court
24 Castle Street
Cambridge CB3 0AJ
UK
Tel: +44 (0)1223 460600
cambridge@analysysmason.com
www.analysysmason.com
Registered in England and Wales No. 5177472

0 Executive summary

[redacted]

[redacted]

[redacted]. Sky has also asked Analysys Mason to estimate the effect of changes in the weighted average cost of capital (WACC) on these services, and to estimate the effect of changes in efficient costs and volumes on these services.

[redacted]

Based on the most recent data, and our analysis, we find that there is a pressing need for updated regulated prices in Ireland, to avoid the main wholesale charges being excessive. T[redacted]

---

1 ComReg Decision D03/16.

2 See paragraph 5.133 of ComReg Decision D03/16, as well as paragraphs 5.113 to 5.116.

3 Comments pursuant to Article 7(3), letter dated 13 July 2018.

4 The third prediction appears to be true, as Eircom reported a EUR4 million (1.3%) increase in depreciation in its annual report for FY18/19, although this increase is not broken down into categories to identify depreciation unrelated to wholesale access such as mobile or FTTH.

5 Approval to adopt and publish Response to Consultation (17/26) and Final Decision, Pricing of Eircom's wholesale services in the WLA Market and WCA Markets, Item for Decision, 15/11/2018.

[redacted] This most recent data also reinforces the concern that the Commission raised in 2018 that the indicative prices need updating. Finally, regulated prices should also be reviewed in the light of ComReg's decision to reduce the WACC from 8.18% to the proposed 6.42%.[6]

In terms of wholesale access services, we have calculated that due to decreasing costs and increasing prices in the final year of the price control period (2018/19), the return on capital employed (ROCE) for wholesale access services increased to 12%, materially higher than the regulated WACC (see Figure 0.1).

	2017/18	2018/19	2019/20
ROCE	11%	12%	-
WACC	8.18%	8.18%	6.42%

Figure 0.1: Wholesale access services ROCE and WACC [Source: Eircom historical cost separated account, 2020]

[redacted]

	2018/19 price (as charged)	2018/19 AM estimated cost-oriented price	2019/20 price (as being charged)	2019/20 AM estimated cost-oriented price
LLU	[redacted]	[redacted]	[redacted]	[redacted]
SLU	[redacted]	[redacted]	[redacted]	[redacted]
SB-WLR	[redacted]	[redacted]	[redacted]	[redacted]

Figure 0.2: Estimated prices for copper wholesale access products (EUR/month) [Source: Analysys Mason, 2020]

[redacted] In addition, we have also estimated the impact that changing the WACC from 8.18% to 6.42% would have on the regulated prices for FTTC-VUA in the current 2019/20 period. We have made this estimate by using a lower WACC in the cost models available to us. Our estimates for FTTC-VUA charges are shown in Figure 0.3.

[6] Analysys Mason understands that Sky has made representations that this figure should be lower. However, for the purposes of this report we are not considering the level of WACC.

[7] Eircom's actual percentage mix of LLU and SLU in the FTTC-VUA product has not been made public

	2018/19 price (as charged)	2018/19 AM estimated cost-oriented price	2019/20 price (as being charged)	2019/20 AM estimated cost-oriented price
FTTC-VUA based on estimated LLU and SLU inputs	19.54 [8]	18.18	19.79	17.10
FTTC-VUA based on 6.42% WACC	n/a	n/a	19.79	18.01

Figure 0.3: Estimated prices for FTTC-VUA (EUR/month) [Source: Analysys Mason, 2020]

Finally, we have estimated that FTTH connection and migration charges should be 6% lower as a result of reducing the WACC applying in the FTTH connection cost recovery calculations. This is shown in Figure 0.4.

	2019/20 price (as being charged)	2019/20 AM estimated cost-oriented price
FTTH connection and migration	170	160

Figure 0.4: Estimated price for FTTH connection and migration (EUR) [Source: Analysys Mason, 2020]

In summary, we conclude that Eircom's wholesale access prices for LLU, SLU and SB-WLR should have been reduced by around 20% to 26% in July 2019, which would have given access seekers a substantial saving of many euros per month,[9] instead of the 1% to 5% price increase applied by Eircom resulting from ComReg's previously communicated indicative prices. In addition, we conclude that FTTC-VUA monthly rental charges should have been reduced after July 2019 as a result of lower LLU and SLU input costs, and upon application of a lower WACC.

[redacted]

[8] Regulated price from 1 March 2019 to 30 June 2019

[9] In addition, consumers would also benefit if lower wholesale prices were passed into lower retail prices.

- replace or recalculate the current indicative prices for WLR, LLU and SLU
- update the associated calculation of FTTC-VUA prices to reflect realistic cost recovery (due to lower input LLU and SLU components, lower (efficient) operating costs and higher line volumes),
- update the cost calculations with the lower WACC, as soon as finalised
- remove any modelled or actual subsidy from FTTC prices to narrowband services.

Based on the evidence we have analysed in this report, we believe that material price reductions are justified, and we have used available information and calculations to indicate the percentages for these reductions. ComReg and Eircom have access to additional information on actual line volumes and actual costs to determine price results based on updated cost models and the principles of cost orientation.

1 Introduction

[redacted]

[redacted]

[redacted] Sky has also asked Analysys Mason to estimate the effect of changes in the weighted average cost of capital (WACC) on these services, and to estimate the effect of changes in efficient costs and volumes on these services.

The remainder of this document is laid out as follows:

[redacted]

- Section 4 assesses the impact of changing the WACC on regulated prices for LLU, SLU and FTTC-VUA
- Section 5 assesses the impact on FTTH connection and migration of changing the WACC.

---

10 ComReg Decision D03/16.

11 See paragraph 5.133 of ComReg Decision D03/16, as well as paragraphs 5.113 to 5.116.

12 Comments pursuant to Article 7(3), letter dated 13 July 2018.

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

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13 [redacted]

[redacted]

[redacted]

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[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

18 Stand Alone Broadband.

[redacted]

[redacted]

[redacted]

[redacted]

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[redacted]

[redacted]

17 [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Figure 3.4: Eircom's return for wholesale access services [Source: Eircom historical cost separated account, 2020]

[redacted]

[redacted]

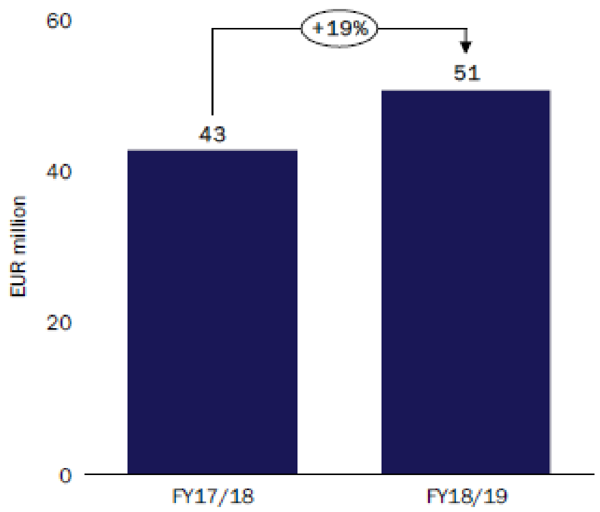
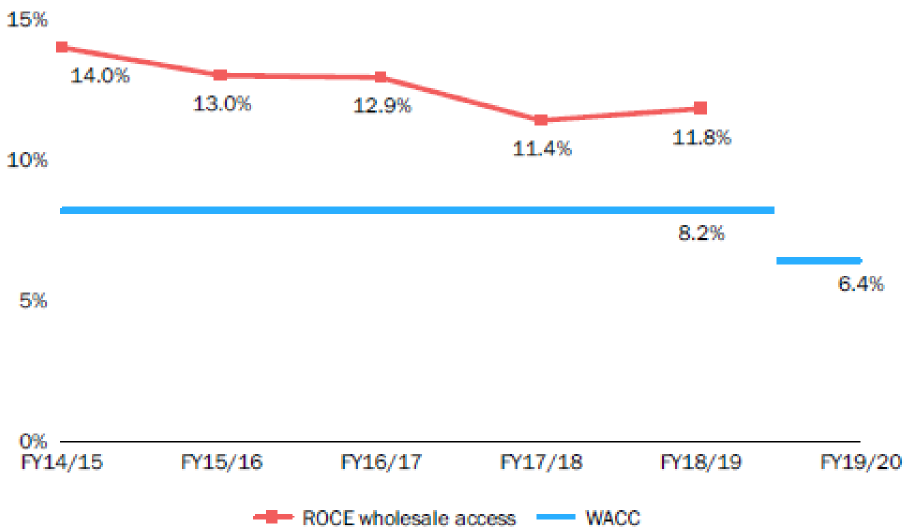


Figure 3.5: Over recovery of costs for wholesale access services [Source: Analysys Mason based on Eircom historical cost separated account, 2020

[redacted]

[redacted]

[redacted]



[redacted]

[redacted]

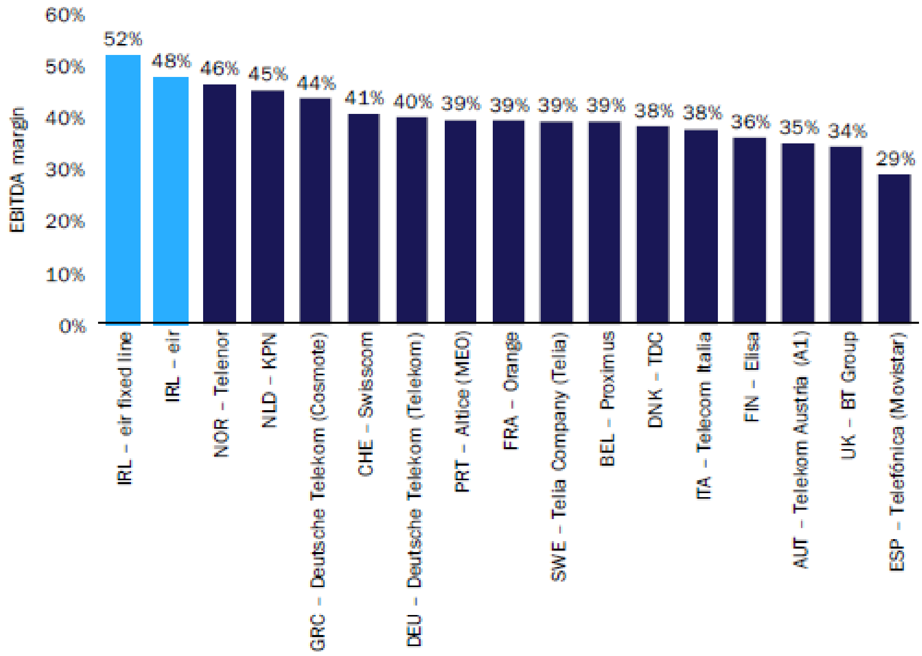
In order for the wholesale access ROCE in FY19/20 to reach the proposed WACC of 6.42%, the wholesale access revenue, and therefore prices, would have to be reduced by about 20%.

We believe it is highly unlikely that current prices will achieve a ROCE of 6.42% (which corresponds to the proposed WACC), given that prices are currently increasing by up to 5% per year in the indicative prices set by ComReg beyond the price control period.

[redacted]

In addition to a high and increasing ROCE, another indicator that Eircom's prices are high relative to operating costs is its high EBITDA margin of 52%. Compared to other European operators, Eircom is at the high end of benchmarks, as illustrated in Figure 3.7.

Figure 3.7: European EBITDA margin benchmark [Source: Analysys Mason, 2020]

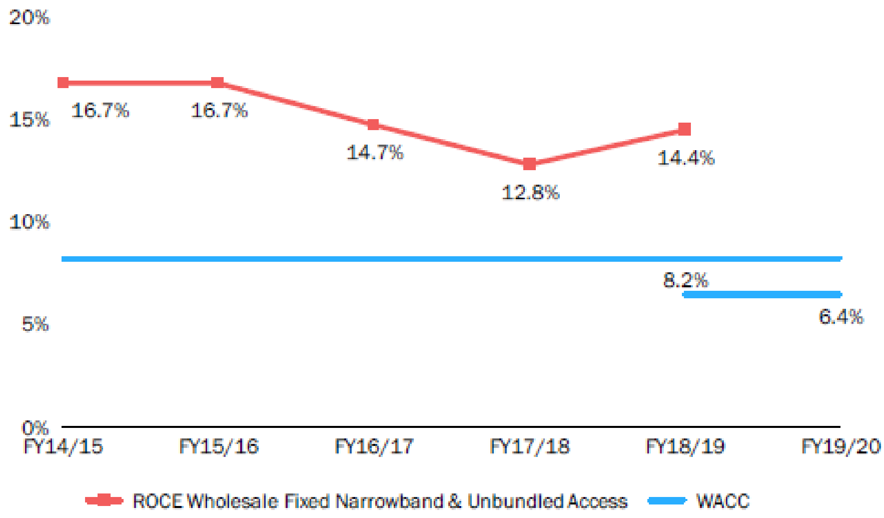


[redacted]

[redacted]

[redacted]

Figure 3.8: ROCE and WACC for Wholesale Fixed Narrowband and Unbundled Access [Source: Analysys Mason based on Eircom historical cost separated account, 2020]



[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

4 The impact of the anticipated WACC is a reduction in wholesale prices

In this section we analyse the impact of a change in the WACC on the regulated prices arising from ComReg's cost models. It should be noted that we would expect to see further reductions in wholesale prices arising from lower input costs (e.g. due to improved efficiency levels in Eircom's operating costs) and arising from applying higher line volumes (actual and forecast).

As part of the settlement proceedings between Sky Ireland and ComReg, ComReg committed to issue a Response to Consultation and Decision in respect of its consultation entitled "Review of Weighted Average Cost of Capital (WACC), Mobile Telecommunications, Fixed Line Telecommunications, Broadcasting (Market A and Market B)" (ComReg Document No. 19/54) which was published on 31 May 2019 ("the WACC consultation").

The WACC consultation included a preliminary WACC figure for Fixed Line Telecommunications of 6.42%. This figure represents a decrease from the previous figure of 8.18% from ComReg's 2014 WACC decision,[22] which was included in the models that were used to set the prices of: SLU/LLU (the 'Revised CAM') and FTTC-VUA (the 'NGA model'). The WACC consultation also highlighted in paragraph 8.5 that the WACC had declined below the regulated value of 8.18% by early 2016, and reached around 6.5% at the start of 2018 (more than two years ago).

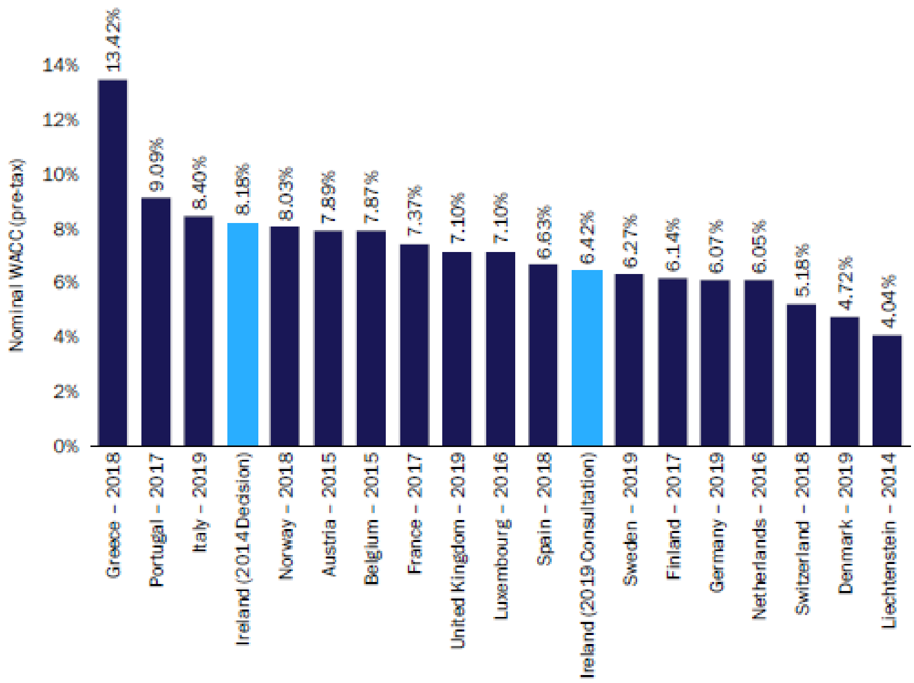
In the following sections, we examine how these WACC values compare to relevant benchmarks and estimate the impact of the change in WACC on the results from the Revised CAM and NGA cost model.

4.1 Comparison of WACC values against benchmarks

In Figure 4.1 we present a comparison of the two WACC values from ComReg against a recent benchmark of the WACC used by regulators for fixed telecoms markets in Western Europe.

22 The previous WACC figure of 8.18% was defined in ComReg Document No 14/136 "Cost of capital", dated 18 December 2014 ('2014 WACC Decision').

Figure 4.1: Benchmark of nominal WACC (pre-tax) for fixed telecoms, including recent model updates [Source: BEREC, 2019, Analysys Mason, 2020]



This shows that the proposed reduction in the WACC in Ireland is in line with relevant European benchmarks. The proposed change would move the value used in Ireland from the higher end of the benchmark range to the mid-range of values.

4.2 Impact of changing the WACC on the regulated prices for LLU and SLU

Testing the impact of changing the WACC on the prices for LLU and SLU would ideally require a copy of the Revised CAM model (even in anonymised form). However, this is not currently available.

In the absence of a copy of the Revised CAM, we have referred to two other publicly available copper access network models. The models used by the Danish regulator[23] and the Swedish regulator[24] give

[23] The model was used by the Danish Business Authority to issue a pricing decision on 29 November 2019. The prices came into force on 1 January 2020. The model is available at https://erhvervsstyrelsen.dk/lraic-fastnet-prisafgorelser-2020-og-2019

[24] The model was used by PTS Sweden to issue a pricing decision in October 2018. The model is available at https://pts.se/sv/bransch/telefoni/konkurrensreglering-smp/prisreglering/kalkylarbete-fasta-natet/gallande-prisreglering/

cost results for both LLU and SLU. Both models were also authored by TERA (as was the Revised CAM) and so are likely to include many of the same approaches and modelling principles.

We believe that, although these models were built for different countries with different population densities,[25] they model a similar form of copper access network and consider similar capital assets (cables, trenches, poles, distribution nodes, etc.). We have also chosen to test the *percentage* change in the model outputs, not the absolute values, because associated capital and operating costs such as construction labour rates vary among EU Member States. We consider that these percentage tests give a valid indication of the impact that a change in WACC would have on results from the Revised CAM.[26]

We tested how the Danish and Swedish models respond to the two WACC values from ComReg (8.18% and 6.42%). The results from the Danish model, for both LLU and SLU, are 15%[27] lower with a WACC of 6.42% compared to a WACC of 8.18%. The results from the Swedish model, for both LLU and SLU, are 17% lower with a WACC of 6.42% compared to a WACC of 8.18%.

On average, this analysis results in a decrease of 16% with a WACC of 6.42% compared to a WACC of 8.18%. We have applied this percentage decrease to estimate what we believe reasonable regulated prices should be for LLU and SLU in Ireland. The results of this analysis for the indicative prices for FY19/20 are shown in Figure 4.2 and Figure 4.3.

Figure 4.2: Estimated impact on LLU prices of reducing WACC to 6.42% [Source: Analysys Mason, 2020]

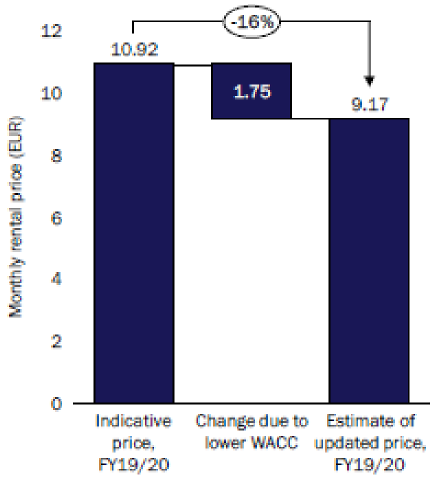
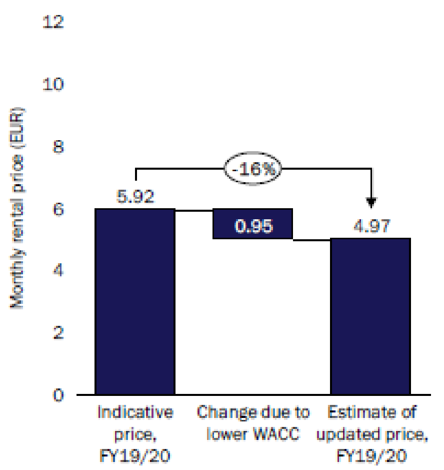


Figure 4.3: Estimated impact on SLU prices of reducing WACC to 6.42% [Source: Analysys Mason, 2020]



25 According to the World Bank, Ireland's population density in 2016 was 69 people per sq. km of land area, compared to 136 for Denmark and 24 for Sweden; see https://data.worldbank.org/indicator/EN.POP.DNST

26 We note that the Swedish model is a fully public 'generic operator' model, and the Danish model is a public model with some inputs rounded (although still producing a result within 10% of the actual confidential calculation). In both cases, the published models are mechanically coherent and functional.

27 The percentage changes for LLU and SLU are slightly different, but both are close to 15%.

We expect that the change in Ireland would be very similar to the changes observed in these tests. The analysis therefore shows that a change in the WACC from 8.18% to 6.42% would have a material impact on the regulated prices for LLU and SLU, giving rise to an estimated reduction in the monthly rental prices of EUR1.75 and EUR0.95 respectively.

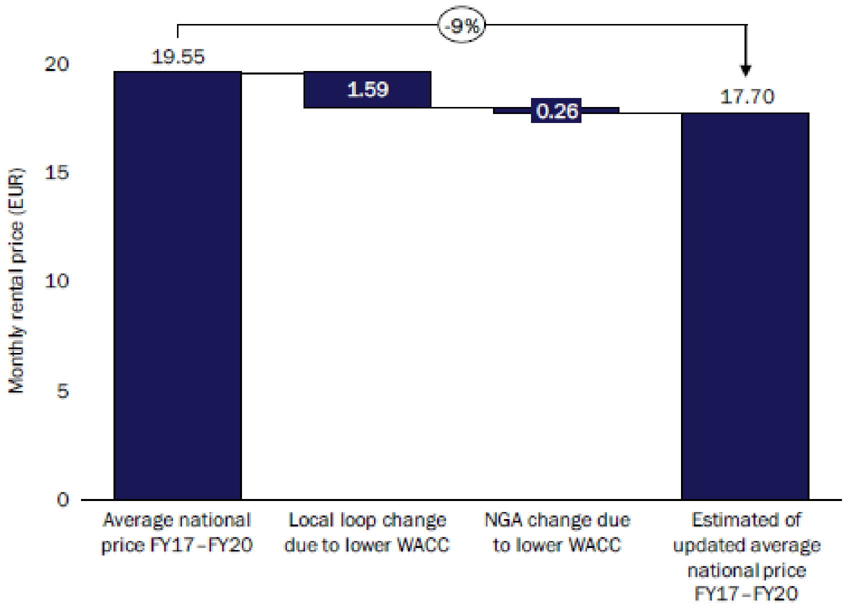
4.3 Impact on the regulated price for FTTC-VUA of a change in the WACC

The existing WACC value of 8.18% is also used in the NGA model, which takes the LLU and SLU inputs from the Revised CAM and combines them with NGA-specific costs to create the total regulated price for FTC-VUA.

We have access to a version of ComReg's NGA model on which we have been able to carry out some quantitative testing. Although this copy is anonymised (and gives a different answer from the regulated prices), it is possible to calibrate the output of the model to pricing results published by ComReg.[28] Following this initial calibration, the different WACC values can be input into the model to estimate the impact on the overall results. We also include the impact of the change in WACC on the blended local loop component of the total FTTC-VUA price. The result of our estimate is shown in Figure 4.4. ComReg should be able to quickly and accurately calculate these impacts by simply using the actual models that it holds.

[28] Our main calibration points are the breakdown of FTTC-VUA total in Fig 20 of Consultation 17/26, and the total final value (including adjustments) given in Fig 10 of Decision D11/18.

Figure 4.4: Estimated impact on FTTC-VUA prices due to a change in the WACC [Source: Analysys Mason, 2020] [Source: Analysys Mason, 2020]



The analysis shows that, notwithstanding any additional adjustments as a result of efficient costs or volume levels, a change only in the WACC from 8.18% to 6.42% is estimated to have a material impact on the regulated price for FTTC-VUA. The change attributable to local loop costs makes up the majority of the total change in costs (a EUR1.59 reduction in rental price per month), in addition to the change attributable to NGA-specific costs (a EUR0.26 reduction in rental price per month).

5 FTTH connection and migration charges are reduced by the anticipated WACC

Eircom proposed in late 2018 a calculation for recovery of the average connection cost (stated as EUR450) over a series of 42-monthly recurring connection and migration payments. As a result, ComReg did not object to a 'cost-based connection and migration charge' of EUR170 which has since been implemented by Eircom. The calculation of cost recovery by the FTTH connection and migration charges is based on a WACC of 8.18% (as per the fixed telecoms WACC from ComReg's 2014 WACC decision).

Using a WACC of 6.42% (as per the 2019 WACC consultation), and with no changes to other parameters in the calculation, the required maximum cost-oriented charge is EUR160. This represents a EUR10 (6%) reduction from the EUR170 currently charged. This means, during the current period when charges are EUR170,[29] that Eircom is:

- immediately benefiting by over-recovering EUR10 on every wholesale customer connected or migrated to another licensed operator, and
- causing a competitive disadvantage to alternative operators which could use an up-front EUR10 wholesale reduction to be more competitive in signing up FTTH customers.

[29] We understand that the charge will decrease to EUR100 on 1 July 2020

alto
alternative operators in the communications market

Clifton House
Fitzwilliam Street
Dublin 2

20 July 2020

Garrett Blaney
Chairperson
Commission for Communications Regulation
1 Dockland Central
Guild Street
Dublin 1
D01 E4X0

Dear Garrett

Re. ALTO – Case IE/2020/2250: Determination of the WACC for the purpose of price control obligations in Ireland Commission comments pursuant to Article 7(3) of Directive 2002/21/EC ("WACC")

In light of the European Commission's recent response to ComReg's Article 7 Notification on WACC, it is incumbent on ComReg, in line with its statutory duty to update existing prices in accordance with the access regulations. We note in particular the European Commission's comments at paragraph 3.2 of the Commission's letter, which state:

> *"**3.2. Ensuring that prices reflect current market conditions***
>
> *While the Commission welcomes the revision of the WACC value notified under IE/2014/1649, ComReg must adjust all regulated prices that are significantly affected by the WACC value, in line with the considerable decrease of the WACC (from 8.18% (current) to 5.61% (notified) for the fixed-line market). <u>The Commission urges ComReg to update relevant pricing decisions as soon as possible, to ensure that prices in the Irish wholesale markets reflect current market conditions, as the WACC is a significant and central determinant of prices</u>."* (Emphasis Added)

ALTO notes that the European Commission's position is in line with BEREC's view that even a small reduction in WACC can have a significant impact on prices.

ALTO has reviewed the BEREC Regulatory Accounting Practice Report from 2017, wherein BEREC notes that for the local access market,[1] a 1% change in the WACC can change regulated wholesale prices by 5 – 10%.[2] A change such as the one proposed in the ComReg Consultation of 2.57% therefore suggests over-recovery of 12 – 25%. These are striking figures in their own right, and particularly so when viewed in light of Eircom's overall financial performance, which would suggest it is one of the most profitable fixed line operators in the world.

It is also consistent with the approach taken by the Irish electricity regulator, which has a history of updating prices during review periods, in recognition of the fact that failure to do so could lead to a significant over (or under) recovery of costs. This has been the case even in instances were adjustments were of a much smaller magnitude than what has occurred in this instance.

This all comes at a critical time for Irish consumers, during the ongoing Covid-19 pandemic where everything from home working, health care and home learning is making highspeed broadband an essential service. In this context, it is abundantly clear that Eircom should not be earning excess profits as the SMP provider, to the detriment of consumers and businesses.

ALTO therefore submits that it is now incumbent on ComReg to immediately implement the European Commission's Recommendation. We trust ComReg accept it is no longer appropriate to use its own delay in reviewing WACC as a basis for not requiring immediate updating of existing prices as was intimated in the draft WACC Decision.

---

[1] BEREC Position Paper - Submission Input to the Commission's WACC consultation 2018 BoR (18) 167 https://berec.europa.eu/eng/document_register/subject_matter/berec/download/0/8257-berec-position-paper-input-to-the-commis_0.pdf – Footnote 3, referencing the below 2017 paper – quantification of WACC 5 – 10%

[2] For the local access market, for example, a 1%-point change in the WACC could change regulated wholesale prices by 5-10%; Source: Regulatory Accounting in Practice Report 2017 (BoR (17) 169), Chapter 5 – WACC, available at: https://berec.europa.eu/eng/document_register/subject_matter/berec/reports/7316-berec-report-regulatory-accounting-in-practice-2017 ft. 3.

Should you have any questions regarding the above we would welcome the opportunity to discuss this with you at your earliest possible convenience.

Yours sincerely,

Ronan Lupton
Chair – ALTO

31 August 2020

Garrett Blaney
Chairperson
Commission for Communications Regulation
1 Dockland Central
Guild Street
Dublin 1
D01 E4X0

Dear Garrett

Re. Case IE/2020/2250: Determination of the WACC for the purpose of price control obligations in Ireland
Commission comments pursuant to Article 7(3) of Directive 2002/21/EC ("WACC")

BT would like to offer the following concerns towards the WACC Decision in view of ComReg's proposal to delay applying the decision to some regulated services and not others.

1. As part of the European Commission's Article 7 process we note and agree with the unusually strong Comments of the Commission's letter[1] (see extracts 1 and 2 below) that ComReg must apply the WACC as soon as possible to all regulated prices significantly affected by the WACC value as detailed below:
"ComReg must adjust all regulated prices that are significantly affected by the WACC value, in line with the considerable decrease of the WACC (from 8.18% (current) to 5.61% (notified) for the fixed-line market). The Commission urges ComReg to update

[1] https://circabc.europa.eu/sd/a/ddd49d70-5806-4c4b-8590-cef7226c2f5a/IE-2020-2250%20Acte_EN.pdf

BT Communications Ireland Limited
is a wholly owned subsidiary of BT Group plc
Registered in Ireland, Registration No. 141524
No. 2 Grand Canal Plaza
Upper Grand Canal Street
Dublin 4, Ireland

tel (+353) 1 4325000
fax (+353) 1 4324590

www.btireland.ie

relevant pricing decisions as soon as possible, to ensure that prices in the Irish wholesale markets reflect current market conditions, as the WACC is a significant and central determinant of prices."

Start of extract 1

3.2. Ensuring that prices reflect current market conditions

While the Commission welcomes the revision of the WACC value notified under IE/2014/1649, ComReg must adjust all regulated prices that are significantly affected by the WACC value, in line with the considerable decrease of the WACC (from 8.18% (current) to 5.61% (notified) for the fixed-line market). The Commission urges ComReg to update relevant pricing decisions as soon as possible, to ensure that prices in the Irish wholesale markets reflect current market conditions, as the WACC is a significant and central determinant of prices.

End of Extract 1

Start of Extract 2

Under Article 7(7) of the Framework Directive, ComReg must take utmost account of the comments of other NRAs, BEREC and the Commission and may adopt the resulting draft measure. Where it does so, it must communicate it to the Commission

End of Extract 2

2. BT notes within the BB price control Decision D11/18 of 2018[2] the footnote (see extract 3 below) clearly provided for the possibility to include the output of the future WACC consultation, hence the 2018 Broadband Price Control Decision clearly does not preclude the WACC draft Decision notified to the European Commission from being applied to broadband once the due process had completed. Eircom were clearly aware of ComReg's WACC consultation proposals as they publicly responded in extensive detail to the

[2] Pricing of wholesale broadband services Wholesale Local Access (WLA) market and the Wholesale Central Access (WCA) markets Response to Consultation Document 17/26 and Final Decision

Directors:
Shay Walsh (MD)
Peter Evans
Aaron Carroll
Eamon Meleady

BT Communications Ireland Limited
is a wholly owned subsidiary of BT Group plc
Registered in Ireland, Registration No. 141524
No. 2 Grand Canal Plaza
Upper Grand Canal Street
Dublin 4, Ireland

tel (+353) 1 4325000
fax (+353) 1 4324590

www.btireland.ie

consultation and made numerous further detailed submissions to ComReg after the public consultation (the additional submissions were published on the EU Article 7 site as part of the notification to the EU Article 7 team). Given Eircom would have been aware of the potential outcomes it should have had time to prepare for the different outcomes.

Extract 3 - Footnote 60 of D11/18

Please note that ComReg plans to review the WACC rate, with a consultation planned for Q1 2019. ComReg reserves the right to require prices to be updated depending on the outcome of any decision ComReg may take on the WACC rate as a result of that consultation process.

End of Extract 3

3. Non-Consistent Application of the WACC

As a provider of alternative broadband services using Eircom's Virtual Unbundled Access (VUA) and our own backhaul network we are concerned ComReg's selective approach to applying the WACC could lead to situations where regulated services such as Broadband FTTC Port charges remain at the high WACC rate yet Margin Squeeze Tests (MSTs) in the same market designed to protect competition would include backhaul elements at the lower WACC rate. Hence Eircom would enjoy a greater return on investment for key aspects such FTTC Port charges whereas the components supplied by competing operators such BT would effectively be limited to the lower return on investment. This is neither reasonable or proportionate and given Eircom has both the incentive and opportunity to create a margin squeeze we are concerned that the proposed inconsistent approach would lead to lower margin space for competitors to compete with Eircom. We strongly do not agree with the approach of ComReg in this matter and it should do the right thing, follow the Article 7 response of the European Commission and apply the rates to all significant regulatory prices immediately such as for FTTC Port prices.

BT Communications Ireland Limited
is a wholly owned subsidiary of BT Group plc
Registered in Ireland, Registration No. 141524
No. 2 Grand Canal Plaza
Upper Grand Canal Street
Dublin 4, Ireland

tel (+353) 1 4325000
fax (+353) 1 4324590

www.btireland.ie

4. We support the ALTO letter to the Chair of ComReg of the 16th July 2020 for ComReg to immediately implement the comments of the European Commission. At a practical level it's been some six years since the last WACC Decision, and we are very concerned the further consultation planned by ComReg could add another 1 to 2yrs (Appeal is very possible for such key issues) to delay implementation of the new WACC.

5. We consider it important to note that the draft WACC Decision at clause 5.2 of the legal instrument states "ComReg shall every year recalculate the WACC for each sector as set out in Chapter 7 of ComReg Decision DXX/20 and each year on or before 30 June publish, by way of an Information Notice, updated WACC values."

   We consider this allows ComReg the flexibility to immediately implement the WACC values determined in the draft WACC decision to all appropriate regulated prices as sought by the European Commission. I.e. the annual approach provides ComReg with the ability to make any necessary adjustments following the learnings from the Access Network Model Review consultation scheduled to start calendar Q3/20. The annual approach neatly breaks any dependence should the Access Network Model Review be delayed or appealed given the experience of the 2018/2019 Appeal of the 2018 Broadband Decision. We therefore consider it reasonable and appropriate to bring this issue to a close and immediately implement the WACC to all appropriate regulated prices and not just some.

Should you have any questions regarding the above we would welcome the opportunity to discuss this with you at your earliest convenience.

Yours sincerely,

John O'Dwyer
Head of Regulation – BT Ireland
Email: [redacted]
Tel: [redacted]

From: [redacted]
Sent: Wednesday 22 July 2020 12:06
To: [redacted]
Subject: WACC notification

[redacted],

ComReg has surmised positions of respondents in the Draft Consultation and Decision. As evident in ComReg's drafting this creates a significant risk that the surmised positions are inaccurate. We are currently still reviewing the notification to the EC but we have already identified two such positions.

1: Paragraph 4.91 is simply wrong. ComReg surmises eir's position as "Eircom also proposed excluding BT, KPN and Swisscom". As evident from Table 7 of eir's response, eir's fixed line comparators clearly include BT, KPN and Swisscom in its analysis. Paragraph 77 of eir's response proposes removing those peers from the list of mobile comparators chosen by ComReg as these companies generate less than 40% of revenues from mobile operations.

2. Paragraph 7.35 is a complete misrepresentation of eir's point. As is clear from paragraph 150 of eir's response, eir considered that the WACC should be completed at the time of the market analysis. ComReg has incorrectly surmised eir's position. Paragraph 152 of eir's response clearly states that "In the event that there is a significant delay of a pricing remedy decision which is a further specification of that market analysis, then ComReg need only re-consult (on the WACC)[1] in circumstances where an updated WACC point estimate falls outside the high-low WACC range identified in the WACC decision for that market.[2] Where the updated point estimate falls within the high-low range then the original WACC decision remains appropriate and is not changed." [emphasis added]. Therefore, it is not in the context of updating the WACC throughout the pricing period that this proposal refers but only checking if the WACC needs to be updated in circumstances where a pricing decision is not made at the same time as the market analysis decision is made (at which point the WACC should also have been determined). In all other circumstances the WACC would hold for the duration of the market review period and for the pricing remedies that are specified or further specified as part of that market analysis decision.

Happy to discuss

[redacted]

[redacted]

From: [redacted]
Sent: Thursday 9 July 2020 10:55
To: [redacted]
Subject: RE: [Confidential] Query on notified WACC decision to EC

Dear [redacted],

Thank you for your email which has brought an error to our attention. Please note that the dates in row 3 of table 18 in relation to indicative prices for SB-WLR are incorrect and should state 1 July 2019 to 30 June 2021, and the reference in FN299 should be to D03/16. Prices for SB-WLR will fall within row 1 on ComReg's adoption of a new pricing decision following its review of the Access Network Model (ANM). "POTS based" FTTC prices fall within row 2 of the table.

This error has been brought to the European Commission's attention and ComReg will insert an amended table in the published decision. ComReg will also publish this email correspondence (with the necessary redactions) as part of its final decision.

Kind regards

[redacted]

From: [redacted]
Sent: Friday 19 June 2020 08:47
To: [redacted]
Subject: Query on notified WACC decision to EC

[redacted]

Hope all is well.

We have a query in relation to the recently notified WACC decision to the European Commission which we would be grateful for your earliest feedback on.

Table 18 which outlines ComReg's plan to deploy the newly proposed WACC in the Third Row – "*Indicative Prices*" where "*Latest WACC will be used if prices reviewed or required to be justified*" – in the last column of this row it then states "*SB-WLR (1 July 2022 to 30 June 2024)*".

Sky would note that as per D03/16 "Indicative Prices" were set from **1 July 2019 to 30 June 2021** and not 1 July 2022 to 30 June 2024. We further note the footnote to this point then refers to Figure 15 of the D11/18. A number of issues arises as a consequences.

1. Is **SB-WLR** as referred to in Row 3 of Table 18 in the WACC decision a reference to the "**POTS based**" element of FTTC in Figure 15 of D11/18?
2. Can we take it that **SB-WLR** "indicative prices" from D03/16 could also be included as an example in Row 3 Table 18 and if not what row would it fall into?
3. If the answer question 2 is yes, then can you confirm ComReg regards SB-WLR to fall under 2 categories of "indicative pricing" 1. **SB-WLR** from 1 July 2019 – 30 June 2021 as per D03/16 and 2. **SB-WLR** 1 July 2022 to 30 June 2024 (**POTs based**)?

Regards

[redacted]

Further comments from Sky in light of ComReg's Draft Decision on the application of the new WACC as recently notified to the European Commission

A. Introduction

1. Sky makes this submission to raise serious concerns about ComReg's draft decision on WACC as notified to the European Commission under the Article 7 Framework Directive procedures on 10 June 2020 (the "Draft Decision"). Sky does not raise any new issues in relation to the WACC figure itself, save to note that we do not consider ComReg adequately addressed Sky's submission on the chosen level of gearing.[1]

2. This submission is focussed on the proposed application of the new WACC figure to existing prices and, in particular, ComReg's position in the Draft Decision that Eircom will not be required to revise its FTTC pricing in light of the new WACC.

3. Where a cost orientation obligation is imposed to prevent excessive pricing, the SMP operator is entitled to a "*reasonable rate of return*" (WACC) under Irish and European law. Aspects of ComReg's WACC decision either fails to recognise this or attempts to redefine the plain and natural meaning of that proviso.

4. **Summary of the key concerns with that position as detailed in this submission:**

    - ComReg has maintained a position that it will intervene "***where there are material changes or exceptional circumstances***". However, it appears to have concluded in the Draft Decision that, in the context of FTTC pricing, it will not intervene on the basis of the revised WACC. This suggests that ComReg has made a serious error in either (a) failing to acknowledge the **material change** in the WACC figure itself, or (b) failing to intervene even where it recognises that there has been a **material change**.
    - ComReg's delay in conducting the WACC review is not a valid ground for not requiring existing prices (FTTC) to be updated with the new WACC, is a breach of Regulation 13(2) of the Access Regulations 2011 and **is in fact irrational** given the delay has already meant a financial windfall to Eircom. Failing to update FTTC prices in line with the revised WACC will exacerbate rather than remedy that market distortion.
    - **Regulatory and pricing certainty principles** demand that the WACC should be updated in existing pricing as soon as practicable (i.e. in line with pricing notification rules). Eircom has no legitimate expectation that it should earn

---

[1] For example, at paragraph 6.21, ComReg suggests "*if Eircom's actual gearing ratio was higher than an optimal gearing level…equity investors and bond buyers would expect higher returns relative to less leveraged comparator companies".* This generic statement makes no attempt to reconcile that view with the empirical analysis presented by Sky at paragraph 21 of its 3 September submission, which demonstrates the implausibility of Eircom's implied equity beta if such an argument were to be tested. We would ask that ComReg reconsider this matter in light of the evidence presented and, if it is still minded to refute Sky's analysis, to explain its reasons for doing so.

substantially above a fair return on investment for the duration of the FTTC price control period as that would be clearly contrary to its cost orientation obligation**.**

- **Regulatory precedent** in Ireland indicates that prices should be updated with the new WACC. The Irish Electricity Regulator (CRU) has rightly updated prices in the middle of review periods in recognition that not doing so could lead **to significant over or under recovery of costs**. The CRU, like ComReg, was advised by **Europe Economics** who indicated that not adjusting for even a fraction (30%) of the movement observed in Eircom's new WACC would lead to "*material over-recovery*" for regulated entities. It is unclear why ComReg has not asked Europe Economics to comment on this issue.
- ComReg's interpretation of Eircom's cost orientation obligation on FTTC pricing in the Draft Decision appears to **wrongly equate it to price cap regulation**.
- ComReg **has not given due consideration** to Sky's submission as to the materiality of the WACC reduction on existing prices.
- An implication of the Draft Decision is that it cannot update existing FTTC prices with an efficient cost of capital without conducting a full review of all inputs. **There is no basis in law for such a restrictive interpretation**, it would amount to a significant dilution of Eircom's over-arching cost orientation obligation and would be contrary to ComReg's approach elsewhere.
- Updating the WACC in margin squeeze tests while not doing so on existing FTTC prices is discriminatory and irrational as it amounts to restricting OAOs to a lower return on investment than the SMP operator, Eircom. That approach and outcome is **diametrically opposed to the purpose of implementing a cost orientation obligation.**
- The delay in updating the WACC to determine the price of assets being subsidised by FTTC prices exacerbates the problem with ComReg's cross-subsidy policy **which already seems to be contrary to European law.**
- ComReg determined in D11/18 that there must be **modelling consistency** between the Revised CAM under D03/16 and the NGA cost model. Maintaining that consistency demands any changes to indicative input prices in the Revised CAM (e.g. LLU and SLU) as a consequence of updated WACC must be passed through FTTC prices in the NGA cost model.
- **Incorrect "build or buy" signals** will be sent to the market as the promise of excessive returns being signalled are not be achievable if prices are not updated with an efficient WACC. Maintaining an inefficient WACC is thus contrary to ComReg's objective to promote efficient investment.

B. The new WACC constitutes a material change that must be reflected in existing prices

5. Nowhere in the Draft Decision does ComReg acknowledge the materiality of the change in WACC and its impact on pricing notwithstanding that it should be the **key determinant** in assessing whether to require existing prices to be updated with the new WACC.

6. In a submission to the European Commission in 2018, BEREC noted that 'even minor changes in the WACC can influence the regulated prices significantly, given that the telecommunications sector is very capital intensive'. BEREC further quantified this statement in an earlier 2017 report noting that for the local access market, a **1%** change in the WACC could change regulated wholesale prices by **5-10%**.[2]

7. ComReg indicated in the Draft Decision that a fair and reasonable rate of return in the fixed line market is **5.61%**, which represents a **2.57%** change from the old rate of **8.18%** which was set in 2014. Based on BEREC's conclusion, current and prospective FTTC prices as outlined in D11/18 are between **12.85% and 25.7%** above a fair and reasonable price.

8. Over the next 12 months, based on the current FTTC VUA charge of **€21.10** and a FTTC base of circa 640k subscribers, this will translate into excess returns of between **€20-€40m**[3] if Eircom is not obliged to adjust its pricing to reflect a reasonable rate of return in accordance with Regulation 13(4) of the Access Regulations 2011.

9. When ComReg conducted its Market Review of the WLA and WCA markets and set cost-oriented prices as part of that review via D11/18 it would have been preferable that it assessed the appropriate level of WACC that was used as an input to those prices at that time. ComReg's external consultants has estimated that had this occurred the appropriate level of WACC at the time those prices came into effect, March 2019, would have been **6.42%**. It is very clear therefore that Eircom has enjoyed **a significant financial windfall** from the delay in updating the WACC. OAOs and, by extension, consumers have been the ones to foot the bill for Eircom's fortuitousness and ComReg's tardiness in this regard.

10. While ComReg did not update the WACC as an input to the NGA cost model as part of D11/18, it clearly recognised the importance of this input in reflecting cost-oriented prices and thus reserved its position to update those prices once that review was complete. This position made sense given that the WACC had not been reviewed for more than 4 years by this time and a significant upward or downward shift in the eventual figure could have a material impact on efficient costs. If evidence had emerged that WACC was considerably higher than used to inform D11/18 then ComReg would have been obliged to update existing pricing if, all else being equal, Eircom were to recover efficient costs. The corollary of that of course is where the WACC is found to be materially overstated in the existing prices it must also be amended in order that Eircom does not over-recover.

11. Had there been no material change in the newly reviewed WACC then not updating prices already laid out in the D11/18 would not have been unreasonable. No case

[2] BoR (17) 169 BEREC Report, Regulatory Accounting in Practice, 5 October 2017, Section 5, footnote 3

[3] FTTC VUA price €21.10*12.85%=€2.71*639k subscribers *12 months = €20.7m and FTTC VUA price €21.10*25.7% = €5.42*639k subscribers *12 months = €41.5m

however can be made to counter the argument that the change is material and ComReg must address this point in its final decision.

C. ComReg's failure to require prospective FTTC prices to reflect the new WACC has not been justified and is in breach of the Access Regulations 2011

12. The materiality of the WACC reduction is not in question. The current WACC is 45% higher than the proposed WACC yet ComReg (who supported BEREC's 2018 submission to the EC) has **made no reference to that materiality** in the Draft Decision. This ought to have been the **most important factor** taken into consideration in determining whether or not to require existing and future FTTC prices to be updated using the new WACC as per the right reserved by ComReg to do so in D11/18 and as ComReg is obliged to do under Regulation 13(2) of the Access Regulations which make it clear that the consideration of cost orientation obligations must take into account a reasonable rate of return.

13. Having placed no weight on the materiality of the WACC reduction ComReg has instead decided not to require FTTC prices to be updated, a decision that has apparently turned entirely on the "*time that has elapsed*" since D11/18. Therefore, ComReg is using **its own delay in carrying out the WACC review** as a justification for not requiring the SMP operator to update its wholesale pricing. If ComReg had conducted the review in a timely fashion, wholesale FTTC charges would be up to 25% lower today. This is an entirely illogical line of reasoning and would mean Eircom should continue to **earn in the tens of millions of Euro per annum** above a reasonable return on investment for some considerable time to come.

14. ComReg is aware that Eircom has benefitted enormously from the delay in the WACC being reviewed. Indeed, having access to the Revised CAM and NGA cost models, Eircom will also be acutely aware of this. It is a **simple exercise for ComReg to quantify the scale of that benefit** by testing the sensitivities of FTTC prices against alternative levels of WACC. Sky expects ComReg has done this and would have done so when it reserved its position to update prices with the new WACC in D11/18. It is therefore **incumbent on ComReg to properly explain** in the Decision why it considers it appropriate for Eircom to continue to accrue such a benefit simply due to ComReg's delay in assessing an appropriate WACC.

15. If it is truly ComReg's position that tens of millions of Euros should continue to be paid by Irish consumers because of its own failure in conducting the WACC review in a timely manner, it raises very serious concerns about how ComReg has discharged its own statutory duties under the Communications Regulation Act 2002 (as amended), including the duty to ensure that end users derive maximum benefit in terms of choice, price and quality. It also raises equally important questions about ComReg's duty to ensure that there is no distortion or restriction of competition in the electronic communications sector.

16. In addition to the potential breaches of the Communications Regulation Act 2002 (as amended) and the Access Regulations 2011 and the resulting detrimental effect on competition and consumers in the Irish market, there is also a material cost to Sky's business and Sky fully reserves its rights in this regard.

D. No consideration appears to have been given to important analysis submitted by Sky

17. On 5 May 2020, Sky submitted correspondence to ComReg which included a report by consultants Analysys Mason ("AM"). The correspondence called on ComReg to take enforcement action against what Sky considers to be non-compliance by Eircom with its cost orientation obligations. The AM report also contained an entire section devoted to the revision of the WACC entitled: "*The impact of the anticipated WACC is a reduction in wholesale prices*".

18. In this section, AM assessed what updated FTTC prices might look like based on a reduction in the WACC from 8.18% to 6.42%. AM relied on publicly available cost models (from Denmark and Sweden) and the redacted ComReg NGA cost model used to set prices in D11/18 to inform their view. In AM's conclusions, the scale of the reduction anticipated in FTTC prices for a 1.76% change in WACC **fell squarely within the range identified by BEREC**,[4] demonstrating the pertinence or appropriateness of the BEREC conclusions referred to in paragraph 7 above.

19. That evidence brought further into focus the need to update FTTC prices immediately due to the material over recovery that would ensue if this did not happen. Sky submitted this report to ComReg on 5 May 2020. This was a full 5 weeks before ComReg notified its Draft Decision to the European Commission. However, it is apparent that **due consideration was not given by ComReg to this important information**. In fact, there is no reference whatsoever to this report in ComReg's assessment of submissions.[5] By contrast, an email submitted to ComReg by Eircom 3 weeks later, on 25 May 2020, was taken into account by ComReg in its assessment (see paragraphs 7.24 and 7.75 of the Draft Decision).

20. Sky would therefore urge ComReg to give due consideration to the AM report and, in particular, to the extent to which maintaining the existing WACC in prices in D11/18 would result in super normal profits by comparison to updating prices with the new WACC. If due consideration is now given to AM's findings, ComReg is bound to conclude that the change in WACC is material in its own right and requires the FTTC prices to be updated accordingly.

21. Sky considers that ComReg cannot avoid commenting on the materiality of the WACC reduction in its decision given the extent to which this factor **must inform** whether or not to update existing prices and given the extent to which a reasonable rate of return

[4] i.e. a 1% reduction in WACC leads to a 5-10% reduction in price for access services

[5] Footnote 8 of the Draft Decision refers to submissions from Sky dated 2 September 2019 and 19 March 2020 therefore it is clear that the submission of 5 May 2020 was not considered.

must be included in the cost-orientated prices imposed under Regulation 13(2) of the Access Regulations 2011.

E. ComReg appears to be treating prices set in D11/18 as though a price cap rather than a cost orientation price control was imposed on Eircom via D10/18

22. The proposition that FTTC prices should not be updated as a consequence of the material change in WACC prior to a full review of the access network (and possibly a further review after that) suggests that ComReg is treating prices in D11/18 as though they were set via price cap regulation. The prices in the Decision **are not fixed prices** whereby if underlying costs fall materially, or evidence emerged that the efficient cost standards on which they were predicated proved to be significantly understated, no changes would be made to those prices and that Eircom could simply bank such material upside as additional (supernormal) profit. Eircom has an obligation of cost-orientation that was imposed precisely to ensure that the SMP operator cannot sustain prices at an excessively high level (as per Regulation 13(1) of the Access Regulations 2011). An excessively high level of pricing cannot be avoided where the rate of return (or the profit permitted) is at level that far exceeds what is considered by the regulator to be a reasonable rate of return in the current market.

23. For example, significant categories of operating costs in the NGA and Revised CAM cost models were based on Eircom's **actual operating costs where these were deemed at the time to be reflective of an efficient operator**. If evidence emerges that Eircom is in fact significantly more efficient in certain cost categories than envisaged at that time,[6] then prices should also be amended to reflect that greater efficiency. This is why Eircom is required to comply with an ongoing cost orientation obligation that places the burden of proof on it to justify the prices laid out in D11/18. The burden of proof on Eircom in this regard is covered by Regulation 13(4) of the Access Regulations 2011:

> *"Where an operator has an obligation under this Regulation regarding the cost orientation of its prices, <u>the burden of proof</u> that charges are derived from costs, including <u>a reasonable rate of return on investment</u> shall lie with the operator concerned….The Regulator may issue directions requiring an operator to provide full justification for its prices and may, where appropriate, require prices to be adjusted."* (Emphasis added)

24. No such burden of proof would be required under a price cap regime because such a regulatory tool is specifically designed to allow the regulated entity to bank any upside it can capture below the price cap – its rate of return is not restricted where it outperforms expectations. Not requiring Eircom to immediately update FTTC prices

[6] And this is obviously case today as can be seen from Eircom's regulatory accounts or it would not be consistently earning significantly more than even the 8.18% ROCE.

with an efficient WACC produces the same result as a price cap regime – Eircom will be permitted to bank additional upside by ignoring efficient costs. In this scenario, prices are, by definition, no longer set by reference to efficient costs, including a fair return on investment, under ComReg's proposal but are rather "locked in" over the price control period.

25. This is precisely the type of price cap outcome Eircom is advocating for in its submissions to ComReg where it suggests the prices laid out in D11/18 are "*bound*" until 2024.

26. While ComReg did not accept Eircom's position that the current FTTC prices are "bound" by an excessive WACC of 8.18% until 2024,[7] its decision not to require prices to be updated as a consequence of such a material drop in the WACC without first conducting a lengthy access network review and a subsequent FTTC price review**, amounts to the same thing in practical terms**.

27. Eircom advanced a legal argument that an excessive WACC must be maintained out to 2024. ComReg has rejected that argument but instead has outlined a process in the Draft Decision that would deliver precisely that same result and has justified this on the grounds of its own failure to conclude a review of WACC in a timely manner.

F. Updating the WACC does not require all other inputs to FTTC pricing to be reviewed

28. ComReg acknowledges that the '*imposition of a cost orientation obligation is to deal with the competition concern of **excessive pricing'***. Paragraph 13(2) of the Access Regulations 2011 identifies a key constraint at ComReg's disposal in order to prevent excessive pricing via the cost orientation obligation, namely, to allow "*a reasonable rate of return on adequate capital employed*". The WACC identifies what constitutes that reasonable rate of return. It is also set at an efficient level in accordance with Regulation 13(3) whereby ComReg is required to "*ensure that any cost recovery mechanism….serves to promote efficiency."*

29. It should be further noted that the Decision Instruments in D11/18 which impose an overarching cost orientation obligation, **expressly contemplated that the prices specified by D11/18 can be amended** (paragraph 3.3 of both DIs) pursuant to that overarching cost orientation obligation. It is clear that where prices no longer reflect a reasonable rate of return or no longer serve to promote efficiency contrary to Regulations 13(2) and 13(3) of the Access Regulations 2011, a failure to amend those prices (whether up or down) would be contrary to the legislation.

30. The need to update prices reflecting an efficient cost of capital (WACC) is explicitly recognised in paragraph 4.1 of the D11/18, DIs:

[7] By this statement, it is unclear whether ComReg considers the prices from 2020 to 2022 to not be bound by the rates laid out in D11/18 or if the statement is directed at the period 2022-2024.

> *"…Eircom* ***shall ensure*** *that the rental charge offered or charged by Eircom to any other Undertaking in relation to FTTC…****shall*** *be equal to the costs incurred* ***by an efficient operator providing FTTC****…"* (Emphasis added)

31. It was therefore appropriate that ComReg reserved its right to require Eircom to update the prices laid down in D11/18 as calculated by the relevant cost models in the event that it established the WACC underpinning the original prices in that decision was found to be materially different to an efficient cost of capital and **in particular, given that the WACC had not been reviewed since 2014**.

32. Eircom's obligations (and ComReg's obligation to enforce compliance with same) are not diluted by the fact that D11/18 specified prices for FTTC out to 2022. If no evidence of a material change in underlying costs was observed, then maintaining those prices until 2022 would be reasonable and the market would have had price certainty out to that time. Any suggestion however that price certainty should trump the need to comply with cost orientation and amend prices where a material change in underlying costs has been identified **is both irrational and contrary to the statutory cost orientation obligation.** That obligation places a burden of proof on Eircom at all times to be able to demonstrate that its charges are derived from costs, including a reasonable rate of return, and gives ComReg the power at all times to require those prices to be adjusted if they cannot be justified on the basis of costs including a reasonable rate of return under Regulation 13(4) of the Access Regulation 2011.

33. Given the incontrovertible evidence that there has been material change in the underlying costs through WACC, there is no **reason why ComReg would be obliged to consider all other inputs** and assumptions that gave rise to the prices specified in D11/18. Just as ComReg considered it unnecessary to update the WACC at the same time as it updated assumptions about volumes, opex, network dimensioning etc, equally there is now no basis on which those other factors need to be considered simply because an up to date WACC is applied. Indeed, this is the very reason ComReg reserved its rights to update prices with a new WACC once that review was complete.

34. ComReg disaggregated looking at all inputs to FTTC prices at the same time when it issued D11/18 without reviewing WACC as part of that exercise. As such it cannot now suggest having reviewed WACC it is compelled to look at all other inputs again. **There is an inherent contradiction in that line of argument**.

35. It should be further noted that D11/18 makes provision for a variation in prices without the need to carry out a full pricing review e.g. para 4.2 of the WLA/WCA DIs. In this regard, **Eircom can seek to reduce prices below those set in D11/18 if it can adduce evidence that such a reduction is justified** in accordance with its cost orientation obligations, i.e. prices can be amended without a full consultation on all inputs. It cannot be the case that price changes from those laid out in D11/18, can only be triggered at Eircom's discretion, otherwise its ongoing cost orientation

obligation would only apply in the context of reductions that are sought by Eircom to its own commercial advantage.

36. On the contrary, paragraph 4.2 merely underscores the fact that prices set under D11/18 **are capable of being amended**[8] by virtue of Eircom's overarching cost orientation obligation under D10/18 **without a full pricing review** and are not, as Eircom claim, "*bound*" until 2024. ComReg is now aware of a material change in the underlying costs associated with an efficient WACC rate and thus has the power to require those prices to be updated in accordance with its remit to promote efficient investment, provide price certainty and protect consumers.

G. It would be discriminatory for ComReg to require WACC to be updated in margin squeeze tests but not FTTC prices

37. ComReg itself recognises that, in relation to the margin squeeze price control, it is not required to take a fresh look at all inputs to that test in order for the new WACC to be adopted going forward. For example, ComReg is not reassessing certain inputs, such as whether the average customer life is the appropriate time horizon under which to conduct a margin squeeze test nor indeed is it proposing to reassess whether a 42-month assumption about that average remains valid. Other factors not up for reconsideration are the appropriate operator base to be considered (SEO/EEO) or "alternative operator market shares" (e.g. 25%). Despite a **wide range of inputs not being reconsidered in margin squeeze tests** ComReg is satisfied that the updated WACC can be used **immediately** in those margin squeeze tests.

38. It should be noted that ComReg's power to set a margin squeeze test in the first instance, including the inputs to such a test, is derived from the same provision under the Access Regulations, namely Regulation 13(1) as the one relied upon to impose cost orientation on FTTC prices. ComReg has not provided any supporting argument as to why a price control in one instance (i.e. FTTC prices) is subject to a more rigorous updating standard than a price control in another (i.e. margin squeeze tests) pursuant to the same legal provision that allows it to impose both. ComReg must explain such a discrepancy in its approach to these price controls.

39. Furthermore, there is a corollary between Eircom's obligation not to cause a margin squeeze and its cost orientation obligations on FTTC pricing. Both remedies are price controls imposed on Eircom as the SMP operator to address a market failure. The WACC represents a fair return on investment **for a fixed line operator** and based on the principle of non-discrimination it must be applied consistently. Failing to update the WACC in FTTC prices ensures Eircom will continue to earn an excessive return of 8.18% prospectively, while at the same time updating margin squeeze tests with the new WACC of 5.61% *de facto* means that **OAOs must remain viable and compete with Eircom on a considerably lower** "*reasonable rate of return*".

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[8] This is also clear from paragraph 12.38 of D11/18

40. This is because the WACC used in the margin squeeze tests is a proxy for a fair return on investment for the SMP operators' competitors while in the context of its use on FTTC prices it represents the fair return applicable to SMP operator itself. Those numbers must be aligned if regulatory certainty and fairness is to be observed and if market distortions are to be avoided. Under ComReg's current proposal **OAOs should be satisfied with a return of 5.61% on investment, while Eircom is entitled to retain a return of 8.18%.**

41. Under ComReg's inconsistent application of WACC approach, an OAO investing in backhaul for example is theoretically protected by Eircom's margin squeeze obligation where Eircom's return on investment between bitstream and VUA can be as low as 5.61%, yet the VUA product on which Eircom builds its bitstream proposition is being allowed a return of 8.18%.

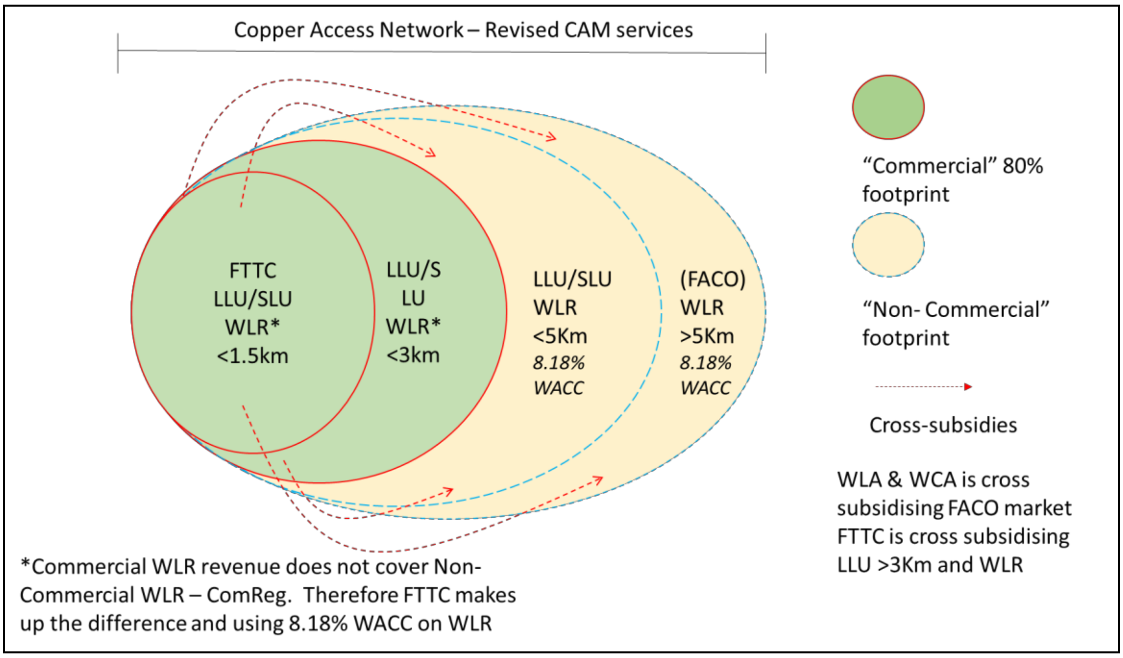
42. Therefore, the SMP operator with the ability and incentive to engage in anti-competitive behaviour, will be allowed to reduce its margins where it faces competition while being allowed to earn supernormal profits where it faces none. The perverse incentive created by this disconnect is that the latter outcome makes pursuing the former strategy more likely.

43. Independent of the legal, regulatory and logical inconsistency of using the new WACC immediately to inform margin squeeze tests but not to set pricing, it is telling that both outcomes are obviously and **materially beneficial to Eircom** and obviously and **materially detrimental to OAOs** in equal measure.

44. ComReg must justify its reasons for taking such an inconsistent and discriminatory approach to the application of the new WACC in a manner that is not covered in its Draft Decision.

H. ComReg's current approach to setting FTTC prices is contrary to European Law and distorts competition. Not updating WACC immediately will exacerbate this problem

45. Current FTTC pricing includes a premium **to cross subsidise** Eircom's loss-making services (those beyond 3km in its access network). This means FTTC prices are being used to cross-subsidise services in different economic markets (FACO) and different services in the same economic market (CGA broadband beyond 3km). Eircom faces competition in both these markets/services from alternative providers and technologies (e.g. mobile voice, WISPs, mobile broadband etc.) yet ComReg is permitting Eircom to subsidise its network to compete against these providers by adding a premium to FTTC prices.



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49. While Sky strongly objects to the fact that FTTC prices should be used to subsidise Eircom's loss making services in another market, or different services in the same economic market where Eircom faces competition, of more immediate concern is the fact under ComReg's current proposal those **loss-making assets beyond 3km will continue to earn a return of 8.18%** and will continue to be funded through FTTC prices under such a regime. This will exacerbate the distortionary competitive effects inherent in such a policy, i.e. Eircom's competitors beyond 3km will have to compete against a subsidy that is itself excessive in order to cover **<u>overstated losses</u>** and FTTC customers will be cross subsidising Eircom services in the FACO market.[10]

50. While ComReg ought to ask itself why Eircom would, for example, deploy broadband services it is not compelled to provide into loss-making areas in the first instance,[11] in the context of the WACC decision it must equally ask itself whether having taken that commercial decision that it should be entitled to earn a return on that "loss-making" investment at a rate of return ComReg **now deems to be excessive** through current and prospective FTTC prices?

51. ComReg needs to clearly explain in its decision why Eircom should be entitled to an ongoing premium on FTTC prices that is predicated on "losses" associated with an excessive cost of capital for years to come on those assets beyond 3km. ComReg also needs to explain how such an approach can promote competition when it seems clear that subsidising **a SMP provider** based on an inefficient cost of capital **in one market** with revenues based on an inefficient cost of capital **from another market in which it also has SMP**, will do anything but distort competition.

52. If FTTC is deemed to be the copper network's "*anchor product*", as determined by ComReg in D11/18 (paragraph 6.60), then there is no reasonable basis on which FTTC pricing should be used to subsidise assets or services that that are incremental to that anchor product. While ComReg may consider it cannot unwind that approach as part of its WACC decision, **it can and should immediately restrict the scale of recovery** on those incremental (capital) assets to an efficient, fair and reasonable return on investment.

53. In the interests of transparency, Sky is calling on ComReg to clarify its position in the final Decision in relation to the application of the WACC to these cross-subsidised incremental assets.

[10] This has the effect of operating as a backdoor Universal Service Fund which may explain why Eircom is no longer making applications for a USF.
[11] In Sky's view, contrary to ComReg's position in D11/18, the services are not loss-making but the costs are in fact significantly over-stated.

I. Eircom's "fair bet" pleadings ignore the fact that it has already accrued significant benefits from the delay in the WACC review and, in any event, are not valid in the context of its cost orientation obligation

54. On 30 January 2018, Eircom CEO, Richard Moat, wrote a letter to the Minister for Communications, Climate Action and the Environment where he claimed that ComReg's intention to implement a cost orientation obligation for FTTC prices "*created a clear disincentive to invest in next generations networks*". As ComReg is aware, this portend turned out to be wide of the mark.

55. In response to this WACC consultation, Eircom claims that applying a fair and reasonable WACC to prospective FTTC prices "*would create regulatory uncertainty and have a chilling effect on investment*". It has also classified updating FTTC prices with an efficient WACC as a "*retrospective*" application notwithstanding the proposal is only to update current and future pricing. Such a change would of course be "*prospective*" and Eircom's "*fair bet*" arguments again suggest that it considers its cost orientation obligation laid out in D10/18 and further specified in D11/18 to amount to a type of price cap regulation, which it is not.

56. In any event, the notion that Eircom should be entitled to several more years of an inefficient WACC on the basis of some vague concept of a "fair bet" needs to be considered in the context of the following facts:

    - **Eircom has no legitimate expectation** that pricing would not be updated if there was a material change in the new WACC. It was clearly flagged in the consultation which led to D11/18 and in the WACC consultation that this was an option.
    - **OAOs have a legitimate expectation** that prices would be updated where there has been a material change in the WACC by virtue of Eircom's **cost orientation obligation**.
    - Eircom's FTTC roll-out was **largely complete** by the time a cost orientation obligation was placed on it in November 2018.[12]
    - By the time cost oriented prices became effective, in March 2019, Eircom had enjoyed almost 6 years of no pricing restrictions. The regulatory forbearance over this period lead to significant price increases in this period that resulted in what ComReg concluded were "***excessive*" FTTC prices**.[13]
    - Eircom has already earned **c€800m on FTTC access charges** (i.e. excluding bitstream revenue) since it launched in 2013 and its current revenue run-rate is in excess of **€40m** a quarter.
    - Taking Eircom's claim of a **€400m** investment in the network[14] (which would have included upgrading the core network so this will considerably overstate actual FTTC access investment), and assuming an unduly short average asset

[12] A fact acknowledged by ComReg in D11/18 – see paragraph 3.110

[13] See paragraph 7.1296 of D10/18

[14] See page 73 of EHIL June 2014 Annual Report

life assumption of 15 years, would imply Eircom has already recovered over **€600m** after depreciation to cover operating costs and a return on investment **since it launched the network**.

- Even at this high level, it is clear that Eircom has already **more than recovered all investment in the FTTC network** long before the economic life of the assets come to an end. The network is now a low-cost cash cow that is bolstering inordinately high EBITDA margins for the fixed line business as a whole **and is being used to subsidise other activities.**[15]
- The figures are in themselves convincing but when taken together with the evidence of Eircom CEO, Carolan Lennon, at an Oireachtas Committee in September 2018, Eircom's protestations that it has not been allowed a "fair bet" return rings very hollow:

> "*At the time, we thought we would* ***have the budget to pass a million homes*** [with FTTC]. *We were faster and at the end it was cheaper than we had thought because when we got to do it, our ducts were in better shape than we thought,* ***and we went further with the money we had****.*"
>
> (Emphasis added)

57. Regulatory certainty does not begin and end with ensuring prices set over a control period pursuant to an overarching cost orientation obligation remain locked in or "bound" for the price control period as Eircom has attempted to argue. Regulatory certainty incorporates amending those prices pursuant to that overarching obligation when evidence has emerged that there has been a material change in the underlying costs. As noted above, there can be little dispute as to the materiality of the change in the WACC underpinning the pricing outlined in D11/18 and the proposed level of WACC.

58. Furthermore, ComReg's duty to regulate the market does not begin and end with considerations about the SMP provider's claims about what entails a "fair bet" investment. OAOs investment decisions also rely on regulatory certainty that remedies imposed on the SMP provider pursuant to that SMP designation, including cost orientation, will be applied in a fair and transparent way. In this regard, Eircom's insinuation that amending forwarding looking prices would amount to "*retrospection*" ought to be dismissed as an attempt to divert attention from the fact that it has already banked substantially above a fair return on investment since 2013 and so has been more than redeemed in terms of any "fair bet" arguments.

59. Indeed, Eircom argued in response to ComReg Consultation 17/26 that the average "*fair bet*" time horizon on **FTTC investment in Europe was 6.8 years**.[16] In seeking to advance the same "fair bet" argument that ensures WACC remains unadjusted in

[15] In this regard, all Eircom's network investment since 2013 has been derived entirely from free cash flow.

[16] See Chapter 5 of CEG report submitted by Eircom in response to consultation – Annex 7 to D11/18.

existing FTTC prices until 2024, Eircom is effectively now calling for that to be extended to 11 years (2013-2024) for Eircom without any justification **for this case of special pleading.**

J. Updating WACC on an interim basis is not uncommon in regulation

60. Requiring an updated WACC to be applied during a price control period is not uncommon, including in Irish regulation. The Irish electricity regulator, the CER (now the CRU), has taken this approach more than once. In 2010, the CER set the WACC at 5.95% for the Regulatory Asset Base (RAB) of utilities that it regulated. At the time, it noted:

> *"The increase in the WACC reflects the increased costs that are faced by the transmission [and distribution] utilities to finance their businesses. This may be a temporary issue and if there is a significant change in circumstances, the CER would propose to review,* ***at the midterm of the review period****, the level of WACC* ***to see if an adjustment is required for the remaining period of the Price Review****. An adjustment, if required, could be an increase or a decrease depending on how circumstances have changed."* (Emphasis added)

61. In this regard, the regulator did precisely what ComReg reserved the right to do as outlined in D11/18, i.e. to update prices with a new WACC depending on the outcome of that review. Following that interim review by the CER (now CRU), it determined that prices for 2014 and 2015 **should be amended to ensure over recovery of costs did not occur**. In fact, the external consultants advising the CER were the same as those retained by ComReg, Europe Economics. The CER noted the following in relation to their advice:

> *"Europe Economics advised the CER* [CRU] *in the Mid-Term WACC review concluding that the 5.95 per cent WACC figure had been broadly appropriate for the period 2011-2013,* ***but if continued*** *into 2014 and 2015* ***it would imply material over-recovery*** *of capital costs for the entities regulated."*[17] (Emphasis added)

62. It is worth noting that the change that Europe Economics identified as a "*material over-recovery*" was a mere **0.75% WACC reduction** – from 5.95% to 5.2%. This is significantly less than the **30% reduction in Eircom's WACC** which ComReg (together with the same consultants - Europe Economics) has identified. It is difficult to see how ComReg would not reach the same conclusion about the material over recovery on Eircom's investment if prices are not adjusted to reflect a far more material reduction.

[17] PR4 WACC for Eirgrid and ESB Networks, January 2015.

63. It is notable that it appears that ComReg has not asked Europe Economics to provide its views on this critical issue. Sky would request that ComReg ask Europe Economics to comment specifically on whether it considers not adjusting the WACC (retaining 8.18%) in 2021, 2022 and beyond would lead to significant over-recovery by Eircom. In particular, the analysis presented by Europe Economics in its report suggests that not only will Eircom's significantly over-recover if prices are not amended prospectively but historic pricing has significantly over-recovered,[18] again confounding any suggestion Eircom has not enjoyed more than a "*fair bet*" on its investment in FTTC to date.

K. Ireland is already a European outlier with a WACC review that is significantly out of date

64. The need for ComReg to require pricing to be updated immediately with a revised WACC is underscored by the fact that **Ireland is one of only 4 of 34 countries** assessed by BEREC not to have updated WACC since 2014 according to its Regulatory Accounting Database 2019.[19] It should be further noted that the majority of NRAs (20) in Europe update WACC as part of their market analysis/pricing reviews, while a further 10 update WACC on an annual basis. As noted above, had ComReg undertaken a WACC review at the time of the WLA/WCA market analysis and pricing decisions, current pricing would be significantly lower than is the case and as such Eircom has already benefitted greatly from ComReg disconnecting the WACC review in this way.

65. If ComReg fails to update existing pricing with the new WACC it is set to stray even further from the norms of its BEREC counterparts.

L. Eircom's submission of 25 May

66. It is clear from Eircom's submission of 25 May 2020 that it is determined that an inefficient/excessive WACC should continue to apply prospectively to FTTC prices. Such an outcome would deliver tens of millions of Euro in over-recovered costs for the SMP provider. In an attempt to bolster its argument that "*the FTTC price path set by ComReg from 1 March 2019 to 30 June 2024 is bound by the existing WACC of 8.18%",* it leans heavily on the argument that a WACC review should be conducted as part of it price review and, failing that, ComReg is somehow bound to conduct a full pricing review if it seeks to update WACC. Sky has already outlined above why there is no basis for such a restrictive interpretation of Eircom's cost orientation obligation and applying such an interpretation now would amount to a variation, without consultation of a decision already made, i.e. that Eircom is subject to an ongoing cost orientation obligation on FTTC prices which places an ongoing burden of proof obligation on Eircom.

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[18] See Figure 1 of Draft Decision

[19] See BoR (19) 240 on WACC

67. Eircom then refers to the European Commission's notice to Anacom[20] in August 2018 which in fact undermines its arguments further. It is clear from a review of the Anacom documentation that conducting a standalone assessment of WACC or reviewing WACC as part of a wider market review procedure are both equally permissible according to the European Commission and that its primary concern was solely that Anacom had failed to notify its own standalone assessment of WACC to the European Commission in the past. ComReg has now notified the European Commission via the Article 7 procedure of the new WACC and Draft Decision so the Anacom case is not applicable here.

68. Furthermore, when the comments by the European Commission to Anacom are read in full and in context, the position outlined is fatal to Eircom's suggestion that FTTC prices are "bound" by a WACC that was last revised in 2014. In this regard, it is worth noting the European Commission's recommendation to Anacom on the need to use up to date information, including on WACC:

> *"The Commission also called upon ANACOM to update its cost model (based on 2012 data and a 2014 WACC)* ***without undue delay*** *with a view to* ***<u>ensuring</u>*** *that fixed termination rates in Portugal are* ***forward-looking and set on the basis of the most recent data available****."* (Emphasis added)

69. While Sky agrees with Eircom that ideally the WACC review should have been conducted at the same time as the market review and the setting of prices pursuant to that review, Eircom's attempt to inextricably link the two things is without merit and highly opportunistic. In this regard, Eircom is fully aware that had ComReg reviewed the WACC at the time it set FTTC prices (and other services) the significant financial windfall Eircom has enjoyed from the excessive WACC of 8.18% would not have materialised. Eircom is therefore, in reality, very pleased that the WACC review did not occur at the same time as the broader price review and is now seeking to portray the delay in the review as something it has been disadvantaged by.

70. In truth, Eircom is arguing that ComReg should have denied it the level of excessive returns it currently enjoys on FTTC prices by reviewing the WACC in 2018 but, having failed to do so, it is technically bound to allow the over-recovery to persist for years to come. Eircom has made no attempt to square that perverse logic with how it sits with Eircom's overarching cost orientation obligation which is central to any such consideration.

71. In taking this position with Anacom, the Commission was cognisant in 2018 that a WACC based on a 2014 assessment needed to be updated with more recent data. Eircom's suggestion that a WACC based on a 2014 assessment must apply until 2024 is patently inappropriate.

[20] C(2018) 5876 – 31 August, 2018

M. The Revised CAM should be updated immediately including inputs to FTTC prices

72. FTTC prices were set by reference to a hybrid BU-LRIC and a TD-HCA modelling approach. The models used to calculate the prices included the **NGA Cost model**, developed specifically as part of the D10/18 market review, and the **Revised CAM model** which was based on ComReg's access network review in D03/16. The Revised Cam model has not been updated since yet informed the bulk of the overall costs of the FTTC price because it calculated the Sub and Local Loop (SLU/LLU) costs inherent in the FTTC price stack.[21] The Revised CAM model further relied on data from 2013/14 and 2014/15 historical accounts and has was never updated with more recent data despite the European Commission communique of July 2018 requesting that ComReg do so urgently. As such, the current SLU and LLU prices from the Revised CAM and quoted by Eircom in its Reference Offers are based only on "indicative" prices beyond the price control period for those services.

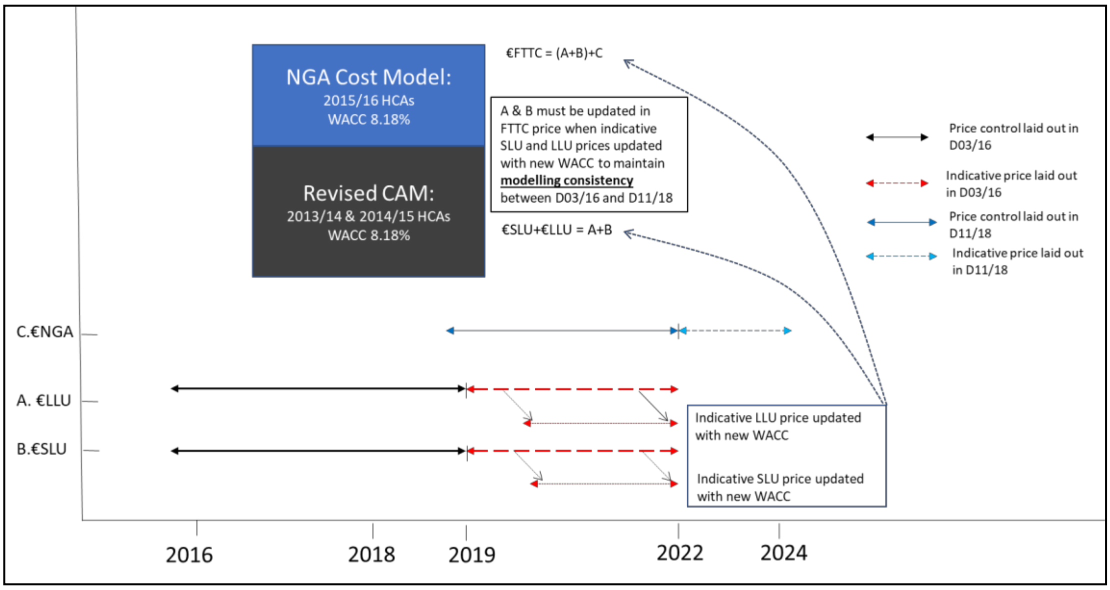
73. Like the NGA cost model, the Revised CAM's capital costs, including for current "indicative" prices is based on what we now know to be a highly inefficient cost of capital of 8.18%. ComReg's Draft Decision rules out revisiting the FTTC price even if the updated WACC is applied to SLU and LLUs indicative prices.

74. This is because, although the Draft Decision at 7.37 suggests ComReg may require such indicative prices to be justified and that any such exercise would be based on the new lower WACC of 5.61%, it is clear it does not intend to pass through the obvious reduction this ought to lead to in FTTC prices as a consequence of lower LLU and SLU prices until it completes a lengthy and already very late ANR.

75. If this approach were to be taken, it will ensure that Eircom earns super-normal profits at every wrung on the ladder of investment including on SLU and LLU services that are currently indicatively priced based on the old WACC.

76. Given the inextricable link between FTTC prices and the Revised CAM, ComReg must be consistent in its modelling application (see chart below). If SLU and LLU prices in the Revised CAM are updated with the new WACC – as ComReg seem to accept given the prices are currently only indicative –then it would be entirely inconsistent and inappropriate to not reflect those changes as they apply to the FTTC price. It is notable, as reflected in D11/18, that ComReg ceded to Eircom's request that consistency between the NGA and Revised CAM cost models be observed and this resulted in a very significant increase in FTTC prices between the consultation (17/26) and the final decision (D11/18).

[21] A fact that has been confirmed by ComReg's external experts - TERA



77. It is therefore appropriate that the models don't again become disaggregated from each other in a manner that is predicated simply on maintaining the FTTC price above a cost-oriented level. Eircom was a significant beneficiary in ComReg accepting its argument that consistency be maintained - that some of that benefit is now eroded by maintaining that consistency is fair, reasonable and indeed consistent. Eircom cannot legitimately argue on both side of the fence on this issue.

78. In relation to the Revised CAM and the need to immediately update WLR, SLU and LLU pricing, ComReg should take note of the fact that Eircom's initial response to consultation concedes that this should happen by reference to WACC where there is a material change. In this regard, we refer to paragraphs 152-153 of the Eircom response:

> *"**In the event that there is a significant delay of a pricing remedy decision** which is a further specification of that market analysis, then ComReg **need only re-consult (on the WACC)** in circumstances where an updated WACC point estimate falls outside the high-low WACC range identified in the WACC decision for that market."* (Emphasis added)

79. It is beyond dispute that there has been a very significant delay in the ANR and ComReg has now consulted on and is due to issue a decision on WACC. In addition, the new point estimate of the new WACC falls significantly outside the high-low WACC range from which the old point estimate of 8.18% was derived. **As such, Eircom clearly recognise and advocate for updating WACC in the Revised CAM**. While Eircom qualify this by suggesting it should be done as part of a wider pricing consultation no explanation has been offered for that constraint.

80. Updating WACC in existing WLR pricing will significantly reduce the WLR cross subsidy currently attached as a premium to FTTC pricing, further compounding the need to urgently reduce the FTTC prices.

81. We would remind ComReg that in July 2018 the European Commission urged ComReg to update the Revised CAM "*without undue delay*", noting in particular the "indicative" nature of pricing produced by that model from 2019 onwards. ComReg has failed to take account of the European Commission's comments which are more than 2 years old and has not even published a consultation on reviewing the Revised CAM at time of writing. Failing to immediately update the WACC in the existing Revised CAM prices, in particular when D03/16 requires an annual review of the appropriateness of those prices, suggests that ComReg has not only not taken utmost account of the European Commission's comments but has completely disregarded them.

N. "Build and Buy" signals do not promote efficient investment and distort competition

82. An important function of WACC is to set the appropriate "Build or Buy" signals to the rest of the market and that signal manifests itself in the prices that are derived from the WACC. Potential investors do not have access to Eircom's cost models because the models have been deemed to be commercially sensitive and therefore must rely on outputs of the models (prices) to inform the build or buy decisions. By maintaining an artificially high WACC for potentially the next several years on FTTC prices, ComReg will be sending a signal to the market that unfeasibly high returns can be earned in this market in a manner that distorts competition and prompts inefficient investment decisions. Put simply, a hypothetically efficient operator cannot earn the excessive level of returns being signalled.

83. By way of illustration, if the price of the regulated service is €20 per month today and for the next 3 years, then that is the signal an investor will take in order to inform its investment decision. Based on its analysis, if it concludes it could deliver the same service at €19 per month including a reasonable return on investment it is taking a clear "build" signal from the market. However, if the €20 signalling price includes a significant premium above the efficient WACC, e.g. €2, the efficient price signal the investor should be guided by is actually €18 per month. In this scenario, the investor will have made an ill-informed decision based on a misleading "build" signal it received due to the inflated WACC underpinning the €20 price point. The "build" signal should reflect the efficient cost of the infrastructure under consideration and thus must reflect an efficient cost of capital if it is to meet that objective.

O. Next Steps

84. ComReg's current proposal to not update existing pricing with the new WACC is contrary to the requirements and the spirit of the Access Regulations 2011 and the Decision Instruments associated with D11/18. The basis on which that proposal has been made is irrational and discriminatory and will result in the distortion of

competition to the detriment of Irish businesses and consumers. The proposal is also contrary to best practice, including by reference to other Irish regulatory authorities, and ignores the guidance and commentary of the European Commission. We strongly urge ComReg to take account of Sky's submission and revise its current Draft Decision in manner that is compliant with the law and consistent with ComReg's regulatory objectives as laid down by statute.

10 July 2020

From: [redacted]
Sent: Tuesday 21 July 2020 14:34
To: [redacted]
Subject: Updated WACC

Dear Commissioners

I hope you are all well. As you are no doubt aware, the European Commission have taken the view that existing pricing decisions need to be updated with the new WACC, without delay. I trust this quells any suggestion that WACC cannot be updated in existing FTTC prices (including the SLU and LLU input prices that make up the majority of FTTC price).

As we made clear in our submission (attached), we are of the view that updating prices in this way is a necessity, in line with Eircom's cost orientation obligations. The fact that the Commission concurs evidently strongly reinforces this view.

We are also conscious of previous Commission recommendations, most notably their recommendation in July 2018 that that ComReg should update the Revised CAM "*without undue delay*" in the interests of "*regulatory predictability*". In its decision D10/18 ComReg accepted the Commission's position and noted that it needed to do this as "*quickly as possible*". As we have discussed on a number of occasions, we remain both concerned and disappointed that, now two years later, the Access Network Review has not yet commenced.

When we have discussed the Access Network Review, you have frequently mentioned its complexity as the reason for the continued delay. I mention this specifically, as it stands in contrast to the exercise that needs to be carried out in this instance, which simply requires updating the existing regulated prices with the new WACC. To do this in line with the Commission's 'as quickly as possible' recommendation would mean doing so immediately.

Eircom's over recovery of costs has been a source of deep frustration for all OAOs for a number of years at this point, while also having a negative knock on impact on Irish consumers. There is now a clear and present opportunity to begin to redress this balance quickly, fairly and in line with the views of the European Commission. It would not be fair, just or reasonable to postpone the taking of appropriate action any longer.

Kind regards

[redacted]

[redacted]

From: [redacted]
Sent: Friday 24 July 2020 12:52
To: [redacted]
Subject: WACC
Attachments: Analysys Mason Report - Non-Confidential Version.pdf

[redacted]

As requested – pleased find attached non-confidential version of Analysys Mason report as requested.

With respect to submission on 10th of July 2020 where we reference Irish precedent for updating WACC independent of other inputs you will recall we provided evidence of the Irish Electricity Regulators approach. Upon review of further historical evidence we have observed that in respect of Tariff Revisions for RTE/2Rn transmission services, ComReg itself has updated WACC alone as an interim measure enforcing compliance with cost orientation – see ComReg Decision 15/14 (paragraph 2.12) and subsequent information notice 14/15 for reference.

[redacted]

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[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

From: [redacted]
Sent: Friday 21 August 2020 12:52
To: [redacted]
Subject: Re: [EXTERNAL] RE: Updated WACC

Dear [redacted]

Many thanks for your response, and I hope you enjoyed your holidays.

Having digested your comments, I believe you have raised a number of points which we think need to be addressed and I have are set these out below. In the interests of transparency, Sky has no difficulty with all of our correspondence being published.

1. We fully support the position that issues must be consulted on. Clearly, the proposed new WACC has been consulted on and many operators, including Sky, have made detailed submissions during the consultation process. Eircom's cost orientation obligation on FTTC has also been consulted on and determined. In that consultation, ComReg recognised that the WACC was out of date and was due to be revised. The European Commission has also stated that ComReg must adjust all regulated prices that are significantly affected by the WACC value, in line with the considerable decrease of the WACC.

   Where there has been a material change in the underlying costs of a service subject to a cost orientation obligation – and there does not seem to be any dispute that the proposed new WACC represents a material change – then those cost orientated prices must be updated accordingly or they will cease to be cost orientated and will cease to comply with Eircom's SMP obligation. Sky is not aware of any provision in EU or Irish law that would prohibit this. In fact, Regulation 13(4) of the Access Regulations 2011 specifically provides for prices to be adjusted even outside of a consultation process.

We therefore expect ComReg to update existing pricing once the WACC decision is published in line with the European Commission's recommendation. The consideration of whether any decision will ultimately be appealed or not should not prevent ComReg from performing its statutory functions and should not be factor in ComReg's decision making process.

2. In respect of the Access Network Review, the point we are making is that the consultation process has not commenced. The European Commission urged ComReg to update the access network model without undue delay in July 2018. ComReg agreed with the Commission that it should commence this work as soon as possible. It is now over two years later, and the consultation process has not commenced despite the recommendation of the European Commission and despite ComReg undertaking in a settlement agreement with Sky in October 2019 that it planned to do so in Q1 2020. We also note that ComReg wrote to the European Commission in 2018 seeking an extension to complete its review by July 2020. This deadline passed and the consultation has still not started. It is therefore not controversial or unreasonable to say that ComReg has not performed well. Given the significant slippages in time to date, the European Commission's latest recommendation to update pricing with the new WACC takes on even greater significance. Delaying updating the WACC until the Access Network Review is complete, or in the case of FTTC pricing, until a further review after that is complete (which seems to be what ComReg is implying), will result in excess returns being earned by the SMP operator for years to come, to the detriment of the telecoms industry and to the detriment of Irish consumers.

3. Sky is very concerned with ComReg's view on Narrowband services in the 2018/19 regulatory accounts and, in particular, with the statement that this has no bearing on FTTC pricing and that it is relevant mainly to WLR and ISDN services. In the context of FTTC pricing, this is not correct. We believe that it would be a serious error if ComReg is making decisions based on that assumption. This is not simply a matter of Sky's opinion; it is verifiably incorrect. The bulk of FTTC costs and revenues are recorded in this section of the regulatory accounts – this is clear from multiple sources in ComReg decisions and indeed was averred to by ComReg in previous legal proceedings. The 14.4% return recorded on Narrowband services in the 2018/19 regulatory accounts now represents almost a three-fold level of return above what ComReg has deemed to be fair and reasonable in its draft decision (5.61%) and as such must factor into serious consideration. Given how fundamentally important this issue is, I would ask that you confirm that ComReg accepts that the bulk of FTTC prices are based on copper loop costs recorded in the Narrowband section of the regulatory accounts or alternatively we ask ComReg to clearly outline to industry why it now considers that such costs recorded in the Narrowband section of the regulatory accounts have no bearing on FTTC pricing.

4. We also have a concern with ComReg's view that Eircom's reported ROCE for Wholesale Broadband Services was less than its allowable regulated rate of return. Independent of the fact that the bulk of the costs and revenues for FTTC are recorded in the Narrowband section of the regulatory accounts, as noted above, the Wholesale Broadband Services costs and revenues include investment in FTTH which, with the exception of connection charges, are not subject to a cost orientation obligation and is at the early stages of roll-out and take up of the service. As such, Sky believes that it is misleading to imply that this is some sort of indication that over-recovery is not occurring on FTTC. The combined return on capital for FTTC and FTTH is significantly depressed by new investment in FTTH. Indeed, it would be something of a concern if a new FTTH network investment were earning returns on capital of 8% in step with its roll-out. In any event, it is notable that even that combined rate of return is above what is deemed to be a fair rate of return today further highlighting the need to update FTTC pricing.

   An appropriate barometer to assess whether Eircom is recovering above a fair and reasonable rate of return on its regulatory asset base is through a review of the Consolidated Wholesale Statement in the regulatory accounts. This clearly shows year after year that Eircom is earning substantially above a fair and reasonable rate and more than double what ComReg itself views to be fair and reasonable. A failure to update all regulated pricing as recommended by the European Commission will ensure that the trend is set to continue and indeed the gap looks set to widen between a fair rate and Eircom's actual excessive returns if that does not happen quickly.

5. ComReg's response suggests that FTTC pricing will only be considered in line with the settlement agreement of 2019. This would conflate issues before the court in 2019 with the proposed new WACC. As you are aware, the matters before the court on that occasion had nothing to do with the level of WACC – it formed no basis of the appeal. Even if there were no court case or settlement agreement on the level of FTTC pricing, the material reduction in WACC now requires urgent updating of FTTC pricing entirely independent of that settlement agreement. The issues that were the subject of the court case obviously remain important and should be considered in accordance with the settlement agreement, but they should not be conflated with the WACC consultation. As such, we would welcome some clarification from ComReg as to how the proposed WACC and the European Commission's recommendation to update pricing is linked in any way to ComReg's commitments under the settlement agreement.

While we fully appreciate that there may be differences of opinion on certain matters, it is clear from your response that certain assumptions have been made and/or positions are being held that are incorrect as a matter of law and/or fact. In the interests of fairness and transparency we would therefore ask ComReg to address those critical issues.

Finally and more generally Sky is concerned that there appears to be a lack of acknowledgement and or indeed interrogation about the current scale of the over-recovery at Eircom which is plain to see not just in Eircom's regulatory accounts but in the extraordinary and growing fixed line profit margins observed in Eircom's statutory accounts. ComReg must ask itself why excess returns are consistently being observed and why Eircom appear to be consistently and materially outperforming the regulatory cost models that underpin the pricing imposed by ComReg. Failure to do so and failure to update existing pricing with an efficient WACC will signal it is satisfied that such outcomes may continue to the detriment of the industry and by extension to the detriment of Irish consumers.

Kind regards

[redacted]

From: [redacted]
Date: Wednesday 19 August 2020 at 16:24
To: [redacted]
Subject: [EXTERNAL] RE: Updated WACC

Dear [redacted]

Thanks for your mail and bringing your concerns under our attention; we appreciate you views. Because of the holidays I only now got around drafting a reply and let me try to address the issues you raised as clearly as I can because in a number of respects our understanding differs from yours.

Firstly, we have not yet taken our final decision in respect of WACC. We plan to do so shortly but I do not know if such a decision would be appealed and if so whether an application for a stay would be sought, and whether such an application would be upheld by a court. Were these circumstances to arise the position may be unclear for some time.

Notwithstanding that, while I fully appreciate the importance in reflecting the effect of changes to WACC – and indeed other material parameters – on a timely basis, there is no getting away from our general legal obligation to consult publicly on any such measure and to subsequently notify the European Commission with any final proposal before any new prices can come into effect.

You say that the Access Network Review has not commenced; that is not correct. In fact the project commenced in 2019 with a tender for technical advisors to help us develop an entirely new access network model which would replace the old CAM. The new model will reflect new market conditions including the prevalence of fibre and the presence of new network operators such as SIRO and NBI. I have regularly updated you on progress of the project (i.e. who our advisors are, that we try and make the model more transparent for interested parties etc.) and it is now almost complete. We plan to publish it for comment in line with our published work programme.

When you mention *"over recovery of costs"* I assume you refer to Eircom's ROCE shown for narrowband services in its accounts for FY 2018/19. As you are aware this has no bearing on FTTC or FTTH pricing and is relevant mainly to WLR and ISDN services. We have recently published proposals to deregulate most of these services as our preliminary view is that operators can address most of the retail market by using voice over broadband and regulation is therefore no longer needed. I also note that Eir's reported ROCE for Wholesale Broadband Services in those same accounts was less than its allowable regulated rate of return for that year.

We plan to publish proposals in respect of WLR pricing for the residual regulated market in the Autumn in parallel with our publication of the new model. We will consider FTTC pricing in line with our published position as set out in our settlement agreement of 2019.

As is our standard procedure, ComReg may publish your email subject to any confidentiality claim. Can you please confirm at your earliest convenience if your email contains anything you consider confidential?

Best regards,
[redacted]

From: [redacted]
Sent: Tuesday 21 July 2020 14:34
To: [redacted]
Subject: Updated WACC

Dear Commissioners

I hope you are all well. As you are no doubt aware, the European Commission have taken the view that existing pricing decisions need to be updated with the new WACC, without delay. I trust this quells any suggestion that WACC cannot be updated in existing FTTC prices (including the SLU and LLU input prices that make up the majority of FTTC price).

As we made clear in our submission (attached), we are of the view that updating prices in this way is a necessity, in line with Eircom's cost orientation obligations. The fact that the Commission concurs evidently strongly reinforces this view.

We are also conscious of previous Commission recommendations, most notably their recommendation in July 2018 that that ComReg should update the Revised CAM "*without undue delay*" in the interests of "*regulatory predictability*". In its decision D10/18 ComReg accepted the Commission's position and noted that it needed to do this as "*quickly as possible*". As we have discussed on a number of occasions, we remain both concerned and disappointed that, now two years later, the Access Network Review has not yet commenced.

When we have discussed the Access Network Review, you have frequently mentioned its complexity as the reason for the continued delay. I mention this specifically, as it stands in contrast to the exercise that needs to be carried out in this instance, which simply requires updating the existing regulated prices with the new WACC. To do this in line with the Commission's 'as quickly as possible' recommendation would mean doing so immediately.

Eircom's over recovery of costs has been a source of deep frustration for all OAOs for a number of years at this point, while also having a negative knock on impact on Irish consumers. There is now a clear and present opportunity to begin to redress this balance quickly, fairly and in line with the views of the European Commission. It would not be fair, just or reasonable to postpone the taking of appropriate action any longer.

Kind regards

[redacted]

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Tá an ríomhphost seo, chomh maith le haon iatáin a bhaineann leis faoi rún agus d'fhéadfadh leis a bheith faoi phribhléid nó cosanta ó aon nochtadh. Is don seolaí(aithe) ainmnithe thuas amháin é. Níl sé ceadaithe go mbeidh rochtain ag éinne eile ar an ríomhphost seo. Más rud é nach tusa an faighteoir ainmnithe, ná cló amach, léigh, cóipeáil, nocht d'éinne nó bain úsáid as an eolas sa ríomhphost seo in aon tslí eile, le do thoil. Más rud é go bhfuair tú an ríomhphost seo trí earráid, dean teagmháil leis an seoltóir láithreach agus scrios an t-ábhar ina iomlán, bíodh sé i gcóip leictreonach nó chrua.

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