



Submissions to Consultation

Costing of universal service obligations: Principles and Methodologies

Submissions received from respondents

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alto

alternative operators in the communications market

**Submission to ComReg in response to Consultation on Costing
of universal service obligations: Principles and Methodologies
Document No.11/15**

Submission By ALTO

Date: April 18th 2011

ALTO welcomes the opportunity to respond to ComReg's Consultation on: Costing of universal service obligations: Principles and Methodologies Draft Decision and Responses.

ALTO is satisfied that ComReg has analysed the various components outlined in the initial Consultation and Call for input to the required levels.

We support ComReg's Draft Decisions and we believe that the Draft Decision arrived at is the correct and proportionate response in all the circumstances.

ALTO

15th April 2011

2 BT Ireland

BT Communications Ireland Ltd (“BT”)

Response to

ComReg’s Response to Consultation & Draft Decision Costing of universal service obligations: Principles and Methodologies (ComReg 11/15).

Issue 1 – 18th April 2011

1. Introduction / Summary

We welcome the opportunity to review ComReg’s conclusions and the USO Draft Decision. We are in general agreement with the approach taken by ComReg in the response and draft Decision document addressing the Irish market but would like to re-emphasize a few points from our original submission and offer a small number new comments.

2. Detailed Comments

2.1 Re-Emphasis

End-to-End cost valuation - eircom is a vertically integrated company offering services at the access, wholesale and retail layers. eircom achieves a mark-up at each layer and equivalent will exist for the internally traded services. We consider the USO services provided by eircom must be considered as an end-to-end product removing the various mark-ups as these provide profit to eircom rather than a financial burden and could lead to an overstatement of cost. We believe an end-to-end valuation will demonstrate a significant reduction in the financial burden on eircom and provide a realistic view.

No reward for poor service and “Catch-Up”

We welcome ComReg’s approach towards “Catch-UP” and re-emphasize our belief eircom commercially chose, through their business decisions, the quality of USO services prior to 2009/10 and such was inefficient, particularly service assurance. We remain of the view eircom should be fined and not rewarded for this action. They are responsible for the need to “catch-up” and should pay any additional costs it has caused.

Efficiency and value for Money.

We remain of the view that eircom could take a more commercial approach towards telephone directories and the NDD. Please also see our point below on tendering out.

Tendering out the USO or parts of it.

As discussed in our original response we believe eircom will be the obvious USP for the coming period, certainly to the end of the current designation in 2012, however if ComReg were to conclude that a levy is to be raised on industry for the USO such would raise significant concerns as to the efficiency of the current USP. In this event we believe that ComReg or the Dept. should issue an open tender for a new USP to provide either part or all of the USO to determine whether better value can be obtained. The constant evolution of mobile and radio technologies offers the potential for others to access uneconomic customers and provides the Dept. and ComReg greater choice of USP.

2.2 New Comments

Ref. Clause 3.67 – We continue to believe that a LFI of 12.5% is a weak target and consider it is right and proper to challenge eircom to do better. The industry was disappointed to see eircom set a target of 14.5% as this is poor for the sector and poor for the consumer.

Ref. Clause 3.102. Traditionally eircom has the most ubiquitous network in Ireland, particularly at the consumer level, and is often able to re-use existing sunk infrastructure such as ducts, poles, cabinets etc, so their threshold to gain benefit has been lower than new entrants. However, going forward with the advent of new mobile and radio technologies the threshold may lower for eircom and importantly other entrants.

Ref. Clause 3.104. NPV is a standard tool for determining the viability of a proposal and once the initial outlay has been absorbed it's very possible the service will be profitable over the longer term. This discussion should be linked into the analysis of uneconomic lines becoming economic, otherwise there is a risk that eircom will be over compensated if the status is not monitored carefully.

2.3 Comments to the Draft Decisions

Ref. Decision 3.11 – We consider that eircom should be required to publish a list of Uneconomic areas (defined at the MDF level) as such would allow the industry to verify the information based on its wide knowledge of the sector, plus other providers may decide to commercially enter such areas with novel solutions such as with radio etc. Basically such notification could stimulate investment that may otherwise not occur.

Ref. Decision 3.32 – If the industry were to be called to pay retrospectively for the USO since 2009 this could have a considerable impact on the functioning of the industry and the ability of operators to recover their costs particularly in the current poor economic environment.

End

3 Eircom

eircom Ltd.

**Response to ComReg's
Consultation**

&

Draft Decision

No. 11/15

**Costing of Universal Service
Obligations:
Principles and Methodologies**

18th April 2011

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Introduction

eircom welcomes the opportunity to respond to this Consultation and Draft Decision paper (11/15) from ComReg in relation to the funding of eircom's Universal Service Obligation ("USO").

The assessment by the Regulator of an application by the Universal Service Provider (USP) for the sharing of universal service funding is an essential aspect of universal service provision under the regulatory framework for electronic communications. The Regulator is permitted to designate an operator as the USP and impose on it very extensive and costly obligations, including where that operator has not applied for designation. In turn, the Regulator is obliged to review a request for funding and, where it is established that there is a net cost which constitutes an unfair burden, it is obliged to establish a sharing mechanism so that the USP does not on its own bear a burden which truly is not proper to it. ComReg's Consultation represents an additional step towards establishing the principles in Ireland which govern applications for funding.

eircom is fully committed to a constructive engagement with ComReg in this process. eircom also recognises that the development of the principles governing the calculation of the net cost of the USO is a challenging task. eircom accepts that the calculation of the USO cost should be robust, sound, detailed and as transparent as possible. However, the requirements that are set by ComReg with the view to achieving such an outcome should be reasonable and not such as to deprive, in effect, the USP of the right to have its application for funding reviewed and the net cost of the USO shared, where it objectively represents an unfair burden for the operator concerned.

In this context, ComReg should also recognise that the estimation of the net cost of the USO is not a mechanistic exercise. While eircom has sought to understand and evaluate the practical consequences of the Draft Directions in 11/15, these cannot be known with certainty until the actual modelling work commences. It is highly likely that the methods chosen will have to be adapted once data, and its limitations, become known. It is inevitable that there will be some level of departure from the "real" cost of USO and its calculations: pragmatic compromises and modifications will be needed.

The present Consultation represents a welcome step which eircom hopes will translate soon into a clear framework for assessing funding applications. There is, because of eircom's precarious financial state and the heavy burden that the USO constitutes for eircom in this context, urgency in allowing and reviewing applications for funding by eircom – as is eircom's undeniable right.

I. PRINCIPLES AND METHODOLOGIES FOR CALCULATING USO NET COSTS AND REVENUES (Section 3)

A. The Costing Methodology to be Used (¶¶3.3- 3.16)

In terms of the Costing Methodology to be used, ComReg's preference is for the "*HCA methodology, properly adjusted for efficiencies, and taking account of the costs that could have been avoided by the USP absent the USO*". In doing so ComReg dismiss the use of what is termed Long Run Average Incremental Cost (see Draft Decision, ¶ 3.16).

As previously explained, eircom is of the view that the use of forward-looking long run incremental costs, including a normal return on capital, is the appropriate methodology and that this view is supported by previous Documents of the European Commission.

eircom notes in this regard that ComReg's reasons for rejecting LRAIC are flawed. It is not correct to associate incremental costs (or the LRAIC per unit of service) exclusively with sending right signals for build/buy decisions. The concept is broader. Incremental costs reflect the cost to the operator – and to society as a whole – of engaging in the activity under review, in this instance the provision of the services falling under the USO. Looking thus at the question from the perspective of eircom currently providing USO services, the incremental cost caused by USO services is equal to the cost that could be avoided in the long run had the USO never been imposed. Hence it reflects the resources that eircom has to give up in providing USO services. In not providing these services, eircom would have avoided the corresponding incremental costs (or the LRAIC per unit of service), from which follows that the concepts of long run incremental cost and long run avoidable cost are equivalent.¹

eircom also pointed out that were an HCA approach used, then an appropriate set of allocation rules for costs would be required, including the possible use of ComReg's LRIC Access Network model to inform the allocation of the HCA cost pool to exchange areas, so as to provide the required level of geographic analysis to support the USO costing exercise.

A number of issues arise in relation to the justification proposed by ComReg:

- First, efficiencies adjustment for HCA are highly unusual – this is explained in further detail below. It appears to eircom in this regard that the requirement of the Direction that funding reflects efficient costs is more consistent with a choice of LRIC. (In terms of the State Aid rules, eircom does not understand their relevance in a context where there is no question of a transfer of *State* resources, and accordingly clearly no possibility of aid).

- Second, ComReg's comparison of HCA and MEA at ¶ 3.10 by reference to underground deployment which would be more expensive than overhead deployment. While this may be generally true, ComReg's analysis is incomplete. eircom understands a "Modern Equivalent Asset" (MEA) to be an asset with the required capacity and functionality that has the lowest discounted cost over future years. This includes operating costs. If poles meet this requirement, then poles should be used. In other words, it is the full cost of the asset that should be considered, not just deployment costs. ComReg's assessment

¹ This is in line with WIK (1997): Wissenschaftliches Institut für Kommunikationsdienste, Costing and Financing Universal Service Obligations in a Competitive Telecommunications Environment in the European Union: Study for DG XIII of the European Commission, Final Report, October 1997, p. 25. Financing Universal Service Obligations in a Competitive Telecommunications Environment in the European Union: Study for DG XIII of the European Commission, Final Report, October 1997, p. 25. Financing Universal Service Obligations in a Competitive Telecommunications Environment in the European Union: Study for DG XIII of the European Commission, Final Report, October 1997, p. 25.

accordingly over-simplifies and misstates the logical consequence of the choice of HCA over MEA.

- ComReg argues at ¶ 3.12 that CCA causes implementation difficulties. It is not clear why ComReg should think so and why using CCA would be more difficult than using HCA. Similarly, ComReg's reason for thinking that there are "*incentives associated with this methodology which may lead to uncertainty*" is not at all clear.

B. Principles and Methodologies for Avoidable Costs (¶ 3.17-¶ 3.35 and ¶ 3.117-¶ 3.124)

ComReg claims at ¶ 3.21 that all respondents to the Consultation agreed that avoidable costs are those costs that could have been avoided if the provision of the USO to "*non-viable customers*" was not required. It is important to be very clear that the USO cost is not just the costs that would be saved if eircom were to stop serving the unviable customers if the USO were to be removed, as suggested at ¶ 3.27. Rather, it is the cost which could have been avoided in 2009/10 if the USO had never been imposed.

Calculation of such cost, consistent with Schedule 2 of the Universal Service Regulations (to which ComReg refers at ¶ 3.17), requires that "[*d*]ue attention is to be given to correctly assessing the costs that any designated undertaking would have chosen to avoid had there been no universal service obligation". This means, significantly, that the relevant time period to be considered is a multi-year period, not just a single year, and that all past costs required to meet the USO obligations in force at the time are relevant to the calculation of the USO cost.

As a case in point, if eircom incurred CAPEX some years ago as a direct result of its USO, and the resulting fixed assets are still not fully depreciated in the period being considered for USO purposes, the annual depreciation to these assets is relevant for inclusion in the USO submission of the USP. This is particularly pertinent in the case of eircom, which has been the designated USP in Ireland since 1999, and more generally having regard to the long economic useful life of many telecommunications assets (e.g. duct, cables, poles, radio towers, exchange buildings, etc.).

It follows that calculating the cost of the USO essentially involves the comparison of a factual situation, where eircom is under USO obligations, with a counterfactual, where eircom is not under any USO obligations, that is, a scenario where the USO has never been imposed. In order for such an analysis to be logically coherent, the key question that must be asked when estimating the net cost of USO is what costs could eircom have avoided in the long run if it had never had the USO. While this is the test set out as a matter of principle by ComReg, this test appears to vary throughout the Consultation Paper. For example, ComReg makes several references at ¶¶ 3.117- 3.214 to the actions that eircom might have taken had the USO been removed in 2009. This is not the correct test. ComReg's proposed Direction to the effect that the net cost calculation should exclude those customers which a commercial operator would continue to serve absent a USO is accordingly wrong.

These points are expanded upon further below.

Before doing so, however, it is necessary to make a number of observations in relation to ComReg's analysis of the Respondents' views to ComReg Consultation Paper 10/94, in particular that at ¶¶ 3.23 of O2 and Vodafone. It does not appear to eircom, on the basis of the extracts included in the Paper, that O2's and Vodafone's views are "*similar*".

O2 is mistaken when it makes the generalised statement that the USP would not reduce its fixed common and joint costs if it did not have a USO. eircom has already explained in

our response to 10/94 that, while eircom would agree that fixed common and joint costs should not be included as avoidable costs in the calculation of the cost of USO, it does not follow that all the incremental costs in the access and core networks would have been classified as direct in the original fully distributed cost model. The fact that a cost can be treated as an overhead in a fully distributed costing model does not mean that it cannot be “avoided” were a particular service or increment no longer supplied. We gave the example of accommodation maintenance costs. In a fully allocated costing model such costs may be treated as an overhead on the accommodation costs. However, if an entire exchange area were deemed to be uneconomic, then it is reasonable to infer that these accommodation maintenance costs would be avoidable and thus proper to include in the USO costing calculations. In other words, while accommodation maintenance cannot be attributed directly to a specific service, as it does not have a unique cost driver, it can be attributed once the increment of analysis is large enough.

In contrast to the view expressed by O2, Vodafone's response appears to identify correctly the essence of an “avoidable cost”, i.e. how the cost would be expected to vary in the long run if eircom had never had a USO, and had thus been able to choose not to supply particular USO areas, customers or services.

eircom agrees with ComReg that the correct test to apply in determining what are avoidable costs is that set out at ¶ 3.26. In particular, eircom agrees that depreciation associated with previous relevant CAPEX should be taken into account in the calculation of net USP cost. The approach outlined in ¶ 3.27 (i.e. to take a single-year view, and that previous relevant CAPEX is sunk and should not form part of the USO cost calculations), is clearly inconsistent with Schedule 2 of the Universal Service Regulations. Furthermore, the calculation of “short run” avoidable cost, would give rise to considerable ambiguity as cost levels would vary depending upon the period of time over which avoidability was assessed. As the time period was increased, the costs would change, trending ultimately towards the long run assessment.

While eircom agrees that only avoidable costs should be considered when calculating the cost of USO, the term “avoidable costs” must be defined in such a way as to include all investments and all operating costs that could have been avoided if eircom had never had a USO. There are essentially four cost types that must be considered: direct costs, directly attributable costs indirectly attributable costs and unattributable costs.

- Direct costs are costs which are not shared, and are incurred directly in the provision of a specific service or for a specific customer. The network termination point is an example of a direct cost. A direct cost can always be avoided by not providing the increment in question: areas or individual customers which have to be served under the USO, public payphones and directory services. This would also include the cost to eircom of calculating the cost of the USO and auditing the submission.
- Directly attributable costs are not incurred directly in the provision of a specific service or for a specific customer, but are uniquely driven by a specific shared cost driver. These costs include trenches, cables and cabinets etc. all of which are driven by the number of lines served by them but are shared between all customers. Hence when the increment of analysis is an area, these costs can be attributed to individual customers relative to the proportion of the copper pairs used by them.
- Indirectly attributable costs are costs that cannot be attributed directly to a specific service or customer, as they do not have a unique cost driver. They are typically used for several activities and may be allocated to services through activity based costing. They, would typically only be avoided when changes are big enough that it is justified to rearrange the activities in question accordingly. When the activities are dedicated to a larger increment, for example a whole MDF area, the indirectly

attributable cost essentially becomes a cost that may be directly attributable to the MDF area.

- Non-attributable costs are costs that cannot be considered to be directly or indirectly (in the sense used above) driven by the number of lines (subscriber access service) or calls (core network service). They cannot be attributed to a specific service or customer and can typically not be regarded as avoidable. However, in the long run, to the extent that these costs are caused by the operator's total activities and the increment under review is part of these total activities, then some of these costs may be avoided.

With this in mind, eircom agrees in principle that “Business Sustaining Costs” as referred to by ComReg at ¶ 3.30, are generally not costs that are relevant to USO because they are not dependent on whether or not eircom is the USP. However, this is correct only to the extent that this category of costs is not defined too widely. For instance, in ¶ 3.29, ComReg refers to CEO salaries as being “*independent of the quantity of service*”. This may not always be the case. An element of the remuneration of a CEO might typically be linked to company turnover, which, in the case of a USP, would be likely to vary depending on the presence or absence of a USO. Overheads are a function of the total activities of a company. To the extent that a sizeable part of these total activities are due to the USO this part would also have caused a part of the overheads and can be avoided. Clearly, it is important to limit the definition of non-relevant costs to those costs which are demonstrably independent on the presence or absence of a USO.

eircom notes in this context that one such avoidable cost is the the cost incurred by eircom in meeting the obligation in terms of USO fault and provision targets set out in Decision D02/08. In the absence of this USO obligation, eircom did not, and would not, meet these targets. The USO cost exercise is intended to determine what costs would arise from a given obligation, or would not have been incurred if the obligation had never existed. The extra cost is quite clear in the case of an obligation imposed only in 2008. The incremental costs of meeting these newly imposed obligations are therefore a very real part of the cost of USO and must be included in the calculations.

In summary, therefore, based on the arguments outlined above, eircom does not agree with the Draft Decisions listed at ¶ 3.34 and ¶ 3.35.

C. Principles and Methodologies for USO Revenue Calculation (¶ 3.36-¶ 3.62)

A number of issues were identified in 10/94 in terms of identifying revenues for the purpose of the calculation of the net cost of the USO. eircom refers to its response and makes the additional submissions:

(i) Reasonable Access Threshold (RAT) - (¶ 2.10, ¶ 3.37, ¶ 3.53, ¶ 3.60, ¶ 7.5)

eircom agrees with ComReg that once-off connection charges (RAT for Standard Connections) should be allocated over the expected customer lifetime, and that the customer can be assumed to remain a customer for at least 4 years.

On the basis of data concerning cases over the period 2005/06 to 2009/10, on the basis of a 4-year life, a customer connecting in January 2006 would be expected to be present on the network in January 2010. Therefore, any excess cost or revenue arising should be spread over the period to January 2010, and so will form part of the 2009/10 submission.

The various relevant cases may be those where excess connection charges were -

- (a) Considered, but the investment cost were found to be less than €7000, and service was provided at standard rates;
- (b) Offered to customers, but customer declined to pay the balance; and
- (c) Customer paid the balance requested.

With regard to category (c), it is relevant to note that eircom bears up to €7,000 cost and the customer the €107.43 (ex VAT) standard connection fee plus the balance of the cost over €7,000. At ¶ 3.53 there is a suggestion that the lump sum payment is large because it exceeds €7,000. Typically, any excess payment by the end user is small, but eircom's cost may be large. Since 2006 only 3% customers have paid for the connection costs exceeding the RAT. In most cases, the total cost was only slightly greater than the €7,000 threshold, so the excess amount paid by the end-user was quite small. 3%. In total, excess charges of 3% were collected, representing about 18% of the total direct cost of these 3% connections. 3%.

ComReg also suggests that the revenue from one-off connection charges should be allocated over the lifetime of the customer, on the basis that any customer who is willing to pay the connection fee in excess of the RAT can reasonably assume to remain as a customer for a period of at least 4 years. eircom notes, however, that a period of four years is likely to be excessive in relation to those customers which benefit from the DSP allowance. Some customers in difficult to serve areas order telephone service for the first time when they qualify for the DSP scheme. This is driven partly by cost, and partly by the fact that a telephone was irrelevant when they were younger, but becomes essential when their families move away, and they become old and infirm, and in need of a lifeline for emergencies. The fact is that many of these customers get their first phone when they are quite old and perhaps in failing health, and so the service may well be ceased within a short time after purchase.

(ii) Meteor and eMobile Revenue (¶ 3.50 & ¶ 3.54)

ComReg considers calls from mobiles as direct revenue in ¶ 3.50, but as indirect revenue in ¶ 3.54. It appears that ComReg considers that all retail revenue from Meteor customers calling uneconomic areas or uneconomic customers must be considered. Identifying this incremental retail revenue may be quite difficult unless an averaging approach is used. Identifying the associated incremental costs may also be challenging. (A number of matters will require consideration, including, how would Meteor/eMobile revenues have differed if a specific line or exchange had never been provided, whether pre-pay revenues would have been smaller, and whether the spend of a post-pay user would have changed). The inclusion of Meteor revenue would result in an increase in the amount of allowable replacements calls, see below.

More generally, an averaging approach might also be necessary with other indirect revenues.

(iii) Replacement Calls (¶ 2.9, ¶ 2.12, ¶ 3.40, ¶ 3.47, ¶ 3.57-¶ 3.58, ¶ 3.62, ¶ 3.157, ¶ 4.26)

eircom accepts that some level of replacement calls will exist in certain situations, and that they will tend to reduce the relevant foregone revenue if a particular uneconomic customer was not served. Consequently replacement calls will tend to increase the cost of USO to the USP. We also note from ¶ 3.47 that the majority of respondents to 10/94 support the inclusion of replacement calls in the USO calculations.

In ¶ 3.57 ComReg says that it “*considers it appropriate to include replacement calls in the net cost calculation **after** a net cost is determined for a user or group of users*” (our emphasis). There is an inherent inconsistency and an element of circularity here, in that (as outlined in the Draft Direction ¶ 3.62), the USO net cost calculation is to include a consideration of replacement calls.

For reference, in ¶ 3.62, ComReg directs:

“Replacement calls: where a net cost exists, replacement calls should be estimated and added to the net cost calculation (where such a net cost is proven to exist)”.

While the dynamics of replacement calls are such that they reduce foregone revenue and hence tend to increase the net cost, replacement calls may also lift the revenue for remaining areas and/or customers. In some cases this might make a customer or an area that would otherwise have been marginally uneconomic to serve economic. This suggests that replacement calls should be included in the iterative procedure used to derive the net cost of USO and should not be taken account after a net cost has been determined.

Clearly therefore, contrary to ¶ 3.57 the issue of replacement calls must be considered in advance of arriving at the net cost figure, rather than after completing the net cost calculation.

As a matter of principle, eircom agrees with ComReg's proposal at ¶ 3.62 to include an estimation of the value of replacement calls in the overall USO calculations although such estimation will be complex. One possible method to make an estimate of the value might be to carry out quantitative market research based on customer surveys. However, because, in the presence of a USO, this exercise as a necessity, will necessarily involve hypothetical questions, the sampling method proposed by ComReg by reference to Decision D08/10 has no application. eircom notes further in this context that the standard of auditing applicable to such estimates should reflect their nature and not be unduly and disproportionately high.

(iv) Apportionment of Indirect Revenue (¶ 3.55 - ¶ 3.56)

In principle, eircom can see some merit in the two-stage process proposed by ComReg in relation to apportioning revenue between an economic customer and an uneconomic customer (be it voice customers or leased lines) (¶ 3.55 and ¶ 3.56). In certain circumstances it is not possible to associate the revenue from an indirect service to a telephone line, for example leased lines. In eircom's last USO funding analysis, leased lines that cannot be associated with a line were averaged across all business lines in the exchange site.

However, this process has to be considered in the light of the other iterations that need to be performed when estimating the net cost the USO. In particular, the estimation of the portion of revenue which economic customers can spare without

making themselves uneconomic may not be readily calculable as it will depend on the sequence of iterations required to identify uneconomic customers. Hence this process appears to be extremely complex, and may, in practice, prove to be incapable of implementation.

Instead eircom would suggest that the potential materiality of the revenues involved first be assessed. In the event that the amounts were not material, and in the interests of reasonableness and ease of implementation, a simple 50/50 split of the revenues between the economic and uneconomic customers would be justified.

(v) Customer Lifetime (¶ 3.53, ¶ 3.117- ¶ 3.124)

The issue of the customer lifetime is discussed at ¶¶ 3.117 to 3.124. It is not clear what Direction ComReg is proposing to make as a result of the discussion. However, eircom notes, as mentioned above, that the appropriate test for calculating avoidable costs is not whether a commercial operator absent USO would choose to continue to serve certain customers at a certain point in time but whether a commercial operator would have chosen to serve these customers had it not been subject to a USO at any point in time.

In addition, and without prejudice to this, eircom notes in relation to ComReg's discussion of these customers according to geo-types that, as ComReg highlights, urban areas are the most eagerly contested. This intense competition, from operators who can "cherry-pick" which areas to serve (minimising their cost), severely undermines the ability of a USP with a national geographically average price to charge a tariff which enables low cost urban users to cross subsidise expensive, low-revenue remote users.

(vi) Wholesale Revenues (¶ 3.61 & ¶ 3.62)

It is important to note that Wholesale revenues (and associated avoidable costs) must be allocated to areas and customers before determining whether the area or customer is uneconomic.

At ¶ 3.61, ComReg says

"Direct revenues will include those revenues from an OAO which will include inter alia:

- *wholesale access (... "SB-WLR");*
- *wholesale calls; and*
- *complementary wholesale services such as bitstream and local loop unbundling ("LLU") etc".*

Indirect revenues are defined at ¶ 3.62 to include "*wholesale interconnection revenue: fixed termination and transit services*". On this basis, eircom understands that revenues from wholesale calls at ¶ 3.61 only include revenues from call origination, as call termination is considered in ¶ 3.62.

Call termination on the fixed network may be readily attributed to area or line. However, transit calls may be difficult to allocate to areas or lines. Some transit calls may be ultimately destined for an access loop on the eircom network. For example, OAO1 might transit a call to OAO2 via eircom, and, in turn, OAO2 pays eircom to terminate the call on a specific SB-WLR line. Other transit calls may not be associated with areas or eircom's access network at all: e.g. transit to third

party DQ providers, mobile to mobile transit between mobile operators (excluding eircom's mobile division), or transit calls to premium rate calls. Therefore, we should exclude the costs and the revenues of all transit calls from the USO funding calculations.

(vii) Premium Rate Numbers:

ComReg regards Premium Rate calls at ¶ 3.62 as indirect, i.e. not directly invoiced to a customer for the services provided directly by the USP. However, end users are invoiced directly by the USP, which, in turn, pays the bulk of the revenue for a premium rate call (less the avoidable cost) to the service provider.

D. Principles and Methodologies for Efficiency Adjustments (¶ 3.63 - ¶ 3.91)

eircom agrees that the cost inputs used to calculate USO costs should be efficiently incurred costs. However, a number of issues arise in relation to the principles and methodologies for the adjustments proposed by ComReg. eircom notes the following:

- First, eircom maintains that there is limited scope for efficiency adjustments: already, eircom's revenues reflect the numerous and detailed efficiency adjustment imposed by ComReg in the context of setting wholesale prices for access to eircom's networks, which, in turn, are reflected at retail level. In addition, efficiency at both network level and organisational level has significantly improved in recent years through a number of specific programmes designed to increase efficiency.
- Second, it is unusual to perform efficiency adjustments to Historical Cost Accounts (HCA). There is an inherent inconsistency between a methodology based on actual costs, and the application of an efficiency adjustment. In forward-looking top-down cost studies, efficiency adjustments are made to the accounting costs through asset revaluation, network optimisation and operating costs. In other words, it is the whole business that is subject to adjustment and as a consequence the approach is internally consistent. When historical capital costs are used as is the case of the USO calculation, care must be taken not to confuse the efficiency gains that may be available when all assets are new with those that are available for the historical assets. Furthermore, a rational profit-maximising operator has incentives to maximise efficiency, or to minimise costs, having regard to uncertainty, the irreversible nature of investment and inherent path dependencies. It can be argued therefore that the actual cost incurred was the most efficient at that time. This might be true even where the operator can clearly identify future productivity improvements. Savings in manpower, or pay cuts that might be acceptable in 2011/12 might not have been achievable in 2009/10. It is not sufficient to argue that "you can do it now, and the technology existed to do it in 2009". Clearly one would expect that a profit maximising operator would have achieved any efficiency savings that were possible in 2009.

eircom has had to absorb the USO costs since its first designation as USP in 1999 and has therefore had sufficient incentive to minimise those costs. Moreover, since eircom is likely to continue to be required to fund a large share of the net cost of the USO, it will have continued incentives to adopt the most efficient response to the USO.

- Third, it is essential in any further efficiency review that the principle set out at ¶ 3.66 of 11/15, namely that *“the issue is not whether the USO service could now be delivered more efficiently, rather, whether at the time of instalment or upgrade, the cost were discharged in the most efficient manner”* be applied consistently in relation to all cost discharged. For example, technological developments might result in switching and transmission costs decreasing over time. As another case in point, the current recession has resulted in significant decreases in property and rental prices, but eircom should not be penalized for having taken into account at the time costs were incurred, the level of property prices at that time.

Another aspect of this includes recognizing what were the technological solutions which were available at the time and which were recognized as appropriate at the time, regardless of subsequent development including in terms of technological development.

There are several references in 11/15 to **“efficient network design”**, including in particular, to the use of wireless systems including cellular mobile service, to deliver USO. In this regard, eircom would note that it has endeavoured to minimise costs in many ways over the period since 1990, including through the use of:

- Rurtel radio systems, where radio systems were more cost effective than copper cable;
- Other radio technologies designed to deliver both voice and broadband;
- Pair gain technology (“carrier systems”) where such technology was more cost effective than copper or radio alternatives; and
- Fixed cellular solutions (FCS) utilising the 2G mobile networks to deliver a fixed voice service.

These solutions are all sufficiently costly that they are rarely preferred to copper, except in extreme circumstances. Some of these technologies have significant deficiencies. They may require mains power, often require provision of external antennae at the customer premises and may have higher fault rates than copper solutions because the electronics are more prone to lightning damage and other failure modes.

Such solutions are also subject to regulatory costs. For example, changes to spectrum allocation in 2008/09 require eircom to remove the existing radio solutions for over 2,800 customers. Changes to spectrum costs would also change the economics of various technologies. As the most efficient technology is no longer available, or only available at a higher cost (in spectrum fees) than before, we expect over 25% of these customers will be served using copper, with most of the remainder served using FCS. Only a small portion will be served using WiMax, but at considerably higher spectrum costs than was previously the case.

eircom notes further that these customers are not just costly to serve: their revenues are systematically lower than the national average \propto . In the absence of the USO, they would only be served at higher prices, or not at all.

- Fourth, eircom fundamentally disagrees that the Line Fault Index of a network generally, and the performance targets set out in ComReg Decision D02/08 specifically, can be used for the purpose of the USO efficiency assessment in the manner proposed by ComReg

(Line Fault Index (LFI) - ¶ 2.13, ¶¶ 3.63 – 3.91)

- First, ComReg seems to assume that a network with a lower fault rate would have lower total cost. This may or may not be the case. The simple example contrasts an overhead network, with a high fault rate and therefore high Opex,

but low Capex, with a fully underground network with a much lower fault index, and hence lower Opex, but much higher Capex. A rational efficient operator would consider the combination of build approaches that minimises total cost². Typically, dense urban areas have lower costs if underground networks are built, and sparsely populated rural areas have lower costs if an overhead network is built, despite the higher fault rate of the latter.

- Second, the references in at ¶ 3.79 of ComReg Doc. 11/15 to LFI as a measure of efficiency do not reflect the scope of the obligation imposed on eircom by ComReg Decision D02/08. In particular, Decision D02/08 requires that certain targets be achieved that are measured by reference to eircom's entire network. In this regard, clearly, a national fault rate target of 14.5 faults per 100 lines for the entire network does not require that every exchange area has a fault rate below this level. In fact, a national target of 14.5% will inevitably be achieved through a mix of LFI significantly above the national average of 14.5% in predominately rural, isolated and high-cost areas, that is, USO areas, and a low LFI in urban areas. It is accordingly entirely inappropriate to test efficiency for funding purposes against a 14.5% target. Indeed, to do so would be tantamount to increasing very significantly the applicable USO targets. Clearly this cannot lawfully be done through the USO Funding mechanism.

The following specific example illustrates eircom's point. If the weighting of lines in Ireland is such that rural areas account for one third of lines, the national average of 14.5% might be best achieved by having a rate of 20% in rural areas, and 12% in urban areas. If the national rate then is required to improve to a rate of 10%, this might be achieved either by achieving a 10% rate nationally, or by a 15% rate on rural areas and a 7.6% rate in urban areas, or perhaps by keeping the rural failure rate at 20%, and improving urban failure to 5%. An efficient operator would identify the costs of each option, and implement the least cost option. It is very unlikely that a uniform rate of improvement would be also be the least cost solution.

In the light of the above, eircom does not believe, or accept, that the performance targets set out in D02/08, which do not recognise the differences of line fault occurrence by geotype but rather work as national *average*, can be used to measure eircom's efficiency for the purpose of USO funding. eircom is accordingly of the view that ComReg's Draft Decision at ¶ 3.91 proposing that efficiency adjustments could be made in light of an "*appropriately adjusted LFI target for the financial year in question*" is unacceptable.

- Fifth, eircom does not accept that the issue of of "**catch-up**" investments (¶¶ 3.81-3.85, ¶ 3.146) is significant in the context of eircom, nor that it is susceptible to justify disallowance by ComReg of particular investments on the basis that the particular Capex was unnecessarily delayed by eircom. There is no reason or basis for ComReg to suggest that eircom, as a profit-maximising private operator has not acted rationally investing in infrastructure as necessary, taking into account potential trade-offs between high Capex and low Opex, as opposed to lower Capex and somewhat higher Opex. The suggestion that eircom might in some way delay its Capex programme to benefit from an as yet unestablished USO fund is simply not credible.

² At ¶ 3.10 ComReg contrasts the MEA (Modern Equivalent Asset) approach with the HCA approach and notes that underground deployment is more expensive than overhead deployment. While this may be true in general, it is important to bear in mind that an MEA is an asset with the required capacity and functionality that has the lowest discounted cost over future years. This includes operating costs. If poles fulfil this requirement, then poles is what should be used. It is the full cost of the asset that should be considered, not just deployment costs.

eircom also notes that a number of consequences in terms of USO Funding calculations would follow from ComReg's assumption that some Capex was unnecessarily delayed.

A simple example might illustrate the situation.

Assuming an application for funding in the calendar year 2010. A van (useful life 6 years) is used by eircom to help fulfil its USO. Suppose this van was bought in 2007 for €6,000, so a depreciation charge of €1,000 hits the 2010 accounts and this feeds into eircom's USO funding application to 2010. Under the principle of "catch-up" investment, ComReg maintains that the previous van had been the subject of "asset sweating" by eircom, and that the current van should actually have been purchased in 2004. ComReg's argument then goes that, if there had been no asset sweating by eircom, the current vehicle would have been purchased in 2004 and would now be fully depreciated. Hence, the depreciation in the USO funding submission should be disallowed by ComReg.

This, however, is clearly illogical and untenable. If this van had been purchased in 2004, it would have had to be replaced in 2010. Suppose the corresponding replacement vehicle in 2010 would have cost €7,000. Instead of eircom's 2010 USO funding submission having a depreciation charge of €1,000 in case of this vehicle, it should have a charge of €1,167.

What this means is that a consistent approach in relation to USO funding, and in particular to the issue of asset sweating, must be adopted and followed. If, in the context of catch-up investment, asset sweating must be avoided, so that assets are regarded as having been purchased by eircom in the year in which the previous asset's expected economic useful lives (EUL) expired, the assets should on this basis, be replaced with equivalent assets when their EULs would have expired. In the case of fully depreciated assets which continue to be used by eircom for the purpose of its USO, assets should be considered to have been replaced at the end of their respective EULs and a notional depreciation charge added to the USO funding submission to account for this.

From the above, it should be clear that the issue of catch-up investment is nowhere near as clear-cut as ComReg sets out in 11/15. In this regard, eircom is of the view that the better approach is to disregard this issue, on the basis that the counter-acting effects would be likely to cancel each other out. This would also greatly facilitate the reconciliation of the USO submission to the underlying accounts, thereby increasing transparency.

In relation to the difference in the treatment of investment for the provision of ECAS by contrast with the USO, eircom does not believe that the explanation provided by ComReg is satisfactory. eircom maintains accordingly that there is no reason to differentiate in the treatment of ECAS and USO investments and that any favourable treatment afforded the ECAS operator should be afforded to the USP.

Finally, in terms of ComReg's proposed Draft Decision as set out at ¶ 3.91, eircom does not believe that it is appropriate that the methodologies and basis for efficiency adjustment can reasonably be open-ended, as ComReg appears to propose. This would run counter to legal certainty and ComReg's obligation to review any funding application on a transparent and objective basis. In this context, the source of the documentation referred to by ComReg is not clear. In particular, it is not clear whether the documentation concerned refers to existing documentation of eircom, or to documentation which could be procured by ComReg. In any event, eircom does not understand the relevance of such

documentation in the context where ComReg proposes to use HCA. In particular, eircom does not understand how an “independent cost model” could be used in the context of HCA.

E. Principles and Methodologies for Cost Identification and Allocation (¶ 3.92 - ¶ 3.128)

eircom agrees with the general proposition at ¶ 3.93 that the net cost calculation of the USO should be based on identifying loss-making provision of services to identified end-users or groups of end-users where these customers would not have been ordinarily served by a commercial operator, subject to the following comments.

(i) The Cost of Geographic Averaging

A category of costs which is not identified by ComReg is the cost incurred by eircom as a result of its obligation under USO to charge uniform prices in all parts of the country (Decision D6/10, and previously Doc. 06/32).

The effect of meeting this obligation is that eircom must have the same price for users with high cost, and with low cost. Clearly this imposes a net cost on eircom.

Consider a simple example, ignoring retail costs and the resale of SB-WLR.

Suppose eircom had 100 customers, and 60 were low cost of €10 each, and 40 high cost of €25 each.

Total cost would be $(60 \times 10 + 40 \times 25)$ €1,600.

The average cost is €16.

Now suppose eircom charges a single price everywhere equal to this average cost. If eircom then charges a uniform price of €16, there would be no loss of customers in the high cost area. Suppose then that 10% of low cost customers decide to buy an alternative service. This would decrease Eeircom's revenues by (6×16) €96: so that eircom's total income would be only €1,504, compared to a cost of €1,600: a 6% shortfall in revenue. This is a net cost resulting from the USO obligation to have geographically averaged prices.

The calculation of the net cost of USO should take account of this fact.

(ii) Uneconomic areas (¶¶ 3.106 – 3.111)

The USO calculation will primarily deal with three areas of costs:

- 1) Access network costs: the cost of the access network incurred in connecting customers;
- 2) Core network costs: the costs associated with carrying calls; and
- 3) Any other avoidable costs (e.g., network costs such as the cost of providing ancillary services and non-network costs such as billing costs).

In relation to the access network and determination of uneconomic areas, eircom agrees that MDF area is a reasonable starting point for the analysis. ComReg furthermore suggests using its Copper Access Model to determine asset requirements by MDF area and to use then these asset requirements to allocate relevant depreciation charges (as

reconcilable to the HCA and taking account of the principle of avoided cost). eircom is in general agreement with this approach, subject to the following comments.

- To the extent that asset requirements are understood as using actual quantities directly, eircom would have to derive a depreciated historical cost per unit of asset category to allocate costs to MDF areas on this basis. eircom's accounting information does not enable such a detailed identification of unit cost and hence the ability to allocate costs on this basis is not possible.³
- The accounting records contain information on the total cost of assets by parent exchange area and by MDF area. However, the use of the complete data set by MDF area would require significant processing to verify its accuracy and completeness. eircom therefore suggests that a combination of the accounting records identified within each parent exchange area and relative asset requirements from the Copper Access Model be used to allocate costs to MDF areas, and where appropriate accounting data from specific MDF areas. This approach is explained below.

The total number of asset quantities (measured by primary cost driver) can be identified by MDF area in the Copper Access Model. The relative amount of each asset category within each MDF area relative to the parent exchange area can then therefore be estimated.

For example, assume we have 3 MDF areas A, B and C within one parent exchange area and the access network consists solely of poles and copper cable. The "copper access model" determines it is optimal to have 100 poles and 10 km of cable in A, 200 poles and 25 km of cable in B and 100 poles and 15 km of cable in C. The historical accounts contain the total amount of depreciation of poles of €100 and €200 for cable. Hence for MDF area A the allocated depreciated cost of poles would be €25 ($100 / [100+200+100]$ the share of poles in the exchange area multiplied by the depreciated cost of poles) and for cable €40 ($10 / [10+25+15]$ the share of poles in the parent exchange area multiplied by the depreciated cost of poles).

The result would be an annual cost⁴ for each network asset within the access network that is an output of the Copper Access Model.⁵ Care will need to be taken to allocate historical depreciated element costs that can be mapped to those elements in the Copper Access Model. Furthermore, exclusions are required where relevant for fixed common costs and joints costs and "Business Sustaining Costs". The result would be the total avoidable cost per MDF area. Based on this information it would also be possible to estimate an average avoidable cost per access line per MDF area using input from the Copper Access Model.

With the above approach the depreciation profile reflected in each MDF area will reflect the depreciated profile that is found in the parent exchange area to which it belongs. ComReg suggests that depreciation profiles be developed by geo-types. However, as most parent exchanges themselves may be grouped into broad geo-types (e.g. urban, suburban, rural etc.), eircom believes that the approach will fulfil ComReg's requirements for most allocations.

³ The outcome of this approach would essentially be efficient capital costs valued at depreciated historical cost. One implication of this is that there would be no need to consider capital cost efficiency adjustments for the access network. The quantities that are output from the Copper Access Model are based on a re-dimensioned optimised access network. While the values may be historic the quantities are efficient.

⁴ The sum of historical depreciation and a return on capital estimated as the net book value multiplied by a pre-determined WACC.

⁵ As an alternative, it would also be possible to use the annualised costs (instead of quantities) of each asset category, as output from the Copper Access Model, as the basis for the allocations.

There will, however, be some parent exchanges with MDF areas covering a large degree of geographical variation. An example of this is found in Galway that has a parent exchange located in Galway city, but also services rural MDF areas. In this case, eircom suggests utilising the detailed cost accounts at an MDF level to assess the allocations and potentially adjust the allocations made using the Copper Access Model and the more aggregated data at the parent exchange level. eircom submits that this approach would strike a good balance between requirement for detail and ease of implementation.

ComReg's Consultation paper provides no direct guidance for the core network costs. Core network costs are comprised of call related (per call) conveyance costs and, duration related (per minute) conveyance and non-conveyance retail services costs. The costs of a nationwide core network are very significant. While the effect on these core costs of the removal of any individual customer will be small, the hypothetical collective removal of uneconomic customers and uneconomic areas may have a sizable effect on cost and hence are to be taken into account as avoidable cost. For the core network therefore avoidable incremental costs are required at a call level and potentially at a more aggregate level depending on the level of network parts that are removed. As noted previously, LRAIC may be viewed as the costs that would be avoided by not producing an increment of output. eircom therefore suggests using its top-down LRAIC core network model adapted to historical costs. This essentially entails running the model without the current cost accounting revaluations and excluding where relevant fixed common costs and joint costs and potentially "Business Sustaining Costs". This will give average avoidable historical costs per call and per minute for all call types. In the unlikely event that a whole parent exchange area is found to be uneconomic, then an adjustment for lower economies of scale realised in the remaining parts of the network will also be required.

In addition to the capital costs discussed above, there is a need to determine a range of other costs including avoidable operating costs. For each set of operating costs, the proportion of the cost that is avoidable at different parts of the network will have to be determined. This will generally follow the drivers and allocations used in the top-down LRIC core model and Copper Access Model. For some costs, however, further analysis might be necessary to establish how these costs may be avoided. In addition, avoided costs related to supplementary services such as Leased Lines, Bitstream access, etc. are needed. This will require separate analysis of eircom's accounts for each service considered.

Having determined the avoidable costs these may be combined with revenue data to estimate the net cost of the USO. This is a complex task which increases in complexity with the level of detail in the inputs.

In the case of determining the net cost of uneconomic areas, the total revenues foregone are not simply calculable as the sum of revenues foregone of individual areas. Simply summing up revenues foregone would result in calls exchanged between uneconomic areas being counted twice. Total revenues would then be overstated. Double counting occurs because revenues from incoming calls originating from uneconomic areas are already counted as outgoing calls and included in outgoing call revenue. Since the double counted component can only be known with sufficient precision after the uneconomic areas are clearly identified and since for this identification the double counted component should itself be known already, an iterative procedure is required. This iterative procedure would broadly consist of the following steps:

- 1) List or rank all areas that are candidates for uneconomic area status according to the simple difference between costs and revenues;
- 2) Determine for each of the areas identified above the part of incoming revenue that comes from the other uneconomic areas;

- 3) Deduct the double counted incoming revenue as determined above. This will increase the deficit. It must be verified whether this increase will shift some areas from an apparent surplus into a deficit position and make them uneconomic; and
- 4) Verify whether due to a change in the number of uneconomic areas the basis for determining the share of double counted incoming revenue has shifted which would require a readjustment of the initial correction for double counted income.

eircom is of the view that ComReg's suggestion at ¶ 3.110 that it would be entitled to reject an application for funding on the basis of potential (unquantified) discrepancies from one "reality check" area to be unreasonable and disproportionate. This is particularly the case where extensive engagement will have occurred between eircom and ComReg in the preparation of the application and in light of ComReg's requirement for an external audit.

(iii) Uneconomic customers in economic areas (¶ 3.112 ¶ 3.123)

eircom does not believe, contrary to ComReg's view at ¶ 3.112 that uneconomic customers in economic MDF areas can be identified on the basis of the universal account number (UAN).

✂

eircom agrees otherwise that a probability analysis is appropriate to calculate the cost of uneconomic customers in economic areas.

eircom notes in this context that for each uneconomic MDF area, distribution information on costs and revenues will be required. The Copper Access Model could be used in this regard by calculating the distribution of lines per line length intervals on a per MDF area basis. This would be done through defining line length intervals, and determining the number of subscriber lines that fall in to each line length interval, for each MDF area. This line length distribution could then be used to estimate the distribution of lines per access cost intervals for the avoided cost of access.

However, this analysis is complicated by the need to measure the avoidable cost on a customer basis. The incremental cost of an individual customer is the cost that the USP would be able to avoid over the long run if it had never served that customer. Hence there are essentially two cost components related to the avoidable cost concept:

- 1) Those assets and operating expenses that are solely incurred for the purposes of serving the customer; and
- 2) The customer's impact on the wider capital and operating costs of the USP.

Avoidable costs that may be incurred solely in relation to the customer will be subject to detailed analysis. However, candidates would include the cost of the final drop, the duct and / or pole the final drop uses, jumpering at the MDF, the line card, traffic costs associated with the calls made by or to the customer and costs of supplementary services.

Wider impacts may be identified separately in the access and core networks. In both networks it is the costs that would be avoided through downsizing the network. In order to estimate the impacts of a reduced access network and the avoidable cost, eircom will use the Copper Access Model (it may in some cases be necessary to use other similar analytical access models where the Copper Access Model is not able to process the data in the required manner). The model would be run with and without a certain customer type(s) removed. The difference between the costs with and without the customer(s) would be the avoidable cost, including both the direct costs of the removed customers as

well as the wider effect mentioned above.

(iv) Commercial Tenders and Voluntary Commercial Tenders (¶ 3.95, ¶ 3.113, ¶3.124)

At the outset, it is not clear to eircom whether there is a difference in “*commercial tenders*” and “*voluntary commercial tenders*”. These terms appear to be used interchangeably. It is also not entirely clear what “tender” is intended to mean.

As a matter of general principle, eircom does not agree that certain lines or customers should be excluded on the basis that they “*have been attained by commercial tender*”. eircom does not agree that such customers “*by their nature avoidable*”, that they “*do not represent the intended customers envisaged by the Regulations*” or that to include such customers “*would allow an unfair tendering advantage to the USP*”.

First, eircom believes that at the level of principle, it cannot be assumed that just because the USO makes a tender, serving the customer concerned is an avoidable cost. Such an analysis ignores that the regulatory context in which the USO is met.

In this regard, while the USO is in theory a retail obligation, in practice it is also a wholesale obligation through eircom's obligation to provide wholesale line rental to OAOs. If eircom refuses to meet an OAO's request for access through SB-WLR, the customer concerned may simply order a retail line – which must be delivered under USO – and then transfer to the CPS operator. Therefore the situation with “voluntary tenders” is that very often the network costs are unavoidable: the choice facing eircom is to bid for the retail revenue, or to have an OAO serve the customer using eircom's wholesale services. If eircom did not bid, only the retail costs and bid costs would be unavoidable.

It is also incorrect to suggest that eircom could “*potentially decrease their tendering bids to attain these customers*”, “*knowing that they would be compensated irrespective of their profitability*” by the USO fund. Firstly, if the service is not a USO service, then no funding will arise. Secondly, if the service is subsidised by a fund, it is probable that the fund will require contributions from all operators, including eircom. So, if eircom were to pay even 40% of the fund, it would have an incentive to minimise the losses on such bids. Thirdly, eircom is subject to a range of pricing obligations with the consequence that eircom cannot bid retail prices which are less than wholesale rates plus at least relevant avoidable retail costs. Any retail customers won by tender will contribute more net revenue (after avoidable retail costs) than if they were served using wholesale services.

It follows that excluding customers gained through tender would, in fact, reduce competition in retail markets because the funding rules would act to limit market entry and inhibit competition. This is because it would be in the interest of eircom not to compete for these customers as eircom in this case would recover at least a portion of the loss arising between the wholesale revenue and the avoidable cost through funding, which it would not if it had won the bid.

In fact, ComReg's position seems to be rather contradictory, in that ComReg considers that it is inappropriate to account for the cost of meeting such tenders where eircom is successful but appropriate where eircom does not bid, or is not successful in tendering, although eircom's network is used for the purpose of serving such customers. ComReg's proposed approach, which results in including certain customers where there is a positive contribution, and excluding them with a net cost is not consistent.

eircom accordingly believes that the distinction drawn by ComReg between customers gained through tender process and others is inappropriate. Without prejudice to this, were ComReg to maintain its position, then eircom notes such a rule, in order to be workable, would require a clear and precise definition of the term “tender”. Does it apply only to a formal procurement process? If a business customer requests operators to quote prices,

and eircom wins with a “bid” using its standard published prices, must the cost and revenue be excluded? If so, a substantial portion of all business activity would need to be examined. eircom believes that identifying these customers will in any event be very difficult.

(v) Ghost Estates (¶ 3.114)

eircom welcomes ComReg's revised position that the costs of serving “Ghost Estates” may be part of the cost of the USO. However, eircom believes that all costs associated with the provision of connection to “ghost estates” should be included in the net cost calculation.

eircom notes the following.

A "Ghost Estate" is a recently built housing estate in Ireland that may be incomplete, and entirely unoccupied, or with a small percentage of houses occupied. Such estates may be in areas that are otherwise economic. It is unreasonable to suggest that eircom should not have planned to serve these houses as it could not have been known beforehand that these buildings would not be occupied. At the time of planning, and commencement of construction, eircom reasonably expected these estates would be fully occupied, and so made plans accordingly.

The planning rules used by eircom take account of the fact that eircom is the USP. eircom therefore plans to be able to serve any customer. The option of deciding not to serve a given estate, or to defer the investment decision until the area achieves a given level of occupancy or demand, is as a result not open to eircom.

The usual practice is to enter an agreement with the local developer to provide the labour to construct the duct and joint box infrastructure for an agreed fee. eircom provides duct, joint box frames and covers and the developer lays the duct before footpaths are constructed and builds the joint boxes. eircom then cables the housing estate before occupancy if possible.

**F. Principles and Methodologies for Cost Identification and Allocation:
Uneconomic Payphones and Other USO Costs
(¶ 3.130 - ¶ 3.141)**

(i) Payphones (¶ 2.19, ¶ 3.130 - ¶ 3.141, ¶ 3.155, ¶ 4.9/13/29/38/51-53)

eircom provides payphones in two contexts. Where eircom perceives a commercial business case, other providers often do so too, so eircom bids for the right to provide payphones at certain popular locations such as airports, railway stations, or shopping centres. These payphones – even if they subsequently turn out to be unprofitable – are not regarded as part of the USO because they do not meet the requirement that USO payphones be accessible by the general public at all times.

The remaining payphones are truly public, and in most cases are provided only because of the USO requirement. Over recent years, eircom has repeatedly reviewed all payphones, and attempted to remove any identified as uneconomic. The payphone removal process is described in ComReg Document 06/14. eircom has proposed the removal of 378 payphones in 2007/8, and objections were received in relation to 73 sites. As a result only 325 were removed. In 2009, eircom proposed to remove 2,151 uneconomic payphones, but objections were made regarding 283 sites. Therefore 1,868 were removed. Most of these were removed before the start of the 2009/10 financial year. The number of payphones at the end of June 2009 was 1,708, and a further 311 were removed during the year. eircom has not proposed any further removals during 2010 or 2011. It is important to note that the net cost of USO arises where eircom had installed a payphone to meet its USO obligation, or maintains a payphone to meet the obligations (as translated into the payphone removal policy). So, the fact that no removals are currently proposed does not imply that there is no net cost. Many of the 356 (proposed for removal, but retained because of objections), are likely to be still uneconomic. This would be over 25% of the base. Furthermore, the decision to remove a payphone today involves a comparison of ongoing maintenance costs and expected revenues (including any advertising revenue). This may be a different calculation than that which would have been made before the payphone was provided. One-off costs for electricity supply, building plinths, providing the kiosk itself and so on would arise if eircom considered whether to provide a new payphone site.

eircom notes ComReg's comment at ¶ 2.19 that "*ComReg will consider the reasonableness of the number of payphones in a geographic coverage area. Where the number of uneconomic payphones is considered excessive/unreasonable, ComReg will adjust the net cost calculation to reflect appropriate payphone coverage (where they are mandatory)*". However, the economics of payphone removal should not be confused with the provision of or existence of uneconomic payphones. ✗. Where an existing payphone is marginally uneconomic, the net saving may not justify the cost of removal. In addition, the removal process (and the inevitable ensuing negative publicity that would be generated by the removal of public payphones) may prevent removal where the removal cost would be justified by the savings. However, if the USO had never required provision of payphones, it is certain that many of the existing payphones would never have been provided by eircom.

Finally, eircom does not believe that there are "intangible benefits" associated with payphones. ComReg suggests that such benefits may include the benefits of advertising on payphones, or improved brand recognition arising from potential customers noticing the eircom logo on a payphone. Advertising revenue from payphones is quite tangible. eircom has engaged in active marketing of all payphone kiosks as potential external advertising sites. Advertisers ✗ are prepared to pay for advertising space, but only in respect of about 400-550 sites. Typically about 350-400 sites might be used at any given time. As one would expect, there is a high interest in pedestrian areas and currently most

of Dublin is being used. There is a particular concentration on Dublin, Cork, Limerick and Galway cities, with satellite towns such as Leixlip, Maynooth or Navan also being very popular. However, it would be rare for payphones in smaller rural towns such as Loughrea or Athy to be enquired about, and isolated rural booths are never used by advertisers. We therefore consider that any potential revenues are realised – not intangible - and they are fully counted in the payphone revenues. There are no additional “intangible” benefits.

(ii) Directories (¶ 2.20, ¶ 3.130 - ¶ 3.141, ¶ 4.12, ¶ 4.19)

ComReg considers that the net cost of meeting the obligation to provide printed directories would be the total avoidable cost, minus the total revenues foregone. This approach seems reasonable.

Over a number of years, eircom has sought to maximise revenues from the provision of directories, and to minimise the costs. It is important to distinguish between those obligations arising from ComReg Decision Notice 06/32, e.g.

- 2.5(a) Provide printed books; and
- 2.5(b) Provide the National Directory database (NDD);
- 2.7(c) Provide Directory Enquiries from Payphones, and
- 2.9 to provide free DQ for certain disabled users.

ComReg claimed in 2006 that

“With regard to directory services, the maintenance of the NDD is cost-neutral as the operation of the NDD is funded by the licence fees for the provision of the information to DQ service providers and printed directories. ComReg also notes that the removal of the obligation to maintain a directory inquiry service will lower any regulatory compliance cost. The printing and distribution of a paper directory clearly involves a direct cost but it also confers advantages through paid-for advertising and the creation and reinforcement of brand awareness”⁶.

eircom has repeatedly sought ways to minimise the net cost of Directories - separating residential users, column layout with surnames not duplicated, truncated addresses, and smaller typefaces all reduce the number of pages needed and reduce the cost per book printed. Similarly, sub-contracting advertising rights in both white pages and yellow pages has maximised revenues. The distribution costs can involve several trade-offs. For example, accurately addressed delivery costs has a higher unit cost than providing a book for every household. Minimising net cost is a complex trade-off, juggling delivery costs, printing and production costs, and advertising income.

ComReg rejects at ¶ 3.52 eircom's view that interconnection is a cost-neutral service, as the cost oriented prices just offset the relevant costs. The treatment of the printed book and NDD should be consistent with the treatment of other services. ALTO, in particular, considers that NDD charges may not be aligned with NDD costs. Other respondents highlight the fact that all operators have certain costs of participating in the market, and that much of the cost of preparing the customer data would arise even if eircom did not run the NDD.

eircom notes further that several respondents have made suggestions that USO might be amended, and certain obligations changed or removed entirely, or services be run on a commercial basis. These suggestions are helpful for future revisions to the USO.

⁶ 06/32, p. 14.

However, the present exercise is concerned with calculation of the net cost for 2009/10, in the light of the obligations that existed at that time. As such, potential changes to the USO for future years are not relevant to the current exercise.

Once a USO costing and funding mechanism is set up, future obligations will be considered in a context where the cost of the obligation is understood, and the parties benefiting and contributing have sufficient information to determine whether a given obligation should be funded as part of the USO fund.

✂

G. Format and Timing of USO Funding Applications (¶ 3.141 - ¶ 3.166)

At the outset, eircom understands that it will be expected in any application for funding to assess the intangible benefits associated with the provision of the USO. In light of the fact that the format and timing of USO funding application is dealt with by ComReg in the context of the calculation of the net cost, further clarification would be welcome.

Under the Universal Service Regulations, it is a right of the USP to apply for funding. While rules may be made in relation to the form and timing of the applications, they should not result in imposing an additional burden on the USP and/or in affect, depriving the USP of its right to apply for funding. eircom in this context notes the following:

(i) Form

10 year investment profile

For reasons previously explained, eircom does not believe or accept that it is necessary to submit a “10 year investment profile”. The issue of “catch-up investment” brings with it unnecessary complexities for little benefits. eircom accordingly submits that the submission of a 10 year investment profile is an unreasonable and disproportionate requirement in the circumstances.

Directors' statement and external audit

eircom does not believe that it is reasonable to require the Directors to certify that the application is “*true and accurate and free of material misstatement (whether caused by fraud or other irregularities or error)*”. ✂

eircom notes that the costs of the external audits that ComReg proposes to require in terms of the USO funding application and the calculation of the benefits of the USO will add (on the assumption that these expenses must be paid by eircom) significantly to the overall cost that eircom will need to incur in order to make a compliant submission for 2009/10 and beyond. This is a cost that is directly associated with USO and incurred as a direct result of a Decision by ComReg and will accordingly be included within USP cost calculations.

Granularity

At ¶ 3.152, ComReg specifies that where “*uneconomic lines/areas are identified, the works orders associated with those areas for the year of assessment must be available upon request by the auditor as supporting documentation for the USO application*”. eircom notes that this level of data is extremely granular and may not in all cases be available. We will however, provide as much of this type of data as is available in support of our USO funding application.

In terms of the application for 2009/10, by way of general comment, eircom notes that the level of detail available is not as detailed as is available for 2010/11 (the data warehouse

where data will be sourced aggregates records after a year for data management purposes). Hence it is likely that some simplifying assumptions will be required in relation to the 2009/10 financial year. However, for future years the full data set will be available. When ComReg finalises its Decision, and as the methodology becomes clearer, eircom will be able to improve the granularity of the available data, as we will have greater knowledge of the type of data that we need to retain for longer periods.

The Call Data Records (CDR) that facilitates the call revenue analysis is available in eircom's Corporate Data Warehouse (CDW) on a rolling 12 month basis. There are two large tables, one for Retail CDRs and one for Wholesale CDRs. The Retail table contains approximately 1.5 billion records while the Wholesale table contains approximately 4.9 billion records. The combined size of the tables is approximately 6.4 billion records utilising 1 terabyte of storage space. Due to the significant volume of data to be analysed, packages like MS Access and MS Excel are not capable of holding and processing the data for analysis. Eircom proposes that the raw data is processed and summarised in the CDW using specialised software which can then be used in MS Excel and MS Access. The process will be fully documented and available for audit purposes.

As the tables only contains 12 rolling months of data, CDR data relating to the 2009/10 financial year has been deleted from the CDW and an alternative method using sampling will be necessary in calculating the USO cost for 2009/10. Data for the period 2010/11 is currently available in the CDW, but as August 2011 approaches, the dataset for 2010/11 will begin to be deleted from the 12 month rolling tables. The USO costing and assessment for 2009/10 will still be in progress and work for 2010/11 is unlikely to have commenced. There is a risk that the full data set for 2010/11 may not be available but eircom are reviewing options to ensure the full data set will be available for assessing USO net cost for 2010/11 subject to a number of constraints including cost incurred of additional storage and practicality of restoring the archived data for analysis.

MS Excel/Access

ComReg requires that submissions be supported by calculations in an MS Excel or MS access format. Eircom does not believe that it is appropriate for ComReg to require the use a specific commercial software. If ComReg wishes to use a specific type of software, it is sufficient to direct that the submissions be in a compatible format.

eircom notes further that it would be helpful in this case to specify a particular version, as certain advanced functions may not be compatible between versions.

To the extent that ComReg requires that only MS Excel or MS Access software be used to support calculations, difficulties will arise. It is the case that previous applications by eircom were supported by models built using excel software, and that some supporting data was supplied in the format of Access databases. However, previous submissions were also supported by data from other eircom systems, and, in particular, from eircom's corporate data warehouse, where the Teradata databases were queried by tools such as Teraminer.

The revised methodology now directed requires significantly finer granularity of costs and revenues, and much larger volumes of data than any previous submissions. MS Access may not be capable of handling a maximum database size greater than 2GB. Multiple databases may be needed. Conversely, MS Excel has recently gained much improved capability. For example, the Teradata OLAP connector allows users of excel PivotTables to connect spreadsheets directly to Teradata databases, without the need to extract data and reformat in MS Access.

More fundamentally, it has not been established that the use of these particular commercial software tools (Excel and Access) is currently the most efficient way to

undertake the net cost calculation. It may have been in the past, but vastly increased granularity, and improved capability of excel, suggests alternative solutions may be required.

In general eircom agrees with ComReg that the USO cost calculation should have a high degree of transparency. However, ComReg must also be cognisant of the fact that transparency also comes at a high cost and there necessarily will be aspects of the model where full transparency is difficult to achieve, this is especially the case given the model will draw extensively upon eircom's detailed accounting, network and revenue information. Furthermore the iterative nature of some of the calculations will require use of visual basic coding.

(ii) Timing of USO Funding Applications (¶¶ 3.161 - 3.163)

ComReg specifies that an annual USO funding application should be made "*within one month of the publication of relevant audited separated accounts, but no later than six months following the end of the USP's financial period*". This, in effect, means that, in the case of eircom, the annual application would be made on 31st December each year. This carries with it a number of difficulties.

- This coincides with the annual publication of the CCA separated accounts. The preparation and audit of the USO submission will be taking place in parallel with the preparation of the USO submission.
- During December, work will also be ongoing on the preparation of the AFI and the Additional Financial Statements, both of which are due to be submitted before the end of January each year.
- Because of Christmas, the staffing levels in December are invariably significantly curtailed
- One month between the publication of the HCA publication and the USO submission is unlikely to be adequate, in view of the volume of work that is likely to be involved.

Accordingly, a deadline at 31st December for a USO funding application is unreasonable.. In previous years, when eircom made USO funding submissions, eircom, with ComReg's express agreement, made submissions at the end of February each year. With the additional granularity now being demanded, even this timeline would be unlikely to be adequate. eircom suggests that the deadline for applications be set at end of March each year.

¶ 3.166 further specifies that eircom "*shall, no later than 6 months prior to the end of the financial year for which the USP intends to make a request for USO funding, submit a provisional statement to ComReg with the claimed net cost figure (if any) arising from the USO*". Again, in the case of eircom, this body of work would need to be completed on 31st December.

eircom also has considerable concerns about supplying a net cost estimate 6 month prior to the end of the financial year when the data would not be ready. Considerable effort would be required to calculate the net cost and this calculation would have to be based largely on forecast data. While we can appreciate the desirability of informing the industry of the potential financial impact to them, it seems reasonable that they simply base their expectations on the previous year's assessment. Producing a draft submission would impose a considerable overhead on eircom, and any added value would be negligible or non-existent.

¶ 3.165 refers to “*Subsequent requests for USO funding*”, i.e. covering periods after 2009/10. We note that the timelines proposed are incapable of being met in the case of 2010/11 as some of the relevant dates are already in the past, and others may be past before the initial claim is fully evaluated by ComReg. For example, a provisional statement for 2010/11 would have to have been made by December 2010, while the final claim for 2010/11 would have to be submitted by the end of December 2011 – probably before ComReg completes its analysis of 2009/10 claims. The provisional statement of 2011/12 would also have to be made by December 2011. It is expected that ComReg’s final Decision will result in some changes to the details of the submissions. It would be preferable that any provisional and final claims for 2010/11 and 2011/12 were consistent with the final calculation for 2009/10 and so should be scheduled to be submitted after that Decision.

II. PRINCIPLES AND METHODOLOGIES FOR CALCULATING BENEFITS (Section 4)

eircom recognises that estimating or quantifying the incremental benefits attributable to USO is difficult. It is important, however, that ComReg's pursues a consistent approach when considering both the costs of USO and the potential benefits of USO. In other words, ComReg must demand the same standard of proof when attempting to establish the benefits of USO as it does when attempting to establish the costs. €1,000 of extra benefits will have exactly the same effect on a potential USO fund as €1,000 less cost. It would therefore be wholly unacceptable for ComReg to insist on excessive and unreasonable levels of accuracy before accepting increments of USO costs, while, at the same time, accepting figures for intangible benefits which might be based on little more than guesswork.

eircom notes that if ALTO's view was correct (namely, that the benefits of USO far outweighed the costs), clearly then there would be no need for a USO. There is no basis in fact for this view. In particular, eircom would point out that no operator applied for designation as the USP. This would be expected if the benefits outweigh the costs.

In identifying any such benefits, eircom agrees that "*it is important to distinguish between benefits which arise due to the large scale of the operator and those which arise from the imposition of USO*" and that "*only the benefits arising directly from the USO can be included in a net cost calculation*". However, in the final analysis, any possible incremental benefits will be largely subjective and may well be immaterial in the overall context of USO. ComReg's Draft Decision concerning the identification of benefits is in this regard very unclear, and in no way prescriptive, of the methodology to be used to calculate potential incremental benefits of USO. This is unsatisfactory and cannot be considered to be an adequate basis for ComReg's assessment, which must be capable of review.

At ¶ 4.5 and ¶ 4.11 ComReg identifies four types of benefits and each of these is addressed in turn below. The degree of uncertainty involved is significant, as is the overlap between the various categories. Care will therefore be needed to avoid double counting of benefits

(i) Brand Recognition (¶ 4.12, ¶ 4.46 - ¶ 4.50)

The brand recognition benefit is the benefit that the USP derives from being seen to provide service to uneconomic areas and customers.

At ¶ 4.12 (under Brand Recognition) ComReg mentions that “*brand loyalty may reduce the advertising and marketing costs*”, while at ¶ 4.13 (under Marketing) ComReg refers to “*logo display on public payphones and WiFi hotspots*”. These quotes show the level of overlap and uncertainty in relation to these two possible categories of potential benefits.

At ¶ 4.50 ComReg makes the statement that “the eircom brand is likely to be very closely associated in the minds of consumers with the universal service”. No basis is given for this statement, and eircom would question if very many people in Ireland are even much aware of the existence of a telecommunications USO, as a relatively small proportion of the population reside in USO areas, and (unlike electricity), Irish people have never been asked to pay for the telecommunications USO. In particular, the obligation of having to provide service to uneconomic areas and customers would be expected to be reduced given the possibility of customers having the option to subscribe to several different providers (who have wholesale agreements with the USP). While the USP bears the cost of USO, the existence of other options may blur this distinction in the general public.

In eircom's view it is necessary, in this particular case, for ComReg to first establish whether a brand reputation benefit exists before an attempt is made at estimating its magnitude. It is possible that the benefit may in fact be negative in which case the appropriate valuation for the benefit would be the net harm that is caused to the profits that the USP earns from profitable customers. To determine the existence of a brand recognition benefit it must be established that there is a significant correlation between a customer's awareness of the USO and the value of the products and services that are bought from the USP. This could be done through statistical analysis. Only if a reputation benefit exists (either positive or negative) would it be necessary to estimate the magnitude of the benefit.

(ii) Marketing (¶ 4.13, ¶ 4.51 - ¶ 4.52)

eircom agrees that the Oftel methodology might be reasonable.

(iii) Ubiquity (¶ 4.14 & ¶ 4.15, ¶ 4.56 & ¶ 4.60)

Ubiquity benefit is much more likely to stem from eircom's status as the incumbent in Ireland, rather than from its status as the USP. Yet very little effort is made by ComReg in these paragraphs to make any such distinction, or to explain how the “general” ubiquity benefit would be excluded from the “USO specific” ubiquity benefit.

It is important to note that the benefit is only derived from those customers that the USP serves solely as a result of the USO. If the USP would have served the customers in the absence of the obligation, then the benefit is simply a result of being a large national carrier. This means that it is only customers moving from uneconomic areas to economic areas that can provide a ubiquity benefit for the USP.

We note that ComReg at ¶ 4.56 explains that this ubiquity benefit would be relevant to “*customers, who are not aware of the existence of alternative suppliers when moving to an area*”. After well over a decade of active competition, the rate of which has expanded exponentially in recent years, as well as the existence in recent years of vibrant competition in other utilities in Ireland such as electricity and gas, it is doubtful if there are very many people left in Ireland who are not aware of the existence of competition and alternative suppliers in Irish telecommunications.

Nevertheless, unlike other intangible benefits, the benefit of ubiquity accrues to the brand name of the seller of services in loss-making areas, not the provider of infrastructure or USP per se. Under mandated wholesaling arrangements, the brand of the seller need not be the same as that of the infrastructure provider. Accordingly, any benefits from ubiquity will be available to wholesalers. ALTO, for example, will be able to attach its brand name to residential telephone services in all areas of Ireland through wholesaling, and will thus be able to obtain benefits from ubiquity.

In other words the existence of a wholesale regime will provide other operators with an opportunity to enjoy the benefits of ubiquity. We therefore recommend that the benefit of ubiquity should be excluded from the USO calculation.

(iv) Life Cycle (¶ 4.16, ¶ 4.54 & ¶ 4.55)

This is quite a complex issue, as clearly outlined in eircom's response to Consultation paper 10/94.

In a normal competitive industry, a firm would choose to serve some uneconomic customers if both the following conditions were met: 1) The firm is of the view that serving the customer would increase the probability of being chosen by the customer when the customer is economic; and 2) The increased probability of being chosen by the customer when the customer is economic produces an expected profit that is larger than the expected profit from only providing service when the customer is economic.

If these two conditions are satisfied for some uneconomic customers, then there is a life cycle benefit in the form of increased profitability. If these conditions are not satisfied, then the rational firm would choose to wait until the customer becomes economic before providing service. In this particular case the customer's USO loss is not offset by any anticipated future benefits of providing service today.

If ComReg intends to consider life cycle effects, it is imperative that the issue is considered consistently. Some currently uneconomic customers may become economic in the future. Equally, some currently economic customers may become uneconomic in the future. Indeed, there is in principle a whole range of different scenarios to consider e.g. where a customer initially is uneconomic, becomes economic as spending patterns change, but then moves back to being uneconomic etc.

If one were to take a lifetime view and use NPV, there would be an equal probability of customers going from economic to uneconomic as going in the reverse direction. In the context of life cycle effects, ComReg must consider how the various scenarios, the effects of which will clearly work against each other. At present, in Draft Decision 11/15, ComReg is being very selective in only considering the scenario where currently uneconomic customers may become economic in the future. Furthermore, due to the uncertainty with which forecasts can be obtained, any resulting life cycle benefit calculation will introduce considerable uncertainty into the calculations, and any outcome will lie within a large margin of error.

In summary, the approach outlined by ComReg at ¶ 4.55, namely that the USO life-cycle benefit "*is likely to be insignificant and, therefore, could be excluded from the valuation of the benefits*", is both reasonable and pragmatic, as well as likely to give the most accurate result.

III. PRINCIPLES AND METHODOLOGIES IN RELATION TO UNFAIR BURDEN (Section 5)

ComReg sets out at ¶ 5.10 the three conditions that in its view must be met for an unfair burden to exist:

- “1. There must be a verifiable, direct net cost.*
- 2. The benefits of the USO must not outweigh the net cost.*
- 3. This positive net cost is (a) material compared to administrative costs of a sharing mechanism; and (b) causes a significant competitive disadvantage for the USP”.*

eircom agrees with conditions (1) and (2), subject to its comments in section II above concerning the assessment of USO benefits. eircom does not agree with condition (3), for the reasons explained in its response to Consultation 10/94, to which it refers, and as further detailed below.

(i) Administrative Costs (¶¶ 5.12 - 5.16)

ComReg's Draft Decision at ¶ 5.16 does not reflect its proposal in Consultation Doc. 10/97 or its Draft Decision as summarised at ¶ 5.10. While eircom agrees that the positive net cost should be “material compared with the administrative cost of the sharing mechanism”, eircom does not agree, as proposed in Draft Decision 5.16, that its entitlement to compensation may in any circumstances be subject to the net positive costs not being “relatively small”. This is particularly so as it is not clear how it is to be determined that the net positive cost is relatively small. eircom accordingly submits that the wording used at ¶ 5.10 should also be used in the Decision, namely that the positive cost is material compared to the administrative costs of a sharing mechanism.

eircom understand this to mean that compensation could only be denied when the positive net cost is on a par with the actual cost of USO. However, as previously explained, eircom does not expect that this will prove to be the case, both because the size of the fund will be significant, and because measures can be taken to limit the size of the administrative costs (e.g. administer USO fund together with regulatory levy payments).

(ii) The USP's Financial Position and Competitive Conditions (¶¶ 5.17 - 5.49)

eircom fundamentally disagrees with ComReg's proposed approach to its assessment of whether an unfair burden exists. eircom continues to be of the view that the *Base* judgment of the European Court of Justice is no authority for ComReg's proposed method for assessing the USP's ability to bear the burden of the USO in light of the USP's “own characteristics”.

The USP's Financial Position (¶ 5.32 - ¶ 5.39)

It is clear from *Base & Others v Ministerraad*, as quoted in ¶ 5.27 that the “*financial situation*” of the company has a role to play in deciding on the existence or otherwise of an unfair burden, given the existence of a positive USO net cost. It is difficult to reconcile this situation with ComReg's statement at ¶ 5.35 that “*The particulars of a company's financial structure, including levels of debt, are not directly relevant to a calculation of USO net costs and are not relevant to a consideration of whether or not any positive net cost constitutes an unfair burden*”. Clearly a heavily indebted company (such as eircom) is

much more likely to suffer an unfair burden for a particular net USO cost than is a company that is debt free. Again, a simple example might illustrate the point.

Consider a USO under 2 particular scenarios.

In both scenarios the USO cost is €200, and the company makes a return before interest of €1,000.

In the case of scenario 1, USP is debt free.

In scenario 2, USP is has large debts and has to pay €500 in interest.

Then in scenario 1, the USO cost would be 20% of profit after interest, whereas, in scenario 2 the corresponding figure is 40%. In these circumstances, clearly the USP in scenario 1 is better placed to bear a USO burden than the USP in scenario 2. It is therefore reasonable that the USP's debt structure would be a relevant consideration in deciding whether a particular USO cost burden was unfair or not.

There is only cursory mention in ComReg's Draft Decision 11/15 of the need to take account of a return on capital in the calculation of USO net cost. ComReg's Decision D01/08 set eircom's WACC rate 10.21% on all services. The WACC must be taken into account and hence there is also a need to identify net book values of assets. At ¶ 5.36, ComReg makes the point that "*the WACC of 10.21% takes account of the impact of financial volatility on eircom's cost of capital*". When one considers the fact that this WACC was set by ComReg in May 2008, following a review process which was initiated by them in early 2007 (well in advance of the onset of the current unprecedented economic recession), it is self-evident that the WACC figure of 10.21% certainly does not take account of the impact of the current financial volatility on eircom's cost of capital. Were the WACC to be calculated for 2010 it would most likely be higher.

The USP's Market Share (¶¶ 5.40 - 5.44)

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

eircom accordingly believes that the analysis of market shares as envisaged by ComReg is not concerned with the assessment of whether the net cost of USO imposes an unfair burden on the USP.

Assume there is net cost of the USO and it is verified and material by the criteria set down by ComReg. For eircom to sustain the burden in the long run it would need to earn annual profits in excess of a fair rate of return on service provided in profitable areas of its business. eircom would have to mark-up the prices of one or more services (regulation may prevent this in some cases) in order to generate these excess profits. This may, however, be an unsustainable situation as competitors will be attracted by the high profits earned in those markets being used to finance the net USO cost, i.e. cherry picking will

occur (entrants who may be less efficient than eircom may be able to enter the market and out compete eircom, ostensibly because they do not have a similar cross-subsidy requirement). The degree to which entry occurs will depend on: the degree to which prices need to be marked up above the level that would apply if the market was effectively competitive; traditional market entry barriers; strategic behaviour etc. A snapshot of eircom's profitability today will tell ComReg nothing about whether self funding the USO is sustainable into the future. What they need to look at (among other things) is how market share has changed over time.

IV. TREATMENT OF CONFIDENTIAL INFORMATION (Section 6)

eircom welcomes the fact that ComReg does not intend to proceed with its original proposal for a "confidentiality ring". As explained previously, eircom does not believe that a departure from established precedent is warranted or necessary.

V. REVIEW OF CONSULTATION RESPONSES (Appendix A)

We note ComReg's stated view in ¶ 7.11 that "*there is no relationship between the treatment of LLU pricing and the provision of USO*". We do not believe that this is correct, particularly as the LLU price has been set based on the costs of a subset of cheaper urban lines. Furthermore, in the engagements leading up to the setting of the LLU price, eircom pointed out the inequity of not permitting eircom to recover all of its legitimate, efficiently incurred costs by way of the LLU price (due to the geographically de-averaged approach put forward by ComReg), and ComReg explicitly put forward the possibility of compensation in the future by way of USO funding. In that context, ComReg's current efforts to de-couple the two inter-related issues lacks consistency and is a cause of concern for eircom.

For the record, ComReg's Decision No. D01/10 in relation to LLU pricing, distinguished between urban and non-urban lines, on the basis that operators are unlikely to serve certain, uneconomic, parts of the market. ComReg accordingly set the price for network access in the form of LLU at a level (€12.41 monthly rental) that is much lower than the average costs of the entire network \propto , reflecting the costs of a subset of cheaper urban lines. This means that eircom is required to offer access to its infrastructure on a national basis at a price that does not allow it to recover its costs which were legitimately and efficiently incurred including, in particular, because of its USO. This means also that while eircom's competitors and their customers benefit from network access at a price that does not reflect the cost of USO, eircom, and all of its customers, in the absence of a funding mechanism, must bear the national average cost (costs rise to over €30 in low density provincial areas).

In this context, where ComReg has acknowledged that not all areas can be served under standard commercial conditions, eircom submits that it is essential that there is a funding mechanism in place so as to restore a level playing field for all competitors including eircom.

VI. REGULATORY IMPACT ASSESSMENT (Appendix B)

eircom does not accept ComReg's neglect of an RIA in this document. This approach by ComReg of treating an RIA as a discretionary add-on at the end of a Decision process is not acceptable.

The net cost calculation should inform any future designations: e.g. if ComReg were to impose any new obligation, the impact on the USO funding should be considered, and the cost/benefit analysis conducted.

In the current situation, the RIA should evaluate the incentives to comply with the USO (including funding) and punishments for failure to comply.

4 Magnet

Magnet Networks welcomes the Draft Decision and Response to Consultation in relation to USO Principles and Methodologies.

Magnet Networks believe that the methodologies set out in this paper and the principles outlined in the Draft Decision are comprehensive and deal with each potential eventuality in relation to USO calculations.

Overall, this consultation and decision was thorough, enlightening and dealt with each issue in a clear and comprehensive manner.

5 Verizon



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Verizon Business Submission to ComReg in response to Consultation on Costing of universal service obligations: Principles and Methodologies (Document No.11/15)

Verizon Business (“Verizon”) is the global IT solutions partner to business and government. As part of Verizon Communications – a company with nearly \$108 billion in annual revenue – Verizon Business serves 98 percent of the Fortune 500. Verizon Business caters to large and medium business and government agencies and is connecting systems, machines, ideas and people around the world for altogether better outcomes.

Verizon welcomes the opportunity to respond to ComReg’s consultation on: “Costing of universal service obligations: Principles and Methodologies Draft Decision and Responses”.

Verizon considers that ComReg has analysed the various components outlined in its initial Consultation and Call for input to the required levels.

Verizon supports ComReg’s Draft Decisions and considers that they are a fair reasonable and proportionate response in light of the issues considered.

Verizon Business

18 April 2011

6 Vodafone



**Vodafone Response to the ComReg Consultation and Draft Decision -
Costing of Universal Service Obligations: Principles and Methodologies**

Introduction

Vodafone welcomes the opportunity to respond to ComReg's Draft Decision in relation to the general principles and methodologies for an assessment of any application by the universal service provider (USP) Eircom for funding of costs claimed by it for fulfilment of its universal service obligation (USO). We do not have any fundamental objections to the draft conclusions reached by ComReg on its proposed approach as described in the main body of the consultation document and listed in Appendix G. These appear, in general, to be reasonable and objectively justified. As Vodafone's views on the principles and methodologies of USO costing have been set out comprehensively in our submissions to previous stages of this consultation process, it is not intended to reiterate them in this response.

Vodafone is however strongly opposed to ComReg's proposal that Eircom may make applications for USO funding retrospectively in respect of past financial reporting periods (2009-2010) and (2010-2011). ComReg has failed to provide any adequate reasoning or justification for this proposed approach, which would have a far-reaching adverse impact on competition and investment in the market.

We would also question the validity, from a procedural perspective, of setting out draft decisions as listed in Appendix G that are not in the format of a Draft Decision instrument.

Vodafone's position in relation to these issues is set out in full in the subsequent sections of this response.

Relevant Funding Period

In paragraph 1.3 of the consultation draft ComReg concludes that Eircom may make applications for USO funding in respect of the periods 2009-2010, 2010-2011, and 2011-2012. However no justification is offered by ComReg for this proposed decision despite its potential implications for regulatory certainty and the dynamics of competition in the market. Vodafone considers that the lack of any rationale offered by ComReg for its decision is wholly unacceptable, in particular when its decision is entirely contrary to its preliminary view on the issue of the relevant funding period for the USO when this matter was considered in 2007 in ComReg document (07/07) 'Provision of Universal Service: Request for Funding by Eircom'.

In document (07/07) ComReg set out its preliminary view in relation to a request for funding made by Eircom in respect of its provision of the universal service on 11 May 2006, and Eircom's view that it was entitled to seek retrospective compensation for annual net costs claimed to be incurred by it in the period since July 1999. ComReg concluded at that time that the appropriate relevant period within which to assess eircom's request would only be the financial period during which Eircom submitted its application, the financial period commencing 1 April 2006. The reasons offered for this proposal at that time, with which Vodafone strongly agreed in its response to that document were¹:

¹ ComReg consultation document 07/07 'The Provision of the Universal Service: Request for Funding by eircom', page 5

1. *In order to conduct a comprehensive examination of the substantive issue, any analysis should be reconciled to the most recently available set of independently verified accounts (i.e. eircom's separated accounts).*
2. *The application of a fund to the periods before 1 April 2006, going back to 25 July 2003, **would be unfair to other operators since they would have made commercial decisions on the reasonable assumption that no fund was to be in operation. At the same time, ComReg notes that eircom could have submitted a request for funding at any time since 25 July 2003, but chose not to.** [Vodafone's emphasis]*
3. *The beginning of the proposed period for assessment i.e. 1 April, 2006, roughly coincides with the date of eircom's application dated 11 May 2006.*

It appears that following ComReg's decision on the basis of this reasoning, Eircom did not progress its application for USO funding further, as no assessment of whether there was a net cost to eircom in respect of its universal service obligation was published by ComReg.

Vodafone considers that the principles set out by ComReg in document (07/07) in support of its decision to reject Eircom's application for retrospective funding of any net costs of its universal service obligation are no less valid now than when ComReg previously considered the issue of the relevant funding period. In particular Vodafone submits that the unfairness to other operators of a retrospective approach as set out by ComReg is of at least equal importance today as operators would until now have reasonably assumed, especially in light of ComReg's previous judgement on this matter, that no potential universal service fund would be in operation in relation to those past financial periods (2009-2010) and (2010-2011) during which commercial decisions were made.

Similarly to our position as set out in response to ComReg document (07/07), Vodafone considers that the extension of the scope of the relevant time period for assessment to encompass past financial periods such as (2009-2010) and (2010-2011) as currently proposed, would be certain to have an adverse impact on the market if it were subsequently concluded that a funding contributions from operators other than the USP for these periods were required. The direct negative impact on the financial position and investment plans of competitors of their being required to provide unforeseen universal service funding relating to an extended time period in the past would be only one of the effects. The competitive distortions that inevitably arise under universal service funding schemes (USFs), as competitors are required to subsidise certain services delivered by the USP using specific technologies, would also be greatly amplified if it were concluded by ComReg that compensation would be granted to eircom for its provision of universal services since 2009.

Vodafone notes that there is no discussion of how additional Eircom wholesale revenue arising from any potential USF and matching OAO and Eircom Retail costs, which are all related to the provision of Retail Narrowband Service by Eircom, will be treated in regulated price control tests (either price setting or margin squeeze) so as to avoid competitive distortions. ComReg has not outlined how any retrospective funding would fit with previously conducted margin squeeze tests and previously determined price controls. If any retrospective USF resulted in non-compliance with such previously conducted tests it is not clear that there is any remedy against eircom. In this regard retrospection could lead to the risk for Eircom from some of its commercial decisions being artificially lowered as it would be at least partially sheltered from the adverse outcomes of business errors.

ComReg has identified the lack of equity in eircom's funding request with respect to other operators. In addition, retrospective application of a universal service funding requirement from 2009 would set a damaging precedent and have a long-run wider adverse impact on the market. If a precedent for imposing a potential funding obligation retrospectively on other operators covering an extended period were established, in line with ComReg's current view, then regulatory uncertainty would be greatly increased. Operators in their decision making would, going forward, have to consider not only current regulatory requirements but also the prospect of obligations that would occur in the future but that would relate to earlier or past time periods. This would have a dampening effect on, for example, the incentives for infrastructure investment and innovation in the market.

In addition Vodafone notes that the implicit principle underlying ComReg's proposed decision to allow potential retrospective funding of estimated net costs of the USP in the provision of the universal service (i.e. that it is appropriate to revisit historical costs and implement cost recovery adjustments on a retrospective basis) would, if legitimate, have wider applicability to all regulated pricing in the market which is cost based. For example eircom has recently reduced the price of LLU migrations. These prices were subject to a cost orientation obligation. If the principle is applied that it is appropriate to look at historical costs and apply adjustments retrospectively then this raises the question of the point at which eircom's actual costs reduced in respect of LLU migrations. If the price decrease became effective at a point in time after the actual underlying costs reduced then it would be necessary for the sake of consistency for ComReg to apply the principle underlying retrospection to also examine whether there is a requirement for a retrospective adjustment to the cost recovery (i.e. price) of the LLU migrations. This is but one example of the implications of consistently applying the principle underlying retrospective funding. On the other side the application of this principle would raise the question of whether eircom could seek a retrospective pricing review of any regulated product if it believed that its actual costs exceeded the ones projected at the time of the initial price setting. Vodafone believes that this would not yield positive results for the market as a whole and ComReg has not carried out any assessment of the wider market impacts of adopting this principle.

The above factors must, at a minimum, be taken into account in any Regulatory Impact Assessment (RIA) undertaken in the event that universal service funding contributions were assessed as being required following an analysis. Vodafone strongly disagrees with ComReg's decision not to undertake a RIA prior to making its current draft decisions.

Vodafone does not understand why, given its clear relevance, ComReg omits any reference to document (07/07) in its present Draft Decision and fails to address why the principles and reasoning underpinning its decision in relation to relevant funding periods in that document now appear to no longer be valid. However this omission falls far short of the necessary standard for decision making that should be met by ComReg. Given the major negative precedent that would be set by ComReg's current draft decision in relation to the relevant funding period, Vodafone must reserve its right to take all available measures to defend its legitimate commercial interests in this regard.

Vodafone Position on Appropriate Funding Period

Vodafone notes that ComReg has not indicated that any formal application from the USP in respect of funding for net costs claimed to incurred by it (of sufficient size to constitute an unfair burden) in respect of its provision of the universal service has yet been made. ComReg's current draft decisions appear to be set out only in anticipation of such an application being made. This is

of central relevance to the appropriate period of assessment of any net cost from provision of the universal service that may arise.

Also, reasons 1 and 3 set out previously above from ComReg document (07/07) which conclude respectively that any USO costing assessment should be reconciled only to the most recently available set of independently verified separated accounts of Eircom, and that applications for universal service funding should coincide with the financial period within which they occur, are in Vodafone's view the appropriate principles to adopt with respect to the current decision that must be made by ComReg on the financial periods for which applications by the USP can be considered.

Consequently Vodafone believes that the optimal approach in light of the above principles, and the apparent absence of any application from the USP received by ComReg to date, is for ComReg to only accept applications from the USP for net costs of USO provision claimed by it only for financial periods from 2011-2012 onwards. Moreover such applications for each financial period should be required to be made no later than six months following the end of the relevant financial period.

Format of Draft Decisions

Vodafone is concerned that the status of the draft Decisions, as set out in Appendix G of ComReg's Response to Consultation and Draft Decision, is unclear given that they are not in the format of a Draft Decision Instrument. Vodafone believes that it is incumbent on ComReg, consistent with effective procedures, to issue finalised decision in relation to the principles and methodologies of a USO costing assessment as a Decision Instrument.

The approach adopted by ComReg in this case is in marked contrast to the majority of other consultations. In these other cases stakeholders are given the opportunity to comment on the proposed wording of the Decision Instrument to ensure that any decision actually mandated properly reflects the detailed reasoning set out in the consultation process. Vodafone believes that ComReg's departure from this practice runs the risk that any disjoint between the wording of the Decision Instrument and the wording set out in the consultation response may yield unintended consequences.