Wholesale Broadband Access:

Price control obligation in relation to current generation Bitstream

Response to Consultation and Final Decision

Reference: ComReg Document 14/73R
ComReg Decision No D11/14

Date: 09/07/2014

An Coimisiún um Rialáil Cumarsáide
Commission for Communications Regulation
Abbey Court Irish Life Centre Lower Abbey Street Dublin 1 Ireland
Telephone +353 1 804 9600 Fax +353 1 804 9680 Email info@comreg.ie Web www.comreg.ie

Redacted Information

Please note that this Decision Document is a non-confidential version of the response to consultation and decision document. Certain information within the Decision Document has been redacted for reasons of confidentiality and commercial sensitivity, with such redactions indicated by the symbol ✂.

Content

Section **Page**

Annex

Section **Page**

Glossary of Frequently Used Terms

Acronym	Full Title
BARO	Bitstream Access Reference Offer
BMB	Bitstream Managed Backhaul
BRAS	Broadband Remote Access Servers
BU-LRAIC+	Bottom-up Long Run Average Incremental Cost plus an apportionment of joint and common costs
DSLAM	Digital Subscriber Line Access Multiplexers
EEO	Equally Efficient Operator
FAC	Fully Allocated Cost
HCA	Historic Cost Accounting
LEA	Larger Exchange Area
LFI	Line Fault Index
LLU	Local Loop Unbundling
LRAIC	Long Run Average Incremental Cost
LRIC	Long Run Incremental Cost
NBP	National Broadband Plan
NGA	Next Generation Access
OAO	Other Authorised Operator
POTS	Plain Old Telephone Service
REO	Reasonably Efficient Operator
RFI	Request for Information
SABB	Standalone Broadband
SEO	Similarly Efficient Operator
SLU	Sub-loop Unbundling
SMP	Significant Market Power
TD	Top-Down
VUA	Virtual Unbundled Access
WBA	Wholesale Broadband Access
WLR	Wholesale Line Rental

Chapter 1

1 Introduction

1.1 This document is a response to the consultation published by ComReg on 19 September 2013 in ComReg Document No 13/90[1] (referred to throughout this document as the "**Consultation Document**") with regard to the appropriate price control for current generation Bitstream and Bitstream Managed Backhaul ("**BMB**") services (referred to commonly as "Bitstream services" throughout this document) in the Wholesale Broadband Access ("**WBA**") market for the price control period.

1.2 This response to consultation and decision document (referred to throughout this document as the "**Decision Document**") provides a summary of ComReg's preliminary views from the Consultation Document, the views of respondents, ComReg's assessment of respondents' views and ComReg's final position. The non-confidential responses to the Consultation Document have been separately published in ComReg Document No 13/90s[2].

1.3 In March 2014 we notified the European Commission (the "**Commission**") of our draft measures[3] in line with Articles 7 and 7A of the Framework Directive[4] as transposed by Regulations 13 and 14 of the Access Regulations[5]. In accordance with Regulation 14(2) of the Framework Regulations, we have taken utmost account of the views expressed by the Commission, as discussed in detail in Annex 4 of this Decision Document. The full text of the letter from the Commission is set out in Annex 3 of this Decision Document.

1.4 There are also a number of other related ComReg decisions ("**Decisions**") which are relevant to this Decision Document and these are discussed in Chapter 3.

1.5 This document is structured as follows:

[1] ComReg Document No 13/90: Wholesale Broadband Access: Price control obligation in relation to current generation Bitstream; dated 19 September 2013.
[2] Bitstream price control: Responses to ComReg Document No 13/90; dated 18 December 2013.
[3] Registered by the European Commission as Case Number IE/2014/1571.
[4] ComReg is required to notify any proposals to impose, withdraw or amend obligations on an SMP operator to the European Commission pursuant to Article 7 of Directive 2002/21/EC on a common regulatory framework for electronic communications networks and services (Framework Directive), as amended by Directive 2009/140/EC (the "**Framework Directive**").
[5] Articles 7 and 7A have been transposed as Regulation 13 and 14, respectively, of the Framework Regulations the European Communities (Electronic Communications Networks and Services) (Framework) Regulations 2011 (S.I. No. 333 of 2011) (the "**Framework Regulations**").

- **Chapter 2**: Executive Summary: This section summarises the main decision points of this Decision Document and ComReg's overall objectives.

- **Chapter 3**: Background: This section summarises the background to the Decision Document as well as an overview of the responses received from interested parties.

- **Chapter 4**: Market Developments: This section sets out the competitive and / or structural developments that may vary prospectively in the WBA market.

- **Chapter 5**: Appropriate form of price control: This section sets out the form(s) of price control that should apply in the larger exchange area ("**LEA**") and Outside of the LEA for current generation Bitstream services in the WBA market.

- **Chapter 6**: Costing methodology and cost model: This section sets out the methodology for the Bitstream cost model and the inputs and assumptions of the Bitstream cost model.

- **Chapter 7**: Retail margin squeeze test: This section sets out the principles that should apply for the retail margin squeeze tests.

- **Chapter 8**: Bitstream ancillary charges: This section addresses Eircom's current Bitstream ancillary charges for current generation services in the WBA market.

- **Chapter 9**: WBA Price Floors: This section sets out our position on changes to the WBA price floor model (the details of which were set out in ComReg Decision No. D06/12 (referred to throughout this document as the '**WBA Price Floors Decision**')) and a reference to the recent Call for Input[6] to Industry regarding an update to the usage / throughput levels.

- **Chapter 10:** Appropriate Market 4 Access Input for SABB: This section sets out the price control obligation for standalone broadband ("**SABB**") Outside of the LEA.

- **Chapter 11**: Decision Instrument: This section sets out the decision instrument associated with the price control and transparency obligation for current generation Bitstream in the WBA market.

[6] Call for Input: Current and future projections on throughput; dated 10 March 2014.

- **Chapter 12**: Regulatory Impact Assessment: This section sets out an analysis of the likely effect of the changes to the price control obligation for current generation Bitstream.

Chapter 2

2 Executive Summary

2.1 ComReg is the regulator for the electronic communications sector in Ireland.

2.2 Our objectives, in line with Section 12 of the Communications Regulations Act 2002[7] ("**the Communications Regulations Act**") are to promote competition, to contribute the development of the internal market and to promote the interests of users within the community. More specifically, ComReg also has an objective to encourage (i) efficient investment in infrastructure and promote innovation and (ii) access to the internet at a reasonable cost to end-users.

2.3 This Decision Document sets out the appropriate price control for Eircom Limited ("**Eircom**") for its current generation wholesale Bitstream services over the price control period.

2.4 In 2011, Eircom was designated with significant market power ("**SMP**") in the WBA market (also known as Market 5) in ComReg Decision D06/11[8] (referred to as the "**WBA Market Decision**" throughout this document). WBA is a non-physical or virtual wholesale input used in the provision of a range of retail products which are used by consumers for broadband internet access.

2.5 As a result of the designation of SMP on Eircom in the WBA market, a number of obligations were imposed, including the obligation of price control and costing accounting. In the WBA Market Decision ComReg specified that "*Eircom shall have an obligation not to cause a margin/price squeeze*". The WBA Market Decision also required Eircom to set prices in accordance with the 2006 retail minus price control that was set out in ComReg Decision D01/06[9] (referred to throughout this document as the "**2006 Retail Minus Price Control**").

2.6 In September 2013 we consulted with industry regarding proposed changes to certain aspects of the implementation of the price control remedy (for current generation Bitstream services in the WBA market) which would vary by geographic area. In March 2014, we notified the Commission regarding our draft measures for current generation Bitstream pricing in line with Article 7 of

[7] Communications Regulation Act 2002 (No. 20 of 2002), as amended by the Communications Regulation (Amendment) Act 2007 (No. 22 of 2007), the Communications Regulation (Premium Rate Services and Electronic Communications Infrastructure) Act 2010 (No. 2 of 2010) and the Communications Regulation (Postal Services) Act 2011 (No. 21 of 2011).

[8] ComReg Document No 11/49 (ComReg Decision D06/11); Response to Consultation and Decision Document: Market Review: Wholesale Broadband Access (Market 5); 8 July 2011.

[9] ComReg Decision D01/06: ComReg Document No 06/01entitled "Retail minus wholesale price control for Wholesale Broadband Access Market" dated January 2006.

the Framework Directive. We have now assessed the responses received to the Consultation Document which is set out in this Decision Document and we have taken utmost account of the views expressed by the Commission in reaching our final position. Please refer to Annex 4 of this Decision Document for ComReg's consideration of the points raised by the Commission. Some of the key points raised by the Commission are also set out in Chapters 5 and 6 below.

2.7 In summary, in this Decision Document we are imposing a national cost orientation obligation with regard to Eircom's current generation Bitstream services. In addition, we are withdrawing the current retail minus price control and instead we are imposing a retail margin squeeze test. The application of both pricing obligations differs somewhat between more urban and less urbanised areas. ComReg has previously defined a LEA[10] which comprises those exchange areas where there is the presence of cable infrastructure[11], local loop unbundling ("**LLU**") based competition, and prospectively, the potential for the rollout of next generation access ("**NGA**"). Areas outside the LEA i.e., "**Outside the LEA**" are those areas which have less / no infrastructure based competition and where the wholesale broadband market is unlikely to become competitive prospectively.

2.8 The key decisions in this Decision Document are a further specification of the margin squeeze obligation and the imposition, amendment and withdrawal of the price control and the transparency obligations contained in the WBA Market Decision.

2.9 The following is a summary of the **key points** of this document:

1) **National cost orientation obligation**:

2.10 Eircom shall be subject to a national cost orientation obligation with regard to current generation Bitstream services. In this regard, Eircom shall be required to ensure that it recovers no more than the actual incurred costs (adjusted for efficiency, plus a reasonable rate of return[12]) associated with the provision of WBA nationally.

2.11 This obligation is consistent with Regulation 13(2) of the Access Regulations[13] which provides that:

[10] Larger Exchange Area.

[11] UPC Communications Ireland Limited ("UPC").

[12] The reasonable rate of return is based on Eircom's weighted average cost of capital ("WACC") of 10.21%. Eircom's WACC is currently subject to a separate consultation as set out in ComReg Document No 14/28. The outcome of that consultation process will be published by ComReg in due course.

[13] European Communities (Electronic Communications Networks and Services) (Access) Regulations 2011 (S.I. No. 334 of 2011).

To encourage investments by the operator, including in next generation networks, the Regulator shall, when considering the imposition of obligations under paragraph (1), take into account the investment made by the operator which the Regulator considers relevant and allow the operator a reasonable rate of return on adequate capital employed, taking into account any risks involved specific to a particular new investment network project.

2.12 The national cost orientation obligation allows Eircom to recover its actual incurred costs adjusted for efficiency plus a reasonable rate of return. The objective of the Bitstream cost model (referred to as the "**Bitstream cost model**") (discussed below) is to ensure that Eircom does not materially over or under recover its actual costs adjusted for efficiency (including a reasonable rate of return) nationally. Please refer to Chapter 12 for a detailed discussion on Regulation 13 of the Access Regulations.

2) <u>Cost orientation obligation Outside the LEA</u>:

2.13 Outside the LEA, Eircom shall be required to ensure that it recovers no more than the actual incurred costs (adjusted for efficiency, plus a reasonable rate of return) associated with the provision of current generation Bitstream services in the area Outside the LEA. In addition, Eircom shall not increase its current Bitstream rental prices Outside the LEA or introduce the price for a new Bitstream monthly rental charge without ComReg's prior approval. The approval process would involve a demonstration by Eircom to ComReg that any proposed increases to Bitstream monthly rental prices Outside the LEA or the introduction of a price for a new Bitstream monthly rental charge should recover no more than its actual incurred costs adjusted for efficiency (plus a reasonable rate of return) associated with that area i.e., Outside the LEA while also ensuring that it complies with the overriding national cost orientation obligation.

2.14 This obligation also ensures consistency with Regulation 13(2) of the Access Regulations as discussed above as well as Regulation 13(4) of the Access Regulations which states that:

"*Where an operator has an obligation under this Regulation regarding the cost orientation of its prices, the burden of proof that charges are derived from costs, including a reasonable rate of return on investment shall lie with the operator concerned*……"

3) <u>Cost orientation obligation based on historic costs</u>:

2.15 The cost orientation obligation (both the national and sub-national obligations set out above) will be assessed by applying the historic cost accounting

("**HCA**") methodology which uses Eircom's costs (adjusted for efficiency plus a reasonable rate of return). This should allow Eircom to recover any money invested in maintaining or upgrading its network on the basis that Eircom will have the assurance that what it spends can be recouped over the price control period – particularly Outside the LEA (e.g., operating expenditure adjusted for efficiencies associated with maintenance expenditure and any relevant depreciation charges associated with capital expenditure). Therefore, Eircom's investment incentives are not negatively affected by this Decision in fact are likely to be enhanced Outside the LEA. This should ensure consistency with Regulation 13(2) and Regulation 13(4) of the Access Regulations as discussed above and as discussed in further detail in Chapter 6 and Chapter 12 of this Decision Document.

2.16 We consider that the use of bottom up long run average incremental costs plus an apportionment of joint and common costs ("**BU-LRAIC+**") as opposed to the HCA methodology in the absence of alternative network competition may encourage Eircom to "sweat"[14] its assets in areas Outside the LEA. This may result in excessive pricing relative to its actual investment without any benefit to end users in terms of alternative platform based investment. The BU-LRAIC+ approach permits the recovery of hypothetical costs which may not have been actually incurred or is likely to be incurred. Given the extent of depreciated assets (i.e., DSLAMs[15] and BRAS[16]) in Eircom's core network and the fact that these assets may not be replaced by Eircom as the market focuses on NGA services, the BU-LRAIC+ methodology could give rise to significant increases in wholesale and retail legacy broadband prices Outside the LEA. This may be detrimental to end-users and wholesale operators that have no alternative options for broadband provision other than purchasing these services from Eircom.

2.17 While BU-LRAIC+ may be useful in setting appropriate "build or buy" signals for other networks this consideration is less important Outside the LEA (rural areas) in Ireland at least where commercial build in current generation Bitstream and in many areas next generation services is unlikely due to low population densities. We have recently initiated a review of Eircom's access prices known as the "**Access Network Review**" which will include a review of the current BU-LRAIC+ methodology. The Access Network Review will include an assessment of the appropriate costing methodology and appropriate price for the main access network services, including LLU, SLU,

[14] In general "sweating your assets" means getting as much as possible out of your assets without having to replace them.
[15] Digital Subscriber Line Access Multiplexers.
[16] Broadband Remote Access Servers.

Line Share[17], Wholesale Line Rental ("**WLR**") and SABB. This review will take place during 2014/2015 and is further discussed below.

2.18 In any event ComReg is of the view that Outside the LEA there is little prospect of potential investment in current generation Bitstream by an alternative operator and it would therefore be inappropriate to chose a pricing methodology that aims to stimulate alternative operator investment. While the ESB Networks and Vodafone Ireland Limited ("Vodafone") have indicated their intention to enter the Irish wholesale broadband market by leveraging from ESB's power transmission network, it seems that the initial roll-out would be confined to areas that prospectively may well form part of the LEA. Outside the LEA ComReg considers that it is unlikely that any commercial operator would replicate Eircom's network. For the majority of exchanges Outside the LEA it is highly likely that investment in NGA broadband will be through state intervention by means of the national broadband plan[18] ("**NBP")**.

4) <u>Annual review to ensure overall national recovery of costs</u>:

2.19 On an annual basis, Eircom is required to compare and reconcile the wholesale current generation Bitstream results from its Regulated Accounts[19] with the planned costs and revenues that are contained in the Bitstream cost model over the duration of the Bitstream cost model[20]. The comparison carried out by Eircom annually as well as the underlying supporting information will be provided to ComReg by the end of February in the year subsequent to the financial year end. If, as a result of this review, it is clear that Eircom significantly under / over recover its overall actual national Bitstream costs adjusted for efficiency (plus a reasonable rate of return) then we may have to assess how any issues of cost recovery might be addressed going forward.

2.20 However, it is important to note that the annual review for cost recovery may not lead to price changes as the review is not a static point in time review but rather where cost recovery issues are apparent a more detailed dynamic review may be necessary with the possibility of a consultation with industry before any possible price changes are made. It is important that any one-off reductions or increases to historical costs do not give rise to distortions in the

---

[17] Shared access to the local loop.

[18] http://www.dcenr.gov.ie/files/PageTurning/NationalBroadbandPlan/index.html#/II/

[19] Please refer to ComReg Document No. 10/67 entitled "Accounting Separation and Cost Accounting Review of Eircom Ltd." dated 31 August 2010.

[20] The model sets out the forecasted costs and revenues of current generation Bitstream and BMB (the "**Bitstream cost model**"). The Bitstream cost model has been developed by ComReg with the assistance of TERA Consultants and input from Eircom. The details of the Bitstream cost model were consulted upon in the Consultation Document and ComReg's final position is set out, more particularly, in Chapter 6 of this Decision Document. Costs and revenues are forecasted over a three year period, up until the end of 2016.

market. Therefore, we plan to only allow price changes where they are likely to be sustainable and where Eircom are clearly materially over / under recovering its costs over a reasonably extended period. We consider that this obligation allows Eircom the opportunity annually to demonstrate if there is a material over / under recovery of its actual Bitstream costs adjusted for efficiency. This provision should ensure consistency with the requirements of Regulation 13(4) of the Access Regulations as set out above and as discussed in more detail in Chapter 12.

5) Obligation not to cause a retail margin squeeze:

2.21 Up until now Eircom has been subject to a national retail minus price control. Instead of a national retail minus control we are now imposing a retail margin squeeze test. This test is differentiated between the LEA and Outside the LEA. In principle, there will be little practical impact compared to the previous obligation as both rely on the same discounted cash flow model (the "**DCF Model**") to determine the appropriate margin. The current national retail minus control assesses one retail product against the cost of one wholesale product, nationally. The retail margin squeeze approach now adopted assesses each area (LEA and Outside the LEA) separately.

2.22 In the LEA the retail margin squeeze test assesses multiple retail products against the one wholesale product (portfolio analysis) to ensure that on an overall aggregate basis that the average of Eircom's retail revenues for all of its retail current generation broadband products recovers the average total retail and wholesale costs. The retail margin squeeze test Outside the LEA assesses each retail product against the relevant wholesale product (product-by-product analysis) to ensure that the revenue for each retail offer recovers its associated retail and wholesale costs.

2.23 ComReg considers that the retail margin squeeze tests are necessary because, apart from the cable infrastructure and LLU based competition, Outside the LEA most competition to Eircom, at the retail level, is still provided over WBA. Eircom still has an incentive and ability to set retail prices at a level relative to its own wholesale process that could foreclose competition. Our approach should ensure regulatory consistency with the Decision on NGA as set out in ComReg Decision D03/13[21] (referred to as the "**NGA Decision**") and with our Decision on Bundles as set out in ComReg Decision D04/13[22] (referred to as the "**Bundles Decision**").

[21] ComReg Document No 13/11: Next Generation Access ("NGA") Remedies for Next Generation Access Markets" dated 31 January 2013.
[22] ComReg Document No 13/14: Price Regulation of Bundled Offers: Further specification of certain price control obligations in Market 1 and Market 4" dated 8 February 2013.

6) **WBA Price Floors Decision to remain in place**:

2.24 For clarity, the minimum price floors price control to minimize the risk of a margin (price) squeeze between WBA and Wholesale (Physical) Network Infrastructure Access (including shared or fully unbundled access) at a fixed location (i.e., the WBA Price Floors Decision[23]) is not affected by this Decision (i.e., the WBA Price Floors Decision will remain in place). The objective of the WBA Price Floors Decision is to prevent Eircom from setting Bitstream prices too low such that they could discourage investment in LLU or other infrastructure operators either investing or planning to invest. Therefore, in the WBA Price Floors Decision ComReg imposed a margin squeeze obligation on Eircom between Market 4 (WPNIA) and Market 5 (WBA) services. This should prevent the risk that Eircom would set current generation Bitstream prices too low which could be detrimental to build/buy signals and investment in networks by other operators. ComReg recently issued a Call for Input in ComReg Document No 14/18[24] where is requested current and future projections on throughput / usage levels from the industry. The outcome of that review is still ongoing and is discussed in greater detail in Chapter 9 of this Decision Document.

2.25 As such, Eircom is required to ensure that it complies with both the retail margin squeeze test (see paragraphs 2.21-2.23) and the WBA Price Floors Decision. If, for competitive reasons, it wishes to reduce retail prices, then complying with both tests may require it to reduce both WBA prices and prices for services that are inputs to the WBA price floors model (such as LLU). However, any such changes would require ComReg review and/or approval.

7) **BU-LRAIC+ to remain in place for access network services**:

2.26 By way of background, the BU-LRAIC+ approach adopted by ComReg in relation to the access network will remain in place for access services provided over the access network and is not affected by this Decision. The access network includes the physical infrastructure of ducts, trenches, copper cables, etc. between the Eircom exchange and the end-user's premises. The BU-LRAIC+ approach was imposed on Eircom under ComReg Decision D01/10 (ComReg Document No 10/10[25]) for LLU and Sub Loop Unbundling ("**SLU**") monthly rental prices (the "**LLU Pricing Decision**"). We have recently initiated the Access Network Review which includes a review of Eircom's access prices. This review will include an assessment of the appropriate

[23] See ComReg Decision D06/12, ComReg Document No 12/32 "Wholesale Broadband Access: Further specification to the price control obligation and amendment to the transparency obligation" dated 5 April 2012.

[24] Call for Input: Current and future projection on throughput; dated 7 March 2014.

[25] ComReg Document No 10/10: Response to Consultation and Decision – Local Loop Unbundling ("LLU") and Sub Loop Unbundling ("SLU") Maximum Monthly Rental Charges; dated 9 February 2010.

costing methodology and appropriate price for the main access network services, including LLU, SLU, Line Share, WLR and SABB. This review will take place during 2014/2015 and it will take account of the Commission's Recommendation of 11 September 2013[26] on non-discrimination obligations and costing methodologies (the "**Non-discrimination and Costing Methodologies Recommendation**") to promote competition and enhance the broadband investment environment.

8) Cost orientation for SABB Outside the LEA:

2.27 The price for SABB Outside the LEA will be subject to cost orientation. Eircom launched a SABB access product, a current generation broadband only wholesale access service, in July 2013. Pending the outcome of the Access Network Review and the associated model in 2014/2015, prices for SABB will be assessed by reference to the narrowband prices currently in place i.e., SABB should be priced at no more than the price of wholesale line rental adjusted for avoidable costs (such as for line card) and other cost differences. Please refer to Chapter 10 of this Decision Document.

Price control period:

2.28 The price control period will last for at least the next two years but in any event it will remain in place until further notice by ComReg. A period of at least two years should ensure that ComReg will have conducted a market analysis for what is now Market 5. In addition, the Access Network Review should also be completed at that point which will take account of the Commission's Non-discrimination and Costing Methodologies Recommendation.

2.29 It is important to note that ComReg expects that this Decision will not result in any immediate changes to current generation Bitstream prices. Instead this Decision provides transparency to the industry insofar as Eircom can recover no more than its actual Bitstream costs (adjusted for efficiency plus a reasonable rate of return) nationally but also in the area Outside the LEA. In addition, this Decision should provide reasonable price certainty and predictability to operators in the WBA market. In particular, Outside the LEA the obligation of cost orientation based on HCA costs ensures that Eircom cannot increase the Bitstream prices Outside the LEA or introduce the price for a new Bitstream monthly rental charge — without demonstrating to ComReg that any revised (or new) prices are based on no more than the actual local costs adjusted for efficiencies (plus a reasonable rate of return) in that area. This is a very important consideration in our view which means that Eircom cannot price excessively for broadband services in rural areas where

[26] Commission Recommendation of 11 September 2013 on consistent non-discrimination obligations and costing methodologies to promote competition and enhance the broadband investment environment (C(2013) 5671 final).

there is no cost justification. This Decision also clearly set outs the regulatory framework for current generation Bitstream services for the foreseeable future. This Decision, when considered in conjunction with other related Decisions on Bundles, NGA and the WBA price floors should ensure that competition is incentivised and fostered in the long term so that end-users benefit from a wide variety of choice at affordable prices.

Chapter 3

3 Background

3.1 Introduction

3.1 In this Chapter we discuss the background to the consultation process associated with determining the appropriate price control regime for current generation Bitstream services in the WBA market.

3.2 Current Generation WBA, or "Bitstream" has been identified as a key requirement which allows OAOs replicate the fixed retail broadband offers of Eircom across Ireland. Please refer to Chapter 3 of the Consultation Document for a discussion on the technical background of Bitstream.

3.3 The Commission has recommended a number of markets as being susceptible to *ex ante* regulation. These markets have been reviewed in an Irish context and obligations were imposed where operators were designated with SMP. One such market is WBA or Market 5 of the Relevant Markets Recommendation[27].

3.4 As a result of the designation of SMP on Eircom in the WBA market, a number of obligations were imposed, including the obligations of access, transparency, non-discrimination, accounting separation and price control and costing accounting. The price control obligation imposed on Eircom was a continuation of the 2006 Retail Minus Price Control. The margin squeeze obligation in the WBA Market Decision specified that "*Eircom shall have an obligation not to cause a margin/price squeeze*".

3.5 As part of the WBA Market Decision, ComReg identified the competition problems associated with the WBA market which included excessive pricing, exclusionary behaviour and as well as concerns around vertical leverage/ predatory practices.

[27] Commission Recommendation of 17 December 2007 on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services.

3.6 In the WBA Market Decision ComReg considered that Eircom would have the ability and incentive to set excessive prices in the WBA market which would exploit retail broadband users and potentially harm competition from other authorised operators ("**OAOs**") relying on Eircom's WBA inputs. Concerns about excessive pricing arise where, absent regulation, price levels are likely to be persistently high with no effective pressure (e.g. from new entry or innovation) to bring them down to competitive levels over the period of the review. In the absence of SMP regulation in the WBA market, Eircom would have the ability and incentive to price excessively. This could raise input costs to retail operators and ultimately raise prices to end-users. Such excessive pricing would thus not only exploit retail broadband users but might also harm competition where the excessively priced WBA input would make it more difficult to compete in related markets, e.g. in downstream markets where operators rely on the upstream input to compete. Currently, this issue is particularly relevant in the more rural areas of Ireland where broadband competition is unlikely to develop in the short to medium term and where Eircom is the main wholesale Bitstream provider. This is discussed in more detail in Chapter 5 of this Decision Document.

3.7 In the WBA Market Decision we also identified scope and incentive for the SMP operator to engage in possible price-related leveraging through pricing its upstream and downstream services in such a way as to give rise to an insufficient wholesale/retail margin which would impede effective downstream competition. In the WBA Market Decision we considered that a vertically integrated operator which has SMP at the wholesale level and provides a wholesale input on which other operators rely to compete in a downstream market could price its upstream and downstream services in such a way as to impede effective downstream competition due to an insufficient margin between wholesale and retail prices. This competition problem remains relevant and this has been discussed in Chapter 5 and Chapter 7 of this Decision Document.

3.8 Following the WBA Market Decision, it was ComReg's intention to publish a decision on an appropriate Current Generation Price Control and WBA Price Floors together. However, following initial consultation[28], ComReg considered that, at that time, the introduction of the price floor decision in the first instance was the more critical price control (see paragraph 3.21) — in particular, as there was already an existing national retail minus price control based on ComReg Decision D01/06 (see paragraph 3.18).

[28] ComReg Document No 10/56 entitled "Wholesale Broadband Access – Consultation and Draft Decision on the appropriate price control" dated 15 July 2010.

3.9 In arriving at this Decision, ComReg has now reviewed the Current Generation Price Control and set out an updated regulatory framework going forward for current generation Bitstream monthly rentals, with particular emphasis on the appropriate pricing approach Outside the LEA.

3.10 The WBA Decision defined the relevant geographic market as being national in scope. While evidence of structural change was identified in areas of overlapping cable and LLU infrastructure this was considered, at the time, to be relatively recent and unstable (absent regulation). ComReg also found little evidence of behavioural change that would distinguish one area from another. ComReg indicated that this issue would be monitored.

3.11 While ComReg considers that the competition problems identified in the WBA Market Decision remain relevant we have decided that certain aspects of the implementation of the price control remedy would vary by geographic area. Please refer to Chapter 5 below for further details.

3.2 Outcome of consultation process

3.12 On 19 September 2013, we published the Consultation Document setting out our proposed views regarding the pricing regime for current generation Bitstream services. This Decision Document now assesses the proposals put forward by ComReg in the Consultation Document, the views of respondents and our final position regarding the price control obligation for current generation Bitstream services going forward.

3.13 There were 7 responses received to the Consultation Document. The respondents were as follows:

- Eircom Ltd.
- BT Ireland Communications ("**BT**")
- Vodafone Ireland Ltd. ("**Vodafone**")
- Magnet Networks Ltd. ("**Magnet**")
- Viatel ("**Viatel**")
- British Sky Broadcasting Ltd. ("**Sky**")
- ALTO.

3.14 The non-confidential responses to the Consultation Document have been separately published in ComReg Document No 13/90s.

3.15 In summary, there was general agreement among the respondents regarding the main proposals set out in the consultation. Some operators raised some concerns / issues and these are addressed in the main chapters of the document below.

3.16 On 4 March 2014, we notified the Commission of our draft measures in line with Article 7 of the Framework Directive. On 11 March 2014 we received a request for information ("RFI") from the Commission seeking additional information and clarifications from ComReg regarding the notified measure on Bitstream pricing. ComReg provided its response to the RFI on 14 March 2014. On 4 April 2014, the Commission submitted its response letter to ComReg. In line with Regulation 14(2) of the Framework Regulations we have taken utmost account of the views expressed by the Commission, as discussed in detail in Annex 4 of this document. The letter from the Commission is set out in Annex 3. The key points raised by the Commission are also discussed in Chapters 5 and 6 below.

3.17 As already set out in Chapter 3 of the Consultation Document, there are a number of other published Decisions which are relevant to this Decision Document. The full details are set out in the Consultation Document. We have set out a summary of these relevant Decisions below.

3.18 <u>2006 Retail Minus Decision</u>: Since 2006, Eircom has been subject to a national retail minus price control based on ComReg Decision D01/06. Further details are set out in Chapter 3 of the Consultation Document and also in the 2006 Retail Minus Decision. This Decision Document will replace the 2006 Retail Minus Decision.

3.19 <u>LLU Pricing Decision</u>: The price control in place in the WPNIA market for LLU and SLU access is cost orientation based on a BU-LRAIC+ methodology. This will be reassessed as part of the Access Network Review during 2014/2015. Further details are set out in Chapter 3 of the Consultation Document and in the LLU Pricing Decision. This Decision Document will not affect the LLU Pricing Decision.

3.20 <u>WBA Market Decision</u>: In 2011 ComReg published its WBA Market Decision in ComReg Decision D06/11, where Eircom was re-designated with SMP in the WBA market on a national basis. The WBA Market Decision specified that the 2006 Retail Minus Decision would continue to apply to Eircom pending any other decisions or directions by ComReg in relation to the appropriate price control. A margin squeeze obligation was also imposed on Eircom in the WBA Market Decision. Further details are set out in Chapter 3 of the Consultation Document and in the WBA Market Decision. This Decision Document is a further specification of the price control obligations set out in the WBA Market Decision.

3.21 WBA Price Floors Decision: In 2012 ComReg published its decision on the WBA price floors in ComReg Decision No D06/12, such as to prevent Eircom from setting Bitstream prices too low such that they could discourage investment in LLU. In the WBA Price Floors Decision ComReg imposed an obligation on Eircom not to cause a margin squeeze between WBA and WPNIA. It further directed Eircom not to set prices for WBA below the minimum price floors (or the "WBA price floors") specified in the decision instrument annexed to the decision[29].

3.22 NGA Decision: In 2013 ComReg published its NGA Decision (ComReg Decision D03/13)[30]. The NGA Decision specifies the obligations relating to next generation services in the WBA market, including a price control obligation based on retail and wholesale margin squeeze tests. There is now consistency of pricing principles between the NGA Decision, the Decision on Bundles and this Decision on current generation Bitstream. Please refer to Chapter 3 of the Consultation Document and the NGA Decision for further details. This Decision Document which is based on current generation Bitstream services will not affect the NGA Decision.

3.23 Bundles Decision: In 2013, ComReg published the Bundles Decision in ComReg Decision D04/13[31]. The Bundles Decision defined two areas with prospectively varying competitive conditions. One area, known as the LEA, where more than one competing infrastructure exist, and the balance being the more rural area (or "Outside the LEA") where infrastructure based competition does not exist to any appreciable extent. The varying competitive conditions between the LEA and Outside the LEA are also reflected in this Decision Document for current generation Bitstream. Please refer to Chapter 3 of the Consultation Document and the Bundles Decision for further details. This Decision Document which is relevant to standalone Bitstream (and BMB offers) offers will not affect the Bundles Decision.

[29] See section 4.3 of the Decision Instrument attached the Price Floor Decision which sets out the allowed price for monthly port cost per user, monthly backhaul cost per user – fixed and monthly backhaul cost per Mbps.

[30] http://www.comreg.ie/_fileupload/publications/ComReg1311.pdf

[31] http://www.comreg.ie/_fileupload/publications/ComReg1314.pdf

Chapter 4

4 Market Developments

4.1 Introduction

4.1 In this chapter we summarise the market developments in the WBA market which were discussed in detail in Chapter 4 of the Consultation Document.

4.2 The WBA Market Decision found evidence of structural change arising in certain overlapping geographic areas. The Bundles Decision subsequently defined two areas with prospectively varying competitive conditions namely the LEA and Outside the LEA.

4.3 The main points are summarised under the following headings:

- Market developments in the LEA
- Market developments Outside the LEA.

4.2 Market developments in the LEA

4.4 As already set out in the Consultation Document the LEA is typically an exchange area being served with Eircom's current generation retail broadband products, NGA services as well as services from an alternative infrastructure-based provider or LLU-based services. The technical considerations (or 5 criteria) used when determining whether an exchange is in the LEA, or not, are set out in the Bundles Decision and which were reproduced in subsection 4.2 of the Consultation Document.

4.5 In the LEA Eircom faces some competitive pressure at the retail level where UPC has rolled-out its bi-directional cable network and where Eircom also faces retail and wholesale competition from OAOs that have unbundled Eircom's exchanges. Eircom's retail prices in the LEA are also constrained by OAOs' that are using Eircom's wholesale inputs to provide retail services. This is more so the case where operators have deployed their own active equipment and use LLU. These points are discussed in more detail in the Consultation Document.

4.6 ComReg also noted the entry of Sky to the Irish retail broadband market with very competitive retail offers. In addition, a joint venture between the Electricity Supply Board (ESB) and Vodafone may establish a presence in the LEA in the medium-term by leveraging from its own access network and backhaul network. Prospectively, therefore further competition in the retail broadband market may come from offers that are not reliant on Eircom's active access services in the WBA market.

4.7 Publically available data on retail broadband market shares indicates that end-users are responding to alternative infrastructure providers i.e UPC's relatively attractive product offering, putting pressure on both Eircom and Eircom's wholesale customers to provide competitive offerings to those who have the ability to access the UPC cable network in the LEA. ComReg included some national market share data in subsection 4.2 of the Consultation Document and this data has not changed significantly since publication of the consultation. In the LEA at the end of December 2013 Eircom has circa ✂% of the WBA market and Eircom Retail has circa ✂% of the Retail broadband market while UPC has circa ✂% of the retail market with the remaining ✂% attributable to OAOs providing retail broadband via Bitstream and LLU / Line Share.

4.8 Eircom's retail broadband pricing strategy has been to focus on increasing product value at the same retail price by providing free upgrades in certain areas, especially in the LEA. Eircom has also separately recently reduced the prices for certain wholesale access products. For example, the usage component of the BMB 8Mbps and 24Mbps product was reduced from €50 to €30 in July 2012 and from €30 to €20 on 1 July 2013. These price reductions applied to Eircom's NGB exchanges relate to approximately over 300 exchanges, extending beyond the current LEA area. These price reductions are largely as a consequence of regulatory rules established by ComReg.

4.9 More recently, Eircom published further changes to the usage charges for both current generation and next generation services. From 1 March 2014 the usage charge for current generation BMB reduced from €20 to €15 while the usage charge for NGA Bitstream reduced from €20 to €10 from 1 February 2014. Please refer to ComReg Information Notice 14/07[32] for further details.

4.10 Eircom has recently announced that it is considering removing the WLR "LEA discount".[33] ComReg will consider the implications of this development in our review of Market 4 and Market 5 in 2015.]

[32] Information Notice No 14/07: Reduction in Bitstream Managed Backhaul and NGA Bitstream Plus Usage Charging; dated 28 January 2014.
[33] See paragraph 10.2.

4.11 As set out in paragraph 3.5, ComReg considers that the competition problems identified in the WBA Market Decision remain relevant. To take into account the different structural changes arising in certain overlapping areas (as identified in the WBA Market Decision) the implementation of the price control remedy will vary by geographic area (see Chapter 5).

4.3 Market developments Outside the LEA

4.12 As already set out in the Consultation Document, the area Outside the LEA corresponds to those exchanges which are in the more sub-urban, rural and remote areas of Ireland. This area has typically higher costs for potential entrants due to longer local loop lengths, greater distance to provide backhaul, and fewer economies of aggregation. Outside the LEA the prospects for entry by a further LLU operator are limited.

4.13 Bitstream is an important access medium Outside the LEA. However, alternative Bitstream-based operators are almost entirely reliant on Bitstream from Eircom in order to provide its retail offering, with only a very small proportion of Bitstream-based subscribers using line share.

4.14 ComReg considers that entry prospects Outside the LEA are limited, largely due to the less favourable cost and scale characteristics. Therefore, currently Outside the LEA there is realistically only one fixed broadband provider, Eircom. This is unlikely to change absent state intervention or the possible entry of ESB Networks.

4.15 At the end of December 2013, Eircom has circa ✂% of the WBA market while Eircom Retail has circa ✂% of the Retail broadband market with the excess mainly relating to OAOs providing retail broadband via Bitstream.

4.16 The Irish Government has announced a National Broadband Plan (“NBP”)[34] which will facilitate broadband download speeds of 70Mbps with a minimum of 40Mbps generally available and 30Mbps available in harder to reach rural areas where a commercial provider will not deliver the equivalent service on a commercial basis. It is therefore envisaged that the NBP will cover a significant proportion of the exchanges Outside the LEA.

[34] http://www.dcenr.gov.ie/Communications/Communications+Development/Next+Generation+Broadband/

4.17 As set out in paragraph 3.5, ComReg considers that the competition problems identified in the WBA Market Decision remain relevant. Given that Eircom has little or no competition from alternative providers Outside the LEA, ComReg has concerns that Eircom may price excessively in the LEA to the detriment of end-users. This issue has been considered in detail in Chapter 5 of this Decision Document.

Chapter 5

5 Appropriate form of price control

5.1 Introduction

5.1 This chapter sets out the most appropriate form(s) of price control for Bitstream (and BMB) monthly rental charges in the WBA market, both in the LEA and Outside the LEA.

5.2 The pricing measures contained in this Decision Document take into account recent developments in the WBA market including the roll-out of cable (by UPC) and increased LLU-based competition. While ComReg considers that the SMP obligations contained in the WBA Decision remain necessary we consider it appropriate to further specify and/or supplement these existing obligations. At this point, ComReg considers it premature to decide whether market conditions are sufficiently unique and stable to merit defining separate geographic WBA markets. Instead, ComReg considers it appropriate to vary the relevant remedy on a geographic basis. ComReg has applied more flexible remedies to WBA products offered/sold within the LEA.

5.3 As already discussed in Chapter 4, the LEA reflects those areas where competitive conditions are different. In particular, the LEA comprises those exchange areas where there is the presence of cable infrastructure (via UPC), LLU based competition and, prospectively, the potential for the rollout of NGA.

5.4 The pricing measures set out in this chapter mainly addresses competition problems in those geographic areas Outside the LEA i.e., those areas which have less/no infrastructure based competition and are unlikely to become competitive prospectively.

5.5 ComReg has taken account of a number of factors, as set out in the Access Regulations, the Framework Regulations as well as the Communications Regulations Act prior to imposing, further specifying or amending any SMP obligation and in particular a price control obligation. This is discussed in detail in Chapter 12 of this document in the context of the regulatory impact assessment (“**RIA**”).

5.6 The remainder of this chapter sets out a summary of ComReg’s preliminary views as set out in the Consultation Document of September 2013, the views of respondents to the Consultation Document, ComReg’s assessment of respondents’ views and ComReg’s final position on the following key points:

1. Appropriate form(s) of price control for Bitstream

2. Price control period and annual reviews

3. Wholesale price notification and compliance procedures.

5.2 ComReg's Preliminary Views from the Consultation

5.2.1 Appropriate form(s) of price control for Bitstream

1. National cost orientation obligation:

5.7 As set out in Chapter 5 (subsection 5.2.2) of the Consultation Document we considered the option of a national cost orientation obligation based on an assessment of the competition problems in the LEA and Outside the LEA. A national retail minus has, to date, been in place — however, it was proposed to replace this with a retail margin squeeze test in both areas.

5.8 ComReg considered that a national cost orientation obligation could be justified for wholesale Bitstream services for the reasons set out in subsection 5.2.2 in Chapter 5 of the Consultation Document.

5.9 Given that Eircom faces more significant retail constraints in the LEA, ComReg was of the preliminary view that Eircom should be allowed to cross subsidise between the different areas (i.e., LEA and Outside the LEA) while ensuring that overall Eircom nationally recovers no more than its actual national costs adjusted for efficiency (plus a reasonable rate of return) in the provision of Bitstream and BMB products and services. At the same time Eircom's pricing would also be constrained by existing regulatory rules such as the requirement not to price below the WBA price floors. This principle was supported by the Bitstream cost model, developed with the assistance of TERA consultants.

5.10 The Bitstream cost model, which is based on best available data at this time, shows that Eircom's current wholesale Bitstream prices in the LEA are likely to be above their actual cost (plus a reasonable rate of return). This means that Eircom appears to be over-recovering its actual costs (plus a reasonable rate of return) in the LEA and under-recovering Outside the LEA i.e., there is a cross subsidy[35] from the LEA into areas Outside the LEA. However, ComReg noted that the split of costs between the LEA and Outside the LEA has not been fully established by Eircom. Therefore, our view on this point was not conclusive. In the absence of actual historic costs by area (LEA and Outside the LEA) from Eircom we made assumptions in the Bitstream cost model to arrive at indicative cost estimates by area, both LEA and Outside the LEA.

5.11 As set out in the Consultation Document, the Bitstream cost model currently suggests that, currently, on a national basis there does not appear to be any material over or under recovery of the actual Bitstream costs adjusted for efficiency (plus a reasonable rate of return). When the costs are compared to the current revenues, i.e., the Bitstream revenues (based on Eircom's current Bitstream prices by volumes) are in line with the actual national efficient Bitstream costs (plus a reasonable rate of return). Therefore, currently Eircom appears to be compliant with the cost orientation obligation at this time.

5.12 However, ComReg was also of the preliminary view that where LEA Bitstream monthly rental prices are set below actual cost (adjusted for efficiency plus a reasonable rate of return) that, end-users Outside the LEA should not subsidise losses in the LEA.

5.13 ComReg also stated in the Consultation Document that the onus would be on Eircom to demonstrate whether it would significantly under / over recover its total actual incurred Bitstream costs adjusted for efficiency plus a reasonable rate of return, nationally (as set out in the Bitstream cost model). If there were evidence of such an under-recovery (which would depend on how effective the retail price constraints are within the LEAs), Eircom may be allowed to charge correspondingly higher prices Outside the LEA subject to the proposed notification and approval procedures.

2. <u>Obligation regarding the recovery of local costs Outside the LEA:</u>

5.14 Another important question raised in Chapter 5 (subsection 5.2.2.) of the Consultation Document was whether a sub-national obligation should be imposed on Eircom in addition to the national cost orientation obligation in order to avoid excessive pricing and provide certainty to the WBA market of the likely evolution of regulated wholesale prices, especially in the area Outside the LEA.

[35] It is important to note that the split of costs between LEA and Outside the LEA has not been fully established. Therefore, our view on this point is currently tentative.

5.15 Outside the LEA ComReg noted in the Consultation Document that Eircom has in excess of ✂%[36] of the WBA market and around ✂% of the retail broadband market. There are very few or no alternative infrastructure broadband providers Outside the LEA and ComReg has concerns that Eircom could price excessively in that specific area absent regulatory intervention. On that basis ComReg was of the preliminary view that Outside the LEA Eircom should recover no more than the actual incurred costs adjusted for efficiency (plus a reasonable rate of return) associated with the monthly rentals for Bitstream and BMB services in that specific area i.e., Outside the LEA while also ensuring that it complies with the overriding national cost orientation obligation. This obligation would apply to any new current generation Bitstream products as well as any increases to existing Bitstream products in that area. Depending on the materiality of any price increases and / or new current generation Bitstream products launched by Eircom relating to Bitstream and BMB monthly rental charges Outside the LEA during the price control period, ComReg stated that it may consult with industry, as appropriate.

5.16 In the LEA we considered that such an obligation was not necessary as Eircom wholesale was less likely to increase wholesale Bitstream prices in the LEA in the presence of a margin squeeze test against retail prices, given that Eircom faces some competitive pressure in the LEA (from UPC and LLU providers).

3. <u>Retail margin squeeze test:</u>

5.17 In the LEA ComReg was of the preliminary view that a retail margin squeeze test would be required for the reasons set out in subsection 5.2.3 in Chapter 5 of the Consultation Document.

5.18 Outside the LEA ComReg questioned whether Eircom would have an incentive to cause a retail margin squeeze in the presence of a national cost orientation obligation and an obligation that Eircom should recover no more than its local efficiently incurred costs (plus a reasonable rate of return) regarding the provision of Bitstream services in the area Outside the LEA. While we considered that Eircom is unlikely to price below its actual cost on a vertically integrated basis and that cost orientation at the wholesale level should ensure that it cannot price squeeze without selling below actual cost adjusted for efficiency (plus a reasonable rate of return) we were of the preliminary view that there was good reasons why a retail margin squeeze test was required Outside the LEA. The reasons are set out in subsection 5.2.3 in Chapter 5 of the Consultation Document.

[36] The market share data is based on volume of subscribers as at 30 June 2013

5.2.2 Price control period and annual reviews

5.19 As set out in Chapter 5 (subsection 5.4) of the Consultation Document, ComReg was of the preliminary view that the price control period should be set for three years.

5.20 ComReg proposed that on an annual basis Eircom should compare the wholesale current generation Bitstream costs and revenues from its Regulated Accounts with the costs and revenues in the Bitstream cost model over the price control period.

5.21 The documentation relating to the reconciliation carried out by Eircom annually as well as the underlying supporting information would be provided to ComReg by the end of February in the year subsequent to the financial year end and for each year over the price control period.

5.22 Depending on the outcome of the annual review and the materiality of any changes required, ComReg stated that it may consult with industry, as appropriate.

5.2.3 Wholesale price notification and compliance procedures

5.23 As set out in Chapter 5 (subsection 5.5.) of the Consultation Document, ComReg proposed that Eircom should notify ComReg of any current generation Bitstream price changes, no later than three (3) months before the new price or the revised price is expected to come into effect. The only exception to this is where there is a wholesale price increase to an existing current generation Bitstream product / service then Eircom should notify ComReg, no later than four (4) months before the increased price is expected to come into effect.

5.24 The wholesale price notifications to ComReg would be in the form of email communication.

5.25 Therefore, where Eircom would decide to increase the price of its Bitstream and BMB monthly rental prices Outside the LEA or to introduce a new current generation Bitstream service Outside the LEA the following proposed notification and approval procedures would apply:

i) Eircom would notify ComReg, in writing by email, no later than four (4) months before it increases the monthly rental charge(s) for Bitstream and BMB Outside the LEA or no later than three (3) months before it launches a new current generation Bitstream product or service Outside the LEA;

ii) At notification, Eircom would furnish to ComReg a detailed written submission demonstrating that the proposed new or increased charge(s) recover no more than the actual incurred costs adjusted for efficiency (plus a reasonable rate of return) associated with that area i.e., Outside the LEA while also ensuring that it complies with the overriding national cost orientation obligation;

iii) The submission would make full and true disclosure of all material facts for the purpose of demonstrating that the proposed new or increased charge(s) recover no more than the actual incurred costs adjusted for efficiency (plus a reasonable rate of return) associated with that area i.e., Outside the LEA, while also ensuring compliance with the overriding national cost orientation obligation;

iv) Upon receipt of the submission[37], ComReg would review the submission and within one (1) month, communicate to Eircom its decision whether to give or withhold approval to implement the proposed new or increased charge(s). Such approval should not be unreasonably withheld by ComReg. Eircom would not implement any new or increased charge(s) for Bitstream and BMB Outside the LEA without having received such approval from ComReg;

v) Prior to the expiry of the one (1) month period, ComReg may seek further information from Eircom to inform its decision as to whether approval to implement the new or increased charge(s) should be given or withheld. If such further information is not provided by Eircom within ComReg's timeline or to the standard required by ComReg, approval to implement the proposed new or increased charge(s) may be withheld pending the required information being made available to ComReg for review and consideration. Upon receipt of the requested information, ComReg would proceed to make a decision as to whether approval for implementation of the new or increased charge(s) should be granted or withheld.

5.26 In the Consultation Document, ComReg asked the following question:

Q. 1 Do you agree with ComReg's preliminary views as set out above in Chapter 5 with regard to the proposed approach for current generation Bitstream and BMB services over the price control period? Please provide reasons for your response.

[37] Receipt of the submission requires an acknowledgement email from ComReg to Eircom

5.3 Views of respondents

5.27 All respondents generally agreed with the pricing approach for current generation Bitstream and BMB services subject to some minor concerns which are set out below.

5.28 **Eircom** stated that despite some outstanding concerns, it was in broad agreement with the proposed approach to the price control set out by ComReg in Chapter 5 of ComReg Consultation 13/90.

5.29 Eircom raised concerns in the preamble to its response that the last market review for the WBA market concluded more than two years ago and this market is now due for renewal. In particular, Eircom believes that ComReg may not at this time lawfully seek to amend or specify any obligation in respect of WBA without first undertaking a market analysis so that relevant developments in the competitive state of the market may be fully taken into account.

5.30 In addition, Eircom also raised some concerns that ComReg had not properly considered the interplay between the national cost orientation obligation and the application of the WBA Price Floors Decision. Its concern related to the protection of LLU investment. Eircom also believes that the WBA Price Floor Decision will require Eircom to price Bitstream above local cost in the more competitive areas of the market. The consequence being that Eircom would have no option but reduce the prices for current generation WBA sold into the less competitive market to a level below local cost. However, Eircom considered that this risk is offset by the trend that the Eircom BMB service is sold into a larger part of the market than has been used to set the WBA floor. This results in local BMB costs that may be close to or above the WBA floor.

5.31 **BT** agreed with ComReg’s proposed approach but had some concerns that the national cost orientation obligation could undermine the WBA Price Floors Decision. It asked for ComReg to clarify and re-consider the application of this aspect of the price control proposal to ensure it does not undermine the WBA price floor.

5.32 BT is also concerned that the split of Eircom's actual costs between the LEA and Outside the LEA may not be of a satisfactory quality to determine the LEA and Outside-the-LEA cost stacks and that Eircom may cross subsidise from less competitive areas into the LEA. BT and **ALTO** considers that the financial information and the Bitstream cost model should be independently verified. In addition, they both believe that the outcome of the annual reconciliation of Eircom’s National and Outside LEA cost review should be formally reported to the industry to understand the likelihood of pricing changes due to under or over recovery.

5.33 **Vodafone** while broadly supporting ComReg's pricing approach for WBA services made a number of comments as follows:

1) Vodafone questioned ComReg's position at paragraph 5.49 of the Consultation Document that it is a commercial decision for a dominant operator to reduce its prices below actual costs in an area which has distinct competitive characteristics.

2) Vodafone also questioned ComReg's reliance on a forward-looking view that there will be constraints on wholesale WBA prices in the LEA when the empirical evidence is that Eircom prices at a surplus to cost in the LEA, has not reduced its pricing to the levels permitted by the WBA price floor controls and when faced with effecting overall reductions in the composite price of an NGA/WLR bundle did so primarily through reductions in WLR pricing rather than allowing reductions in the price of CGA services.

3) Vodafone believes that ComReg's own assessment that Eircom is effectively using profits from services in areas where it faces competition to subsidise discretionary investment and costs in areas where it does not face competition is so counter intuitive that at a minimum it begs a more detailed analysis and explanation of the data upon which it is based.

5.34 **Magnet** raised the point that the price control (for the cost orientation obligation) is dependent on information solely from Eircom and that if this information is not sufficient that it would prove difficult to determine the appropriate cost stacks. Magnet also raised the point that a full market analysis should be carried out where data is provided from all operators in the market.

5.35 **Viatel** was also generally supportive of ComReg's approach but it made a number of comments as follows:

1) It considers that there is a potential market niche in the medium sized towns for the emergence of new alternative infrastructure providers and that extending the LEA zone to those areas could be detrimental to the emergence of competition.

2) While Viatel agrees with the 3 year price control, it believes that an interim review after 2 years should be carried out given the ongoing changes in the broadband market i.e., LTE, cable, etc.

3) Viatel also stated that where promotions are used and they satisfy the controls in place from a retail minus perspective, there is an underlying assumption that these promotions are paid and applied at the time the product is purchased. This is important as the SMP operator attracts retail customers by using such promotions therefore OAOs should also have the opportunity to know that such payments and credits will be applied as soon as possible to the point of sale. If this does not happen then it impacts cash flow of the business making future acquisition and retention activity more difficult. This is of particular concern to smaller operators.

5.36 **Sky** also generally agreed with ComReg’s proposed price control but raised some concerns as follows:

1) Sky believes that the Bitstream cost model should be kept under regular review so that the model remains relevant and appropriate. Sky refers to the fact that the model is based on the Eircom historic cost accounts for 2011/12 projected forward over the next three years but it raises the point that subsequent to 2011/12 Eircom announced its plan to reduce headcount by circa 2,000 staff by June 2014. Sky believes that such cost reductions may gain greater savings that the efficiency adjustment applied in the model of 5%.

2) Sky also stated that any price increases outside the LEA should be consulted on with the industry.

3) With regard to ComReg's statement that it “...*does not expect any material over/under-recovery to arise during the price control period*...”’, Sky requested ComReg to share any evidence that it has to the fullest extent possible in this regard with industry.

4) Sky referred to the recent ComReg Key Market Data Quarterly Report which indicates that DSL/Bitstream connections in Ireland reached their highest ever level, having increased by circa 10k in Q2 alone. Sky believes that if this trend were to continue, it suggests that Eircom wholesale’s pool of customers (CGA and NGA) will grow significantly and therefore, higher economies of scale ought to be achievable as a result. The Bitstream cost model needs to take account of these market developments as they arise.

5) Sky has also requested ComReg/Eircom to provide (at least) high level information on key sensitivities to changes in various underlying assumptions in the Bitstream cost model (e.g. volumes). This would inform stakeholders as to whether their own internal forecasting is in line with ComReg/Eircom's view, or where it is not, it can assist in business planning associated with such risks, especially where these have implications for underlying wholesale (input) prices.

5.4 ComReg's Assessment of Responses

5.37 Having considered the views of respondents, ComReg has set out its assessment of the issues raised by the respondents above under the relevant subject headings below.

Market analysis:

5.38 Eircom states that ComReg may not seek to amend or specify any obligation in respect to WBA without first undertaking a market analysis so that relevant developments in the competitive state of the market may be fully taken into account. ComReg notes Eircom's point regarding the market analysis for WBA but would like to point out that recital 15 of the Access Directive[38] expressly anticipates that remedies may be imposed on an SMP operator without requiring an additional market analysis, as long as a justification that the obligation in question is appropriate and proportionate in relation to the nature of the problem identified. The review of the WPNIA and WBA markets has commenced and is currently at an early phase. If as a result of the outcome of these market reviews it is clear that changes are required to the remedies already in place then adjustments will be made accordingly. In the meantime, we have analysed and updated the WBA Market Decision with market information available, both retail and wholesale market shares, for the purposes of amending and further specifying the price control remedy for current generation services in the WBA market.

[38] Directive 2002/19/EC. " The imposition of a specific obligation on an undertaking with significant market power does not equire an additional market analysis but a justification that the obligation in question is appropriate and proportionate in relation to the nature of the problem identified."

WBA Price Floors Decision:

5.39 BT and Eircom have concerns that the national cost orientation obligation would undermine the WBA Price Floors Decision thereby creating economic harm to those operators using LLU. BT asked for ComReg to clarify and re-consider the application of this aspect of the price control proposal to ensure it does not undermine the WBA price floor. However, ComReg would like to clarify that there is no specific cost orientation obligation imposed on the LEA but rather a national cost orientation obligation. In practice, the cost orientation obligation will most likely not bind in the LEA such that price changes will be necessary. We consider that this is because there are greater retail price pressures in the LEA which in the presence of a retail margin squeeze test, exert downward pressure on wholesale prices. While Eircom can reduce its prices in the LEA it must at all times comply with the WBA price floors i.e., Eircom cannot price below the WBA price floors.

Costing data and assumptions in the Bitstream cost model:

5.40 A number of respondents raised concerns that the data used in the Bitstream cost model is sourced from Eircom only and that it would be necessary to independently verify this information. ComReg notes that the information contained in the Bitstream cost model is based on Eircom's historic cost accounts which have been audited by PricewaterhouseCoppers ("**PwC**") in line with the accounting separation obligations set out in ComReg Decision D08/10[39]. The data and assumptions contained in the Bitstream cost model have been reviewed by independent consultants, TERA and by ComReg and we consider that this is sufficient for the purposes of this review.

5.41 Sky raised some concerns that the 5% efficiency adjustment applied to the Bitstream costs in the Bitstream cost model may not be sufficient given the headcount cost reductions in recent years and that such cost reductions may gain greater savings that the efficiency adjustment applied in the model of 5%. ComReg would like to point out that the annual review should assess material differences between the costs in the Bitstream cost model and the actual costs reported for current generation Bitstream in the historic cost accounts. This should be sufficient to address any significant differences in costs over the price control period.

[39] ComReg Document No 10/67 entitled "Accounting Separation and Cost Accounting Review of Eircom Limited" dated 31 August 2010.

5.42 Sky referred to the recent increase in DSL/Bitstream connections and stated that such market developments need to be reflected in the Bitstream cost model. ComReg notes that the number of customers on Eircom's network has slightly increased but to a lesser extent than that stated by Sky. In addition, ComReg would like to clarify that the relevant volumes for the purposes of the Bitstream cost model are current generation Bitstream volumes only. ComReg has assessed the recent change in volumes for current generation Bitstream services while also taking into account the actual Bitstream costs for 2013 (based on Eircom's historical cost accounts for 2013) compared with the forecasted volumes and costs in the Bitstream cost model. At this point we consider that no price changes are necessary given that no material differences arise between the actual costs and volumes for current generation Bitstream and the forecasted costs and volumes in the Bitstream cost model over the duration of the Bitstream cost model (which is based on forecasted costs and volumes up to end of December 2016). However, we will continue to monitor this as part of the annual review.

5.43 With regard to Sky's point that ComReg should provide high-level sensitivities to changes in the main underlying assumptions in the Bitstream cost model, ComReg would like to point out that the Bitstream cost model is a mechanism for assessing Eircom's recovery of costs and not a model for setting Bitstream prices per se. The methods used for forecasting the costs and volumes in the Bitstream cost model have been discussed in the consultation and we are of the view that industry has had sufficient visibility of the key inputs subject to the requirement to maintain commercial confidentiality.

5.44 A number of respondents also questioned the accuracy of the split of Bitstream costs between the LEA and the area Outside the LEA in the Bitstream cost model. As already set out in the Consultation Document, the current split between the LEA costs and the costs Outside the LEA is tentative until such time as the actual cost information by area is available from Eircom. However, the outcome of the split of costs between LEA and Outside the LEA is not surprising as networks generally demonstrate the characteristics that more densely populated areas are <u>cheaper per customer to build than more rural areas</u>. Consequently, ComReg considers that to set prices based on cost in each area could have negative effects on take-up. In the interim and absent the information from Eircom we have had to make a number of assumptions in the Bitstream cost model to arrive at indicative cost estimates by area, both LEA and Outside the LEA. Therefore, our view on the split of costs between the LEA and Outside the LEA is not conclusive. However, where Eircom wishes to introduce a new or increased price for Bitstream and BMB Outside the LEA it will be required to justify the proposed prices based on costs on a sufficiently robust disaggregated basis.

5.45 Vodafone questioned ComReg's position at paragraph 5.49 of the Consultation Document that it is a commercial decision for a dominant operator to reduce its prices below actual costs in an area which has distinct competitive characteristics. As already set out in paragraph 5.49 of the Consultation Document, Eircom may price below actual costs so long as it complies with the WBA Price Floors Decision as well as competition law. This pricing regime therefore gives Eircom some flexibility in the LEA while preventing Eircom from setting Bitstream prices so low such that they could discourage investment in LLU.

5.46 Vodafone also questioned ComReg's assessment that wholesale Bitstream prices in the LEA are constrained when Eircom is in fact pricing at a surplus to the cost in those areas and has not reduced its prices to the WBA price floors. ComReg would like to point out that Eircom's wholesale prices in the LEA are constrained by virtue of the retail minus / retail margin squeeze control in place. Absent regulation, this constraint would not feed through to wholesale Bitstream prices. In addition, where Eircom's prices are above the WBA price floors, then this should give further ability to OAOs to use LLU to compete more strongly with Eircom in the LEA.

5.47 Vodafone also claimed that ComReg's view that Eircom is effectively using profits from services in areas where it faces competition to subsidise discretionary investment and costs in areas where it does not face competition is so counter intuitive that it begs a more detailed analysis and explanation of the data upon which it is based. ComReg would point out that it is the norm across other telecoms services and indeed across other utility service companies where there is geographically averaged pricing that there may be an ability to cross-subsidise higher cost areas with revenues attained in lower cost areas. For example, this is the case for WLR services sold by Eircom. In addition, it should be noted that while the WBA market is national in scope we have recognised that there are different competitive dynamics geographically, as discussed above in Chapter 4.

Promotions:

5.48 Viatel raised some concerns that promotions from the SMP operators are not paid (or credited) at the time the product is purchased and that this impacts the cash flow of smaller operators business making future acquisition and retention activity more difficult. ComReg is of the view that this issue is beyond the scope of Decision Document but that Viatel should consider raising this issue either bilaterally with Eircom or separately with ComReg.

Price control period:

5.49 Viatel believes that an interim review after 2 years should be carried out given the ongoing changes in the broadband market. ComReg considers that the price control period should remain in place until we consider that a further review is necessary. A period of at least two years seems appropriate as this should ensure that ComReg has conducted a market review for what is now Market 5 and in addition ComReg should have also completed the Access Network Review while taking utmost account of the Commission's Non-discrimination and Costing Methodologies Recommendation. Therefore, the price control period should remain in place until further notice by ComReg but in any event it should be in place for at least the next two years.

5.50 ComReg considers that the annual review of the Bitstream cost model should also provide the market with reasonable price certainty and stability.

Other:

5.51 Viatel considered that there is a potential market niche in the medium-sized towns for the emergence of new alternative infrastructure providers and that extending the scope of the LEA to those areas could be detrimental to the emergence of competition. The LEA criteria have been determined by a separate decision, the Bundles Decision, published in ComReg Decision D04/13 (ComReg Document No 13/14) earlier in 2013, without legal appeal. The criteria regarding the LEA have not been re-opened as part of this consultation process.

5.52 With regard to Sky's point that ComReg should consult with the industry on price increases for current generation Bitstream Outside the LEA, ComReg notes Eircom's entitlement under the Access Regulations[40] to earn a reasonable rate of return on its efficiently incurred costs. Consequently, the precise level of prices to ensure compliance with Eircom's cost orientation obligation is not necessarily a matter for formal regulatory consultation. Naturally ComReg will continue to seek to understand the impact of prices changes on all affected parties.

5.53 Sky also requested clarification from ComReg on the statement that it "...*does not expect any material over/under-recovery to arise during the price control period*...". ComReg makes this observation because the Bitstream cost model includes forecasts of Bitstream costs and forecasts of volumes of customers and these indicate that current prices allow for the recovery of costs over the price control period. Of course this will be monitored to ensure that outturns are reasonably in line with expectation.

[40] Regulation 13(2) of the European Communities (Electronic Communications Networks and Services) (Access) Regulations 2011.

5.5 ComReg's Final Position:

5.54 A detailed justification of the price control proposal was set out in the Consultation Document. In this Decision Document we have considered the views of respondents and how this would impact on the price control obligation being imposed on Eircom. ComReg has not restated its justification from the Consultation Document in this Decision Document where no change to the obligations is considered relevant.

5.55 Further to our notification to the Commission on 4 March 2014 and the views expressed by the Commission in its response letter received by ComReg on 4 April 2014 we have taken utmost account of the comments received as set out in detail in Annex 4 of this Decision Document. The Commission invited ComReg to reconsider the imposition of cost oriented prices based on HCA, and to incorporate the pricing review with respect to the core network in its ongoing access network review. While ComReg accepts the invitation to reconsider the imposition of cost orientation, in the interim and until such time as the Access Network Review is complete we believe that the cost orientation obligation should be imposed in the WBA market for the reasons set out in Annex 4.

5.56 In addition, the Commission called on ComReg to set out clearly in the finally adopted measure how the proposed differentiated cost-orientation obligation and the margin-squeeze tests will interact with the WBA price floor in both the LEA and Outside the LEA, in order to increase transparency and predictability with regard to the regulated prices. To clarify, Eircom must ensure that it does not set its Bitstream prices below the national WBA price floors. In fact the WBA price floors are in place to prevent the Bitstream prices from being set so low that they might foreclose economically efficient alternative investment by other operators. As such, Eircom is required to ensure that it complies with both the retail margin squeeze test (see Chapter 7) and the WBA Price Floors Decision. If, for competitive reasons, it wishes to reduce retail prices, then complying with both tests may require it to reduce both WBA prices and prices for services that are inputs to the WBA price floors model (such as LLU). However, any such changes would require ComReg review and/or approval.

5.57 Since publication of the Consultation Document we have reconsidered the duration of the price control period of three years. Instead we consider that the price control period should remain in place until ComReg considers that a further review is necessary. In any event the price control period should be in place for a duration of at least two years. This should ensure that ComReg has conducted a market review for what is now Market 5 and in addition ComReg should have also completed the Access Network Review. Therefore, the price control period should remain in place until further notice by ComReg.

5.58 We would also like to clarify that as part of the annual review by Eircom of actual Bitstream costs and volumes to the forecasted Bitstream costs and volumes in the Bitstream cost model, we consider that Eircom should provide ComReg with a split of Bitstream costs between current generation and next generation services given the likely migration to NGA services going forward. It is important for ComReg to understand the split of Bitstream costs between current and next generation services so that we can compare the actual reported current generation Bitstream costs from the accounts to the current generation forecasted costs in the Bitstream cost model. In this regard, for the year ending June 2014 going forward and as part of the annual reconciliation of actual current generation Bitstream costs (from Eircom's accounts) to the forecasted current generation Bitstream costs in the Bitstream cost model, Eircom should provide a split of its annual Bitstream costs (per Market 5) as follows:

- NGA specific Bitstream costs
- Non-NGA specific Bitstream costs
- Shared asset costs i.e., backhaul service used by both current generation and next generation service — with costs split between those allocated to NGA and costs allocated to non-NGA.

5.59 Eircom should consider the most appropriate basis for determining the split of shared asset costs between current generation and next generation Bitstream services so that it is clearly understood by ComReg and Eircom. For example, Eircom may consider the capacity used by the different services in order to determine the appropriate split between both services. Eircom's decision on how it defines the split of costs between shared assets should be discussed with ComReg in advance of implementation in the historical cost accounts for 2014.

5.60 In addition, there were some minor comments raised by respondents in their response to the question around the draft Decision Instrument which related to the wording of the obligations set out in this Chapter. The respondents' comments are set out in Annex 2 of this Decision Document as well as ComReg's views on each one. With regard to the obligation to recover no more than local costs (adjusted for efficiencies plus a rate of return) Outside the LEA, we have clarified in the Decision Instrument that such costs should be derived from Eircom's historical costs accounts and forecasted forward over the duration of the Bitstream cost model. This is consistent with our views set out in the Consultation Document.

5.61 Please refer to subsection 12.3 and 12.4 in Chapter 12 of this document for a detailed discussion on how the price control obligations set out below meets our regulatory objectives as well as being consistent with Regulation 13 of the Access Regulations.

5.62 We have set out below the details of the obligations that Eircom must comply with as a result of this Decision.

5.5.1 Appropriate form(s) of price control for Bitstream

National cost orientation obligation:

5.63 Eircom should be subject to a cost orientation obligation with regard to the monthly rental charges for current generation Bitstream and BMB products and services which are provided within the WBA market.

5.64 Eircom should ensure that it recovers no more than its total actual incurred cost adjusted for efficiency (plus a reasonable rate of return) associated with the provision of current generation Bitstream and BMB nationally, in line with the Bitstream cost model. Such costs should be derived from Eircom's historical costs accounts, forecasted forward over the duration of the Bitstream cost model.

Obligation regarding the recovery of local costs Outside the LEA:

5.65 Eircom should ensure that it recovers no more than its actual incurred cost, adjusted for efficiency (plus a reasonable rate of return) associated with the provision of current generation Bitstream and BMB services Outside the LEA which shall be calculated in line with the Bitstream cost model. Such costs shall be derived from Eircom's historical costs accounts, forecasted forward over the duration of the Bitstream cost model.

Retail margin squeeze test:

5.66 Eircom should be subject to an *ex ante* retail margin squeeze test in the LEA and Outside the LEA. The retail margin squeeze tests are further specified in Chapter 7 of the document.

5.5.2 Price control period and annual review:

5.67 The price control period will last for at least the next two years but in any event it will remain in place until further notice by ComReg. A period of at least two years should ensure that ComReg will have conducted a market analysis for what is now Market 5. In addition, the Access Network Review should also be completed at that point which will take account of the Commission's Non-discrimination and Costing Methodologies Recommendation.

5.68 Eircom should submit annually to ComReg a written statement reconciling the costs it actually incurs in the provision of Bitstream and Bitstream Managed Backhaul for the preceding financial year with the forecasted costs and revenues contained in the Bitstream Cost Model for current generation Bitstream services. Eircom should provide a written statement explaining the extent, if any, of any such discrepancy between the actual costs and revenues and the forecasted costs and revenues in the Bitstream Cost Model over the duration of the Bitstream cost model[41]. The written statement should be provided to ComReg in accordance with the procedure which governs the provision of Additional Financial Information contained in the Decision Instrument annexed to ComReg Decision D08/10 and should be provided no later than seven months after the end of the financial year. Please note the requirement on Eircom to provide a split of the Bitstream costs between current generation costs and next generation costs as discussed in subsection 5.5 above.

5.5.3 Wholesale price notification and compliance procedures:

National price notification and compliance procedures:

5.69 Eircom should unless otherwise agreed by ComReg, make publically available and publish on Eircom's publically available wholesale website at least three (3) months in advance of coming into effect, any proposed price increase to an existing Current Generation WBA product, service or facility. Eircom should notify ComReg in writing by email with the information to be published at least one (1) month in advance of any such publication taking place, that is, four (4) months prior to any amendments or changes coming into effect. These notification periods may be varied with the agreement of ComReg or at ComReg's discretion.

Price notification and compliance procedures Outside the LEA:

5.70 Eircom should notify ComReg, in writing by email, no later than four (4) months before it increases the monthly rental charge(s) for current generation Bitstream and BMB Outside the LEA.

5.71 At notification, Eircom should furnish to ComReg a detailed written submission demonstrating that the proposed new or increased charge(s) comply with the national cost orientation obligation as well as the obligation to recover no more than its local costs Outside the LEA. The submission should make full and true disclosure of all material facts for the purpose of demonstrating that the proposed new or increased charge(s) comply with the national cost orientation obligation and the obligation to recover no more than local costs

[41] The model is based on forecasted data (costs, revenues and volumes) up to the end of December 2016.

Outside the LEA. Upon receipt of the submission, ComReg should review the submission and within one (1) month, communicate to Eircom its decision whether to give or withhold approval to implement the proposed new or increased charge(s). Such approval shall not be unreasonably withheld by ComReg. Eircom should not implement any new or increased charge(s) for Bitstream and BMB Outside the LEA without having received such approval from ComReg. Prior to the expiry of the one (1) month period, ComReg may seek further information from Eircom to inform its decision as to whether approval to implement the new or increased charge(s) should be given or withheld. If such further information is not provided by Eircom within ComReg's timeline or to the standard required by ComReg, approval to implement the proposed new or increased charge(s) shall be withheld pending the required information being made available to ComReg for review and consideration. Upon receipt of the requested information, ComReg will proceed to make a decision as to whether approval for implementation of the new or increased charge(s) should be granted or withheld. The notification periods referred to above may be varied with the agreement of ComReg or at ComReg's discretion.

5.72 For the avoidance of doubt, approval in this context means that ComReg is of the view (based on the information provided to it by Eircom) that the notified wholesale Bitstream and BMB product(s) does not appear to breach the obligations set out in this Decision. The granting of approval does not amount to a definitive finding by ComReg that a particular wholesale Bitstream or BMB product is compliant, or will remain compliant in the future, with the cost orientation obligations set out in this Decision. It should be noted that the granting of approval is strictly without prejudice to ComReg's right to take action (whether pursuant to this Decision and/or pursuant to any of its relevant statutory enforcement powers) in respect of any wholesale Bitstream and BMB products that it believes may be non-compliant with Eircom's regulatory or competition law obligations. It is incumbent on Eircom to ensure that all wholesale Bitstream and BMB products remain compliant with this Decision at all times.

Chapter 6

6 Costing Methodology and Bitstream Cost Model

6.1 Introduction:

6.1 In this chapter we discuss the details of the modeling approach, as well as the inputs and assumptions used to determine the Bitstream cost model. The Bitstream cost model should be used by Eircom to ensure that it recovers no more than its national Bitstream costs adjusted for efficiency (plus a reasonable rate of return). The Bitstream cost model should also be used by Eircom and ComReg to monitor compliance with Eircom's national cost orientation obligation.

6.2 The rest of this chapter looks at ComReg's preliminary views from the Consultation Document, the views of respondents, ComReg's assessment of respondents' views and ComReg's final position on the following key points:

- Costing methodology
- Cost modelling approach
- Usage/throughput price Outside the LEA.

Costing Methodology:

6.2 ComReg's Preliminary Views from the Consultation

1. Appropriate cost standard:

6.3 In Chapter 6 (subsection 6.2.1) of the Consultation Document ComReg considered that the fully allocated cost ("**FAC**") approach should be adopted in the Bitstream cost model, as opposed to long run incremental costs ("**LRIC**"), Long run average incremental costs ("**LRAIC**") or LRAIC plus a mark-up for common costs ("**LRAIC+**").

6.4 ComReg was of the preliminary view that the FAC approach would result in a price signal which has the advantage of being relatively consistent with the recorded investments incurred by Eircom. In the FAC approach the whole set of costs incurred by Eircom are typically allocated to products following allocation rules determined by the direct and indirect causality of costs with products. This approach includes fixed and common costs.

6.5 Please refer to Chapter 6 (subsection 6.2.1) of the Consultation Document for a further discussion on each option.

2. Historical costs or current costs:

6.6 In Chapter 6 (subsection 6.2.2) of the Consultation Document ComReg considered that historic costs should be used as opposed to current costs on the basis that historic costs may be more pragmatic and practical especially where there are limited prospects of investment by alternative infrastructure i.e., especially with regard to the area Outside the LEA.

6.7 Current costs would ensure that Eircom recovered its future costs thereby encouraging investment. This would mean that a potential entrant is charged an access price in principle similar to what it might pay to build its own network, and thus has a finely balanced 'build-or-buy' decision. ComReg was of the preliminary view that the current cost approach would be particularly relevant in the more competitive areas of the country i.e., the LEA.

6.8 On the other hand ComReg was of the preliminary view that the historic costs would use Eircom's costs, which would reduce the chance of under/over recovery of costs as the value is linked to the actual investment made. Some of Eircom's assets may be fully depreciated but still in use and this approach should ensure that Eircom is not over recovering the costs for these assets.

6.9 Please refer to Chapter 6 (subsection 6.2.1) of the Consultation Document for a further discussion on each option.

6.10 Please refer to subsection 6.2.2 in Chapter 6 of the Consultation Document for a further discussion on the *Arcor*[42] case and its relevance with regard to this decision.

3. <u>Appropriate cost model:</u>

6.11 In Chapter 6 (subsection 6.2.3) of the Consultation Document ComReg considered that the preferred option for the cost model was a hybrid model which is based on top down ("**TD**") data (using Eircom's costs from the historical cost accounts) and which incorporates dimensioning / engineering rules and assumptions from Eircom in order to apportion the costs in the model. ComReg considered that this approach should give incentives to Eircom to invest in areas Outside the LEA as any further investment by Eircom could be recovered through the Bitstream prices so long as they can objectivity justify the actual cost invested adjusted for efficiency.

6.12 The other option - a BU model - is aimed at promoting efficient entry, since the BU cost model can consider how a network would be built today, rather than modelling the actual network built. ComReg was of the preliminary view that while pure BU models allow for the calculation of the efficient costs of providing a Bitstream service the main risk of this approach is that it could reward Eircom for investment that did not take place, especially Outside the LEA.

6.13 Please refer to subsection 6.2.3 of the Consultation Document for further details on the difference between the two models.

6.14 In the Consultation Document ComReg then asked the following question:

Q. 2 Do you agree with ComReg's preliminary views regarding the appropriate costing methodology for the Bitstream cost model? Please provide reasons for your response.

6.3 Views of Respondents

6.15 All respondents generally agreed with the costing methodology for the Bitstream cost model. However, some operators made a number of comments which are set out below:

6.16 **Eircom** stated that:

[42] The judgment of the European Court of Justice ("the ECJ")delivered on 24 April, 2008 in Case C-55/06 Arcor AG & Co. KG v Federal Republic of Germany on 24 April, 2008.

"Eircom agrees that the costing methodology is broadly appropriate. ComReg has chosen a hybrid model with top down input cost data but with a network dimensioned on the basis of engineering rules rather than based on Broadband equipment actually deployed by eircom. The transmission network has been modelled based on eircom historic costs forecast over three years with a reasonable assumption around future efficiencies. Use of the FAC basis ensures that the service takes an appropriate allocation of joint and common costs. This combination is the appropriate one to test cost orientation in the areas outside the LEA where competitive entry based on an alternative investment is unlikely...".

6.17 Eircom discussed in some detail the reason why a different model is required for the provincial areas beyond the reach of an efficient LLU investment. Eircom stated that this model (i.e., the Bitstream cost model) has correctly been built from Eircom's actual costs with some adjustments for efficiency. Eircom also discussed in some detail the main reasons why the WBA price floors model used to ensure sufficient economic space for an efficient LLU investment in urban areas is not the appropriate cost model to assess Eircom Bitstream prices nationally against any possibility of excessive levels.

6.18 **BT** stated that:

"*The Eircom current generation broadband network is now mature hence we agree with ComReg that its total modelled costs should generally reflect its actual total costs. We agree a present day replacement cost model could overvalue the network and would be inappropriate other than for network upgrades. We therefore agree cross checking costs against statutory accounts is valid*."

6.19 A number of respondents, including BT, Magnet and ALTO reiterated its concerns about the quality of the geographical split in the Bitstream cost model between the LEA and Outside the LEA.

6.20 **Vodafone** agreed with ComReg on the proposed methodology but noted the following concerns:

1) The use of a FAC approach would not allow an apportionment which was sufficiently rigorous to prevent OAOs paying for cost elements which were not related to the wholesale services that they are buying

2) A cost oriented price as a principle does not permit the introduction of wholesale discounts or promotions going forward. If the pricing for an average unit recovers the average cost associated with that unit then any discount to the price of that unit cannot be recovering its cost allocation.

6.21 **Sky** agreed with ComReg's general approach to cost modeling but made some comments as follows:

1) While Sky agreed that the Bitstream cost model should be dimensioned based on engineering and capacity rules of Eircom's actual network, Sky stated that this is dependent on Eircom managing its network in accordance with these same rules and in accordance with international best practice. However, according to Sky there is evidence that Eircom has not been managing its network in accordance with its own engineering rules based on recent developments and that ComReg is currently investigating this issue.

2) Sky also raised the issue of verification of Eircom's cost data in the Bitstream cost model. Sky has concerns that Eircom may have greater scope for inappropriate allocation of costs to Outside the LEA.

6.22 **Viatel** also agreed with ComReg but it noted some issues as follows:

1) Viatel sought more clarification on how ComReg will "dimension" the hybrid model with engineering and capacity rules based on actual network alignment.

2) Viatel also stressed that there should be independent verified confirmation that the historic cost accounting data is accurate and reflective of the actual costs being incurred by Eircom.

3) Viatel also questioned whether there are costs included in the Bitstream cost model that may be common to both traditional WBA and NGA services.

6.4 ComReg's Assessment of Responses

6.23 Having considered the views of respondents, ComReg has set out its views under the relevant subject headings below.

<u>Costing data</u>:

6.24 A number of respondents raised concerns about verification of the historic cost accounting data used in the Bitstream cost model regarding the split of costs between the LEA and Outside the LEA. This point has already been addressed at subsection 5.4 above (paragraphs 5.40-5.47). With regard to Sky's concerns that Eircom may have greater scope for inappropriate allocation of costs to Outside the LEA, it is important to note that by virtue of this Decision Document Eircom shall not recover any more than local efficient costs (plus a reasonable rate of return) in the area Outside the LEA and therefore this should prevent any concerns around over recovery of costs or excessive pricing Outside the LEA. In addition, where Eircom propose to increase its Bitstream prices Outside the LEA it would be required to provide ComReg with the appropriate disaggregated costing information to justify the cost of provision of Bitstream Outside the LEA.

6.25 Further to Vodafone's point about using a fully allocated cost (FAC) cost standard, ComReg would like to point out that a detailed assessment of the costs in Eircom's historic cost accounts has been conducted by ComReg and TERA to ensure that the relevant costs are included. Therefore, we are satisfied that the FAC approach is the appropriate methodology to adopt. The other option would be a BU approach but this would not reflect Eircom's actual costs.

6.26 Viatel questioned whether there are costs included in the Bitstream cost model that may be common to both current generation WBA and NGA services. ComReg would like to clarify that NGA was only launched in May / June 2013. Therefore, Eircom historical cost accounts up until 30 June 2013 would not include any significant level of NGA costs. However, going forward and as part of the planned annual review it is important that Eircom can provide ComReg with a split of the Bitstream costs between current generation and next generation services so that ComReg can assess any movements between the actual current generation Bitstream costs from its accounts to the forecasted current generation Bitstream costs in the Bitstream cost model. This has been discussed in some detail in Chapter 5 (subsection 5.5) above.

<u>Cost orientation and allowance for promotions and discounts</u>:

6.27 Vodafone raised the point that a cost oriented price should not permit the introduction of wholesale discounts or promotions going forward on the basis that if the pricing for an average unit recovers the average cost associated with that unit then any discount to the price of that unit cannot be recovering its cost allocation. ComReg would like to clarify that discounts and promotions are acceptable so long as they are not discriminatory and do not create a margin squeeze. It is important to note that the cost orientation obligation relates to all current generation Bitstream services in the WBA market. Therefore, recovery of costs is assessed across the aggregate of current generation Bitstream products provided in the market. It is therefore unnecessary to show that an average unit recovers the average cost associated with that unit; it is total costs that ComReg is concerned about. Furthermore, while discounts and promotions are limited in duration, costs are assessed over the medium term to long-term. ComReg also considers that promotions and discounts are good for competition in the market, can boost volumes and revenues for operators and can benefit end-users where such discounts are passed through to the retail level.

<u>Network dimensioning</u>:

6.28 Sky claims that Eircom has not been managing its network in accordance with its own engineering rules. While ComReg recognises that the particular issue raised by Sky is being addressed separately as part of the Industry Bitstream Forum, ComReg, along with industry will continue to closely monitor this issue. In any event we currently consider that the inputs and assumptions of the Bitstream cost model are reasonable but these will be continuously monitored during the price control period.

6.29 With regard to the point raised by Viatel on clarification of how the network will be dimensioned ComReg would like to point out that the costs in the Bitstream cost model are based on Eircom's accounting system (and in accordance with its audited accounts). The Bitstream cost model uses a cost driver (i.e., number of DSLAM per site, size of backhaul links, etc.) to allow for the allocation of Eircom's national Bitstream costs between LEA and non LEA areas. It also allows us to forecast Eircom's national costs over the duration of the Bitstream cost model (that is up to the end of December 2016). As a consequence, the capacity and engineering rules are not used to set the costs but to set the cost drivers which allows for the allocation of costs geographically and to forecast the costs going forward. Paragraphs 6.3.5, 6.3.6 and 6.3.7 of the Consultation Document further specify these rules. It is not possible to go into any further detail on Eircom’s application of its engineering rules for confidentiality reasons.

6.5 ComReg's Final Position

6.30 A detailed justification of the appropriate costing methodology for the national cost orientation obligation for current generation Bitstream services was set out in the Consultation Document. In this Decision Document we have considered the views of respondents and how this would impact on the price control obligation being imposed on Eircom. ComReg has not restated its justification from the Consultation Document in this Decision Document where no change to the obligations is proposed.

6.31 Further to our notification to the Commission on 4 March 2014 and the views expressed by the Commission in its response letter received by ComReg on 4 April 2014 we have taken utmost account of the comments received as set out in detail in Annex 4 of this Decision Document. The Commission is concerned that the proposed use of HCA in calculating the cost-orientated price (albeit only as regards core network elements) does not allow the SMP operator a sufficient and stable return on investment Outside the LEA, where it is most likely that the cost-orientation will actually apply. The Commission stressed the importance of maintaining the correct build-and-buy signals in order not to foreclose potential investment altogether, including from new market players. In this context, the Commission referred to the possible market entry as announced by the ESB.

6.32 We have taken utmost account of this point as discussed in Annex 4. In essence we consider that the reason for choosing the HCA methodology as opposed to the BU-LRAIC+ methodology is mainly due to the fact that in the absence of alternative network competition the BU-LRAIC+ approach may encourage Eircom to "sweat" its assets in areas Outside the LEA resulting in excessive pricing relative to its actual investment without any benefit to end users in terms of alternative platform based investment. Given the extent of depreciated assets (i.e., DSLAMs and BRAS) in Eircom's core network and the fact that these assets may not be replaced by Eircom, the BU-LRAIC+ methodology could give rise to significant increases in wholesale and retail legacy broadband prices Outside the LEA in the medium-term. This would be detrimental to end-users and wholesale operators that have no alternative options for broadband provision other than purchasing these services from Eircom. While BU-LRAIC+ may be useful in setting appropriate "build or buy" signals for other networks this consideration is less important Outside the LEA (rural areas) in Ireland at least.

6.33 On the other hand the use of the HCA methodology will allow Eircom to recover any money invested in maintaining or upgrading its network on that basis that Eircom will have the assurance that what is spends can be recouped over the price control period — particularly Outside the LEA (e.g., operating expenditure adjusted for efficiencies associated with maintenance expenditure and any relevant depreciation charges associated with capital expenditure). Therefore, Eircom’s investment incentives are not negatively affected by this Decision and it may in fact encourage investment Outside the LEA. It is also important to point out that this Decision on current generation Bitstream will not impact on NGA investment such as that of the ESB as ultimately the WBA Price Floors Decision provides the appropriate “build or buy” incentives in that regard.

6.34 Please refer to subsection 12.3 and 12.4 in Chapter 12 of this document for a detailed discussion on how the price control meets our regulatory objectives and also discussion on the choice of costing methodology.

6.35 We have set out the details of the costing methodology obligations that Eircom must comply with as a result of this Decision.

6.5.1 Costing methodology

Appropriate cost standard:

6.36 The appropriate cost standard for the Bitstream cost model should be the fully allocated cost (“FAC”) approach.

Historic costs or current costs:

6.37 The appropriate cost base for the Bitstream cost model should be Eircom’s historical costs (plus a reasonable rate of return) forecasted forward over the duration of the Bitstream cost model (that is up to the end of December 2016) and adjusted for efficiencies where appropriate. The same cost base should apply for costs Outside the LEA.

Appropriate cost model:

6.38 The Bitstream cost model should be a hybrid model with top down cost data with the use of a cost driver (i.e., number of DSLAM per site, size of backhaul links, etc.) to allow for the allocation of Eircom's national Bitstream costs between LEA and non LEA areas. As a consequence, the capacity and engineering rules are not used to set the costs but to set the cost drivers which allows for the allocation of costs geographically and to forecast the costs going forward.

Cost Modelling Approach:

6.6 ComReg's Preliminary Views from the Consultation

6.39 As set out in Chapter 6 (subsection 6.3.2) of the Consultation Document, the costs in the Bitstream cost model are taken from Eircom's 2011/12 historic cost accounts, with a further breakdown provided to ComReg through the Additional Financial Information ("**AFI's**")[43] to achieve the necessary level of detail to arrive at national unit costs. These costs are specific to Eircom's core/ transmission network.

6.40 In Chapter 6 (subsection 6.3.2) of the Consultation Document ComReg listed the relevant costs that were included in the Bitstream cost model as follows:

- Digital Subscriber Line Access Multiplexer (DSLAM) Costs
- Broadband Remote Access Server (BRAS) Costs
- Repair and Maintenance Costs
- Line Share/Local Loop Contribution Cost
- Aggregation Node and Transmission Costs

6.41 The costs NOT included in the Bitstream cost model were the following:

- Installation and Provisioning Costs
- Carrier Billing and Administration Costs

6.42 The equipment based costs listed above (DSLAM, BRAS & Aggregation Nodes) included the following cost categories:

- Depreciation/Capital Costs
- Network Building Costs
- Network Power and Air-Conditioning Costs
- Field staff: Operating and Maintenance Costs
- Other Direct Operating and Maintenance Costs
- Indirect and Common Costs.

[43] Eircom is obliged to provide AFI's to ComReg annually as set out in ComReg D08/10, Accounting Separation and Cost Accounting Review

1. **Assessment of Costs for Efficiency:**

6.43 In Chapter 6 (subsection 6.3.3) of the Consultation Document, ComReg considered that the costs reported in Eircom's AFIs could be considered as a reasonable representation of efficient costs as Eircom had purchased broadband equipment in a market where infrastructure competition exists in the LEA. Due to the competitive pressures from other operators such as BT, Magnet and UPC (amongst others), ComReg was of the preliminary view that there may be a sufficient incentive for Eircom's expenditure (capital and operational) in the core network to be reasonably efficient.

6.44 ComReg proposed to include an annual efficiency adjustment of approximately 5% to the forward looking operating costs in the Bitstream cost model. ComReg considered that this efficiency should be achieved in the coming years where ComReg notes for example that there had been recent staff reductions, reductions in rents, other general reductions to costs as a result of the economic downturn in Ireland.

2. **Model Layout/Architecture:**

6.45 As set out in Chapter 6 (subsection 6.3.4) of the Consultation Document, ComReg was of the preliminary view that charging regime should be the same as the one already implemented in the WBA Price Floors Decision. Therefore, the proposed Bitstream cost model would be based on the following:

- Cost Per Port
    - Monthly per port cost per user – the fixed cost associated with running the network.
- Cost of backhaul
    - Monthly Backhaul costs per user – a fixed portion of the cost of backhaul based on the level of Bandwidth usage per user.
    - Monthly Backhaul costs per Mbps – a variable cost raised at the 95th percentile of the 5 minute readings in any calendar month.

6.46 The Bitstream cost model establishes a national unit cost per subscriber for the provision of Bitstream services. The Bitstream cost model looks at Eircom's network equipment and usage costs and attributes these costs to each exchange based on different dimensioning rules.

6.47 The proposed layout of the Bitstream cost model and the process by which the national unit cost per subscriber is calculated is set out in a graph in Figure 6.1 in the Consultation Document.

3. Model Input: Network Demand

***Total No. of Subscribers*:**

6.48 As set out in Chapter 6 (subsection 6.3.5) of the Consultation Document Eircom provided ComReg with the proposed demand forecast for the total number of likely active subscribers on Eircom's network (i.e., Eircom retail + Wholesale Bitstream) over the price control period. This was used to project forward the number of active subscribers in each exchange. The subscriber numbers are projected for the period 2014 to 2017.

6.49 While the overall retail broadband market is expanding, it is expected that the number of wholesale Bitstream end-users will remain relatively stable over the price control period. The forecasted subscriber numbers is based on the latest available figures from ComReg's quarterly reports over the 2012 period.

6.50 Please refer to Chapter 6 (subsection 6.3.5) in the Consultation Document for further details on the number of subscribers in the Bitstream cost model.

Total Bandwidth:

6.51 As set out in Chapter 6 (subsection 6.3.5) of the Consultation Document, the bandwidth required to run the network was also supplied by Eircom for June 2012. The bandwidth requirement in the Bitstream cost model is linked to the number of subscribers per exchange and the split per retail product for each exchange. The total bandwidth requirement is then forecast forward based on the forecasted number of subscribers on the network and the average usage levels of subscribers.

6.52 On the basis of feedback from operators that there is a growing expectation for higher bandwidth usage amongst end-users, ComReg was of the preliminary view that bandwidth levels would increase considerably over the price control period. Therefore, the Bitstream cost model used an average throughput per subscriber across a range of values from 150 kbps to 300 kbps. This is discussed in more detail below.

4. Model Process: Costs

6.53 As set out in Chapter 6 (subsection 6.3.6) of the Consultation Document, by taking the total number of subscribers and the total bandwidth requirement into consideration the total network requirement for Eircom's Core network can be established.

6.54 Using the network requirement, two types of cost drivers can be determined to allow the dimensioning of the network:

- Number of ports required: based on number of subscribers per exchange to establish a per port cost per user
- Total required bandwidth: based on bandwidth per product per exchange to establish bandwidth usage levels per exchange.

6.55 Using these cost drivers, the network can be dimensioned in terms of the costs it takes to run the network i.e., the Bitstream cost model calculates the number of DSLAMs/BRAS etc required on an exchange by exchange basis. The cost drivers define the level of costs per exchange.

6.56 The network dimensioning methodology is illustrated in Figure 6.3 in the Consultation Document.

6.57 In the Consultation Document, ComReg set out that the proposed Bitstream cost model is based on network dimensioning rules which determine the assets required to run the network. This in turn determines the level of capital costs of the network. Both types of cost drivers allow for the dimensioning of the different types of equipment which is required to provide Bitstream services.

5. Model Process: Cost Apportionment & Dimensioning

DSLAM Costs:

6.58 As set out in Chapter 6 (subsection 6.3.7) of the Consultation Document, the DSLAM configuration (i.e., amount of investment per exchange necessary to run Bitstream services) is calculated based on an incremental number of cards which can host a set number of lines. Based on the size of the exchange, the DSLAM cost taken from Eircom’s Regulated Accounts is apportioned on an exchange by exchange basis.

6.59 The total DSLAM costs are then divided by the total number of subscribers to establish a national unit cost for DSLAMs per subscriber. This fixed unit cost forms part of the national unit cost.

6.60 The DSLAM equipment dimensioning per exchange is illustrated in Figure 6.4 of the Consultation Document.

6.61 Please refer to Chapter 6 (subsection 6.3.7) in the Consultation Document for further details on the cost apportionment and dimensioning of the DSLAM costs.

BRAS Costs:

6.62 Similar to the dimensioning of the DSLAMs, the total number of BRAS required by Eircom is calculated based on the total number of subscribers throughout the network. Please refer to Chapter 6 (subsection 6.3.7) in the Consultation Document for further details.

6.63 The required number of BRAS costs per exchange is based on the total number of subscribers per exchange.

6.64 The methodology for apportionment and forecasting of the BRAS costs is the same as the methodology for the DSLAM apportionment as discussed above.

6.65 The total BRAS costs are divided by the total number of subscribers to establish a national unit cost for BRAS per subscriber. This fixed unit cost forms part of the national Bitstream unit cost.

Repair Costs:

6.66 As set out in Chapter 6 (subsection 6.3.7) of the Consultation Document, the total repair costs were taken from Eircom's 2011/12 Regulated Accounts. In the Bitstream cost model, the costs are apportioned to exchanges using the actual data reported in the line fault index ("**LFI**"). The latest available LFI was submitted by Eircom in June 2013 and is dated from the end of May 2013. The costs are weighted by the number of subscribers per exchange and a fixed unit repair cost per subscriber is then calculated and forms part of the national Bitstream unit cost.

Line Share/Local loop contribution Cost:

6.67 As set out in Chapter 6 (subsection 6.3.7) of the Consultation Document, this is a fixed charge that every operator must incur to use Eircom's Access network.

6.68 In order to ensure the overall contribution to costs that WBA products make to costs of the copper access network, ComReg was of the preliminary view that the Local Loop contribution should form part of the Bitstream cost stack. ComReg proposed to take the value of the Line Share rental[44] service (€9.24 per annum, or €0.77 per month) and allocate it on a per subscriber basis in the Bitstream cost model.

[44] ComReg Decision D04/09, ComReg Document No 09/66 entitled "Rental price for shared access to the unbundled local loop – Response to Consultation Document No 08/106 and Decision; dated 18 August 2009.

Aggregation Node and Transmission Costs:

6.69 As set out in Chapter 6 (subsection 6.3.7) of the Consultation Document, the number of aggregation nodes is dimensioned on the basis of the number of backhaul links from the installed DSLAMs. The “backhaul links” represent the transmission costs.

6.70 Determination of the number of aggregation nodes was illustrated in Figure 6.6 of the Consultation Document.

6.71 Based on the number of subscribers in each exchange, the total bandwidth requirement for the exchange can be determined. This then determines the level of usage from each exchange. Based on this level of usage, the Bitstream cost model assigns a backhaul cost weighting per exchange. Please refer to Chapter 6 (subsection 6.3.7) in the Consultation Document for further details.

6.72 As set out in the Consultation Document, in order to derive a unit cost for transmission, the total transmission costs are divided by the total bandwidth requirement per subscriber (average bandwidth per subscriber multiplied by total number of subscribers). This Mbps unit cost forms part of the national Bitstream unit cost.

6.73 Given that transmission costs are difficult to forecast, ComReg pointed out in the Consultation Document that any changes to transmission costs as a result of the separate annual review for leased lines under ComReg Decision D02/12[45] should also be reflected in the Bitstream cost model where appropriate.

6. <u>Model Outputs:</u>

6.74 As set out in Chapter 6 (subsection 6.3.8) of the Consultation Document, for regulatory consistency, we considered that, the cost oriented national Bitstream price should be split into fixed and variable elements, similar to the WBA price floors.

6.75 As noted in the Consultation Document, the total Mbps usage charge incurred by OAOs has been increasing due to an increase in average usage of traffic.

6.76 The Bitstream cost model performs a sensitivity analysis for a range of throughput values that takes a reasonable average throughput into account. Consequently, the throughput costs are based on a weighted average of a range of throughput values from 150 kbps – 300 kbps.

[45] ComReg Document No 12/03: Further Specification of the Price Control Obligation in the wholesale market for the terminating segment of Leased Lines; 2 February 2012.

6.77 Figure 6.7 and Figure 6.8 of the Consultation Document demonstrates how the Bitstream cost model uses these values to assess the appropriate level of the national Bitstream price. Please refer to Chapter 6 (subsection 6.3.8) of the Consultation Document for further discussion on this point.

7. Model Review

6.78 In order to ensure that the Bitstream cost model remains appropriate over the price control period, ComReg proposed in Chapter 6 (subsection 6.3.9) of the Consultation Document that Eircom should conduct a review on an annual basis. The annual review will reconcile the costs in the Bitstream cost model to Eircom's Regulated Accounts to assess whether the costs in the Bitstream cost model are an accurate representation of the actual costs adjusted for efficiency of the Bitstream network over the duration of the Bitstream cost model.

6.79 ComReg then asked the following question:

Q. 4 Do you agree with the proposed principles, inputs, assumptions and outputs associated with the Bitstream cost model, as set out above in Chapter 6? Please provide reasons for your response.

6.7 Views of Respondents

6.80 There was broad agreement among the respondents with regard to the principles, inputs, assumptions and outputs associated with the Bitstream cost model. However, some operators made a number of comments which are set out below.

6.81 **Eircom** stated that the Bitstream cost model has been developed over a period for a number of purposes and suffers from the requirement of having to perform a number of roles. For this reason Eircom believe there are a number of inconsistencies which may be unavoidable where a single modelling approach is used to develop an appropriate view of costs in areas outside the LEA with limited infrastructure competition, and of costs inside the LEA where there is infrastructure competition. Eircom's main concern in this regard relates to the charging for Bitstream usage which is addressed separately below under subsection 6.10.

6.82 **Vodafone** while broadly in agreement with the Bitstream cost model made some observations as follows:

1) At paragraph 6.50 of the Consultation Document ComReg outlines that the backhaul is based on a per Mbps price however one of the key technical characteristics of this backhaul is that it should be uncongested. Vodafone stated that if Eircom is to be allowed to charge a regulated price based on costs associated with this characteristic then failure to supply the service as described is just a failure to supply by a dominant operator.

2) At paragraph 6.73 of the Consultation Document regarding Network Building Costs Vodafone reiterated two statements as follows: "*the network building costs are taken from Eircom's Access Reference Offer price list*" and "*Network building costs are taken from Eircom's own operating costs and include a rate of return i.e., the WACC*." Vodafone believes that it was not clear which approach is being adopted.

3) At paragraph 6.73 of the Consultation Document regarding Field staff Operating & Maintenance (O&M) Costs, Vodafone highlighted the reference to LFI stating that ComReg gives no indication of whether it will carry out any assessment of whether the network related drivers for LFI associated with Bitstream are those of an efficient operator. If the LFI is higher than one would expect from an efficient operator then Vodafone believes that simply accepting the actual LFI rewards inefficiency.

4) At paragraph 6.73 of the Consultation Document regarding Other Direct O&M Costs Vodafone stated that ComReg does not outline any efficiency adjustments it proposes to make notwithstanding the fact that Eircom's operational cost reduction programmes are indicative that past costs were inefficient.

6.83 **Sky** generally agreed with the proposed approach with regard to the inputs, assumptions and outputs of the Bitstream cost model but it reiterated the importance of independently verifying Eircom's cost data. Sky believe that notwithstanding Eircom's national obligation for cost orientation for wholesale Bitstream, the proposed regulatory construct does create an incentive for Eircom to misallocate costs from inside the LEA to outside the LEA, because it faces less competitive pressure (in both retail and wholesale) in the latter. Sky also urged ComReg to keep its proposed efficiency adjustment of 5% under review, given the scale of staff rationalisation underway at Eircom (and due for completion in mid-2014).

6.84 **BT** made some comments as follows:

1) Copper costs (including maintenance) should not be included given these are recovered through the PSTN/WLR service. The exception to this would be the copper costs for the SABB product which by the absence of the PSTN/WLR service must have the copper costs applied.

2) BMB should be priced the same in and out of the LEA.

3) Business IP ("BIP") products are priced independent of the customers' actual usage and should therefore be re-priced to avoid over recovering the cost of backhaul, and should share a common backhaul cost with BMB.

6.85 **Viatel** was generally supportive of ComReg's approach but it raised a number of comments as follows:

1) It is important for the coming years to protect investments made by operators in Market 4 in terms of LLU and EFM[46] based services. It should be noted that the undermining of LLU investments will also have a direct impact on EFM services. Viatel asked if there was a possible case of "exchange launched" VDSL services to perhaps reduce this risk.

[46] Ethernet in the First Mile.

2) Viatel believed that it would be much more straightforward for all parties if the €15 connection fee was waved off permanently. In return, Eircom could partly cease the credit/rebate policy which does not typically allow a product manager to draw a long-term pricing strategy and therefore limit competition.

3) Viatel considered that the "reasonable rate of return" / WACC should be amended given that Eircom's Cost of Capital has changed significantly since 2008 and notably following the examinership process. It believes that the cost of capital should be updated every two years based on the actual costs involved.

6.86 **Magnet** agreed with ComReg's proposed principles for the Bitstream cost model but stated that ComReg should cross reference Eircom's data on product costing profitability with the costs incurred by Eircom's wholesale customers.

6.8 ComReg's Assessment of Responses

6.87 Having considered the views of respondents, ComReg has set out its views under the relevant subject headings below.

Relevant cost inputs and assumptions of the Bitstream cost model:

6.88 This point raised by Sky around the verification of the costing data used in the Bitstream cost model has already been dealt with by ComReg at subsection 5.4 above. Sky also raised some concerns around the 5% efficiency adjustment. This has been addressed by ComReg at subsection 5.4 above.

6.89 With regard to Vodafone's point seeking clarity on the Network Building costs used in the Bitstream cost model, ComReg would like to clarify that these costs are based on the rental charges from the ARO price list (service schedule 101, table 3.1.1 of the Eircom Access Reference Offer price list[47]).

[47] www.eircomwholesale.ie

6.90 In response to Vodafone's point about Operating and Maintenance costs and if ComReg will carry out any assessment of whether the network related drivers for LFI associated with Bitstream are those of an efficient operator, ComReg would like to clarify that the LFI is used to allocate repair costs. These repair costs are associated with the faults related to broadband in the access network (equivalent to the Line Share fault repair charges). As it is difficult to isolate the relevant efficient LFI for broadband faults only it means that it is extremely complex to make appropriate efficiency adjustments. However, even if these were identifieable it would have a relatively low impact given their low overall value.

6.91 Vodafone also raised the point with regard to Other Direct O&M Costs and stated that ComReg does not outline any efficiency adjustments it proposes to make. ComReg would like to point out that at paragraph 6.48 of the Consultation Document ComReg clearly sets out that an annual efficiency adjustment of 5% has been applied to the operating costs in the Bitstream cost model.

6.92 With regard to Viatel's point that the WACC requires a review, ComReg would like to point out that the WACC is currently under review by ComReg. We refer to our recently published consultation in ComReg Document No 14/28[48]. The outcome of that consultation process will be published by ComReg in due course.

6.93 Further to BT's point that copper costs should not be included in the Bitstream cost model with the exception of the SABB product, ComReg would like to clarify that copper costs are not included in the Bitstream cost model except in the case of SABB.

6.94 With regard to Magnet's point that ComReg should cross reference Eircom's data on product costing profitability with the costs incurred by Eircom's wholesale customers, ComReg is of the view that the annual reconciliation process should allow for this comparison.

[48] ComReg Document No 14/28 entitled “Review of Cost of Capital“ dated 11 April 2014.

Costs / prices in the LEA and Outside the LEA:

6.95 With regard to Sky's point around the incentive for Eircom to misallocate costs from the LEA to Outside the LEA ComReg would like to point out that up until now Eircom under the current retail minus regime, had the flexibility to increase prices Outside the LEA but had chosen not to do so. In addition, this Decision Document should ensure that Eircom does not recover in excess of its actual costs (adjusted for efficiency plus a reasonable rate of return) for the provision of Bitstream services in the area Outside the LEA. Therefore, this Decision Document should give the industry certainty that Eircom cannot increase prices Outside the LEA without ComReg's prior approval and without demonstrating to ComReg that the revised prices are based on no more than local costs adjusted for efficiency plus a reasonable rate of return, Outside the LEA.

6.96 Further to BT's point that BMB should be priced at the same rate both inside and Outside the LEA, ComReg would like to point out that BMB in the LEA and Outside the LEA may present very different characteristics of scale and scope when using the same or similar network infrastructure. Depending on these differences and how the underlying costs interact with retail pricing, it may in some circumstances be necessary to differentiate unit costs/prices by area to avoid margin squeeze issues. This is a complex area and ComReg has recently issued a "Call for Input"[49] which also considered inter alia this issue. ComReg is currently considering those responses and its position in relation to same. BT also raised a point that BIP products are priced independent of the customers' actual usage and that these should therefore be re-priced to avoid over recovering the cost of backhaul. BIP is a retail product and therefore is unregulated. However, quality of service requirements at the retail level is factored into the cost of the backhaul at the wholesale level.

Other:

6.97 With regard to Vodafone's point on uncongested backhaul, ComReg considers that this appears to be part of the normal O&M (Operations and Maintenance) interaction between operators rather than an absolute "failure to supply". This issue should be addressed either bilaterally with Eircom or at the industry forum.

[49] Call for Input: Current and future projections on throughput; dated 10 March 2014.

6.98 In response to Viatel's point about exchange launched VDSL, ComReg note that this point is not directly relevant to this consultation. However, it seems that the issue of exchange launched VDSL is currently under discussion at the NGA Forum and therefore any views or concerns that Viatel has should be raised in that context.

6.99 With regard to Viatel's point about the migration charge of €15, this is discussed in Chapter 8 below.

6.9 ComReg's Position

6.100 A detailed justification of the inputs, assumptions and outputs of the Bitstream cost model were set out in the Consultation Document. In this Decision Document we have considered the views of respondents and how this would impact on the price control obligation being imposed on Eircom. ComReg has not restated its justification from the Consultation Document in this Decision Document where no change to the obligations is proposed. We have set out below our final position with regard to the Bitstream cost model.

6.101 Since publication of the Consultation Document we have analysed the actual movements in Bitstream costs and volumes. While there have been some movements in Bitstream volumes and costs (based on the 2013 historical accounts), the overall impact of these changes is not material to warrant any changes to Bitstream prices when assessed against the forecasted Bitstream costs and volumes over the duration of the Bitstream cost model. However, ComReg intends to keep this under review as part of the planned annual review with Eircom.

6.102 Therefore, the inputs, principles, assumptions and outputs of the Bitstream cost model as set out in the Consultation Document remain largely relevant.

Usage / throughput price Outside the LEA

6.10 ComReg's Preliminary Views from the Consultation

6.103 As set out in Chapter 6 (subsection 6.3.10) of the Consultation Document, ComReg considered that the current usage charge to OAOs whose usage levels are significantly above the average throughput in the Bitstream cost model were significantly above the cost to Eircom of providing transmission at the 95th percentile. To militate against excessive usage charges, for those OAOs whose usage levels are above the average throughput in the Bitstream cost model, ComReg proposed that Eircom should recover no more than the LRIC that is caused by the additional traffic for those operators, which is above the average usage in the Bitstream cost model. ComReg considered that the LRIC should be equal to the cost of having to extend / build out the

Eircom network as a result of the additional traffic caused by the particular OAO in question above the average cost of usage from the Bitstream cost model. In the LEA, we considered that this obligation would not be required given that OAOs can use LLU or virtual unbundled access (“**VUA**”).

6.104 In summary, in the Consultation Document we proposed that Outside the LEA Eircom should recover no more than the long run incremental cost for usage based on the cost of traffic for that particular OAO which is over and above the average cost for usage in the Bitstream cost model.

6.105 ComReg then asked the following question:

Q. 3 Do you agree with ComReg’s preliminary view in relation to Eircom’s usage charges Outside the LEA where Eircom should not recover in excess of the long run incremental cost that is caused by the additional traffic by operator on the core network, over and above the average cost for usage in the Bitstream cost model. Please provide reasons for your response.

6.11 Views of Respondents

6.106 All respondents agreed with the proposal that Eircom should not recover in excess of the long run incremental costs that is caused by the additional traffic by operator on the core network, over and above the average cost for usage in the Bitstream cost model, except for Eircom who disagreed. Eircom, Sky and Viatel put forward some detailed comments as follows:

6.107 **Eircom** disagreed with ComReg's proposed approach regarding usage charges Outside the LEA. Eircom claims that the implication of ComReg’s proposal seems to be that one OAO that takes delivery of 100Mbps of BMB traffic from the Eircom network should pay a different price from another OAO that also receives 100Mbps of BMB traffic. Eircom stated that this difference would seem to be driven by the number of Bitstream ports that the OAO also rents from Eircom and this is despite the fact that BMB traffic and BMB ports have separate charges – and separate costs. Eircom stated that the BMB service is provided on a shared basis across the Eircom NGN to several OAOs, and to Eircom’s own downstream businesses and that Eircom finds that to charge any two OAOs on a different basis for the same usage service would conflict with the obligation of non-discrimination.

6.108 Eircom also attached a separate note (please see Annex 1 of the Eircom response set out in ComReg Document No 13/90s) on the six widely accepted pricing principles that are applied in relation to the recovery of costs for wholesale services that are subject to a price control of cost orientation. In essence, Eircom set out the following key points in relation to the six pricing principles:

- Cost causation: The costs of Bitstream traffic should be recovered from those that cause them to be incurred.
- Cost minimisation: The costs of Bitstream traffic should be recovered so as to give Bitstream operators incentive to minimise the costs of that traffic.
- Distribution of benefits: The cost of Bitstream traffic conveyance should be recovered from those who benefit from it.
- Effective competition: The costs of Bitstream traffic should be recovered in a way which promotes effective competition. This means that the price structure should not distort competition in either the WBA market or in the downstream market.
- Reciprocity and symmetry: Reciprocal charging implies that Eircom charges relating to Bitstream traffic service should be raised on a similar basis to charges that other providers of Bitstream services apply to Eircom. However, Eircom does not purchase Bitstream services from other operators in Ireland so this principle is not relevant.
- Practicality: The outcome should be easy to implement as a general principle. That means that the basis for charging should be clear and the necessary information for generating bills should be available in robust and reproducible form. In addition, the operator should have the capability to reconcile their use of the Bitstream service to the billed charges

6.109 Eircom stated that if such a control is necessary, which it does not believe it is, then a cost model that reflects the shared usage by multiple services traversing the Eircom NGN core is the only viable basis. Eircom used an example of where two OAOs are competing in the retail Broadband market based on BMB services they purchase from Eircom. The 95th percentile of the monthly traffic readings for both is 1 Gbps and the first operator has connected 10,000 ports whereas the second has connected 5,000 ports. The retail services marketed by the first OAO results in average busy hour traffic per user of 100 kbps whereas the retail service offered by the second OAO results in average busy hour traffic per user of 200 kbps. Eircom stated that it is implied that Eircom should somehow charge the OAO renting 5,000 ports less for the 1 Gbps of BMB traffic than they should charge the OAO renting 10,000 ports for the level of busy hour traffic and they believe that there is no basis in any of the accepted principles of cost recovery normally applied to the setting of regulated wholesale prices to support such a conclusion.

6.110 **Sky** fully agreed with ComReg's proposal regarding usage charges. It set out three scenarios where competitive distortions can create harm to operators, especially higher usage operators. Each of the three scenarios is set out in Sky's response to the consultation (ComReg Document No 13/90s) with illustrative diagrams to explain the potential impact. Sky explains that in summary, of each of the three subsets of customers assessed (which would cover Eircom's entire retail base) Eircom retail would have a competitive advantage vis-à-vis operators with higher average usage profile subscribers, if those operators are charged for excess usage over the Eircom average usage profile in a linear fashion - as currently happens. While Sky does not object to ComReg's proposal that Eircom should be permitted to recover its LRIC costs on the excess traffic, it would expect the incremental cost of Sky's excess traffic would be close to zero.

6.111 In terms of implementing the proposal on usage charges, Sky considered that the easiest way would be that outside the LEA, Eircom applies a 100% discount to usage in excess of the average usage assumption used to calculate Eircom's monthly backhaul costs per Mbps. Subsequently, where Eircom can adequately demonstrate that there is incremental cost associated with the excess traffic, a retrospective charging mechanism could be implemented for high usage operators, provided those incremental costs could be independently verified in a timely manner e.g. any charge pertaining to incremental traffic should be billed (based on ComReg approved rates) no later than 2 months after the relevant month in which the excess usage was consumed.

6.112 Please refer to Sky's non-confidential response set out in ComReg Document No 13/90s for the full details.

6.113 **Viatel** fully agreed with ComReg but stated that ComReg should carry out a regular review of the actual usage incurred (at an aggregate level) to ensure that the usage is in line with that being applied in the Bitstream cost model. Viatel recommended that this should be done at least once per quarter as the information is available in real-time from Eircom's system. Viatel also suggested that as bandwidth needs increase that there is a need in each period to have a maximum charge per customer with a review of this maximum usage charge once every quarter in line with Eircom usage reports.

6.12 ComReg's Assessment of Responses

6.114 Having considered the views of respondents, ComReg has set out its views below under the relevant headings.

Discrimination:

6.115 Eircom disagreed with the proposal for charging for usage mainly on the basis of discrimination. While we agree that it may be discriminatory for Eircom to apply different conditions (i.e., to charge two operators different rates) in equivalent circumstances (i.e., where both operators have the same impact in terms of loading the network), ComReg believes that the argument of discrimination does not apply when one operator generates in total more traffic. For example, if Operator A generates 2 Gbps and Operator B generates 1 Gbps and they both have the same number of customers but the traffic per customer for Operator A is twice that of Operator B, then it may be reasonable to apply a lower price per Mbps for Operator A.

Alternative usage charging options:

6.116 With regard to the proposal put forward by Sky on usage charging as set out in paragraph 6.111 above, ComReg does not believe that it would reflect a fair solution for usage charges. ComReg is of the view that all operators should pay according to the traffic they use including their fair attributuion of fixed and common cost. This is normal regulatory practice both here and overseas.

6.117 ComReg has received a number of alternative usage charging proposal as part of the responses received to the Call for Input ComReg Information Notice 14/18[50]. This is a complex issue ComReg is considering this matter from several perspectives. On one hand, Eircom is generally entitled to recover its efficiently incurred costs. The question arises as to how the cost of backhaul or transmission should be recovered in aggregate. Another issue is how best to structure Bitstream prices within the regulatory requirements in a way that is fair to all players and is of maximum benefit to end users. ComReg is currently assessing its position to the issues identified in ComReg Information Notice 14/18 and will come back to this matter separately.

Ongoing review of usage levels:

6.118 In relation to Viatel's point about the ongoing review of the actual usage incurred, we note that there is an obligation already on Eircom (in the NGA Decision) to review the usage data for current generation and next generation services on a quarterly basis and to update the associated models where appropriate. We monitor to ensure that this happens as part of our day-to-day activities.

[50] Information Notice 14/18 entitled "Current and future projections on throughput", dated 10 March 2014.

6.13 ComReg's Final Position

6.119 Further to the views of respondents and the recent publication by Eircom of revised usage charges for both current generation BMB and NGA Bitstream plus services in ComReg Information Notice 14/07[51], we do not believe that it is necessary at this stage to intervene on a subset of charges relating to BMB. However, we are currently assessing responses to ComReg Document No 14/18 which provided information from industry on current and projected throughput levels and this will be dealt with separately by ComReg. As part of that review, ComReg will consider amongst others an appropriate pricing structure for BMB and whether a monthly cost per port and per Mbps (as set out in paragraph 6.45) remains appropriate.

6.120 We consider that the usage charges for current generation services are adequately covered by the national cost orientation obligation now in place by virtue of this Decision Document. Eircom will need to ensure an appropriate cost recovery mechanism as between fixed charges and variable capacity related charges. Therefore, for now, we consider that no additional obligations to those already in place (as part of this Decision) are required in relation to usage charges. ComReg is currently considering responses received to the "Call for Input" ComReg Document No 14/18 and intends to address the key issues received from interested parties separately in due course.

6.121 It is important to note that in line with the obligations set out in the NGA Decision, Eircom has an obligation[52] to review the usage levels for current generation and next generation services on a quarterly basis and to update the associated models where appropriate.

[51] Information Notice 14/07 entitled "Reduction in Bitstream Managed Backhaul and NGA Bitstream Plus usage charging; dated 28 January 2014.
[52] Please refer to Section 4.5 and Section 11.20 of the Decision Instrument contained in Annex 2 of ComReg Document 13/11 (ComReg Decision D03/13).

Chapter 7

7 Retail Margin Squeeze Test

7.1 Introduction

7.1 In this chapter we discuss the principles that should apply in relation to the retail margin squeeze test for current generation Bitstream services in the LEA and Outside the LEA.

7.2 As noted earlier in Chapter 3, in the WBA Market Decision we identified the scope and incentive for the SMP operator to engage in possible price-related leveraging through pricing its upstream and downstream services in such a way as to give rise to an insufficient wholesale/retail margin which would impede effective downstream competition. In the WBA Market Decision we considered that a vertically integrated operator which has SMP at the wholesale level and provides a wholesale input on which other operators rely to compete in a downstream market could price its upstream and downstream services in such a way as to impede effective downstream competition due to an insufficient margin between wholesale and retail prices.

7.3 As part of our assessment of the appropriate price control for current generation Bitstream going forward, we have considered the varying competitive conditions between the LEA and Outside the LEA prospectively in the WBA market.

7.4 Instead of a national retail minus control we have decided that a retail margin squeeze test should apply, and that ComReg would differentiate the test between the LEA and Outside the LEA. In principle, there will be little material change to the previous obligation as both rely on the DCF model to determine the appropriate margin.

7.5 The main difference between the national retail minus control and the retail margin squeeze is that the retail minus assessed one retail product against the cost of one wholesale product, nationally. On the other hand, the retail margin squeeze approach imposed in this Decision Document assesses the potential for a margin squeeze on a differentiated basis between the LEA and Outside the LEA.

7.6 In the LEA the retail margin squeeze test assesses multiple retail products against the one wholesale product (portfolio analysis) to ensure that on an overall aggregate basis that the average of Eircom’s retail revenues for all of its retail current generation broadband products recovers the average total retail and wholesale costs.

7.7 The retail margin squeeze test Outside the LEA assesses each retail product against the relevant wholesale product (product-by-product analysis) to ensure that the revenue for each retail offer recovers its associated retail and wholesale costs.

7.8 The retail margin squeeze approach therefore reflects the way the WBA market (in terms of geographically differentiated competitive dynamics) has evolved over the past number of years.

7.9 In addition, a retail margin squeeze test in the LEA and a separate retail margin squeeze test Outside the LEA should allow Eircom more flexibility in the LEA where it faces retail constraints from cable and other LLU operators. This change also brings the monitoring of current generation retail broadband services in line with the NGA Decision with regard to NGA broadband services.

7.10 The rest of this chapter looks at ComReg's preliminary views from the Consultation Document, the views of respondents, ComReg's assessment of respondents' views and ComReg's final position on the following key points:

1. Principles of the retail margin squeeze test.

2. Implementation of the retail margin squeeze tests.

3. Retail price notification and compliance procedures.

7.2 ComReg's Preliminary Views from the Consultation

7.2.1 Principles of the retail margin squeeze test:

1. <u>Appropriate model type</u>:

7.11 In Chapter 7 (subsection 7.2.1) of the Consultation Document ComReg considered that the DCF model remained appropriate given that it looks at costs and revenues over a number of years and takes into account the time value of money unlike the static model that just assesses one particular accounting period.

2. <u>Retail costs and assumptions:</u>

7.12 As set out in Chapter 7 (subsection 7.2.2) of the Consultation Document, as a starting point, the current DCF model uses Eircom's costs — historic costs which are based on Eircom's audited Regulated Accounts and Eircom's forecast of those costs — as a data source. These costs both historic and forecast are then adjusted to reflect the likely costs that a new retail broadband market entrant would likely incur.

7.13 In summary, the DCF model includes one-off start-up costs, ongoing fixed and variable operating costs including capital costs and a terminal value. In addition, a number of costs are further inflated by an overhead mark-up of 25% in order to reflect the likely new retail broadband market entrant mark-up of common costs. The cost categories which incur this additional mark-up are: Sales; Product Development; Help Desk; and Order Handling.

7.14 The costs categorised used in the current DCF model are as follows:

- Sales costs
- Marketing / Advertising
- Product management & development
- Accommodation
- Help Desk
- Billing
- Modems
- Order Handling
- Corporate overhead
- Servers and collocation
- Internet connectivity (peering charges)

- Backhaul charges
- Wholesale connection.

7.15 Please refer to Chapter 7 (subsection 7.2.2) of the Consultation Document for full details on each of the cost categories above. In order to derive the total retail costs incurred by a new entrant the above cost categories can all be adjusted for scale and scope.

7.16 With respect to revenues which are taken into account in the DCF these are limited to rental and connection charges. No value added service revenue is included, as the DCF model is based on a new entrant which is limited to an internet connection business. In addition, any additional revenue from excess usage is not taken into account.

3. <u>WACC:</u>

7.17 As set out in the Chapter 7 (subsection 7.2.3) of the Consultation Document, ComReg has applied a discount rate based on Eircom's weighted average cost of capital (WACC) of 10.21% in the DCF model.

4. <u>Time Horizon and Terminal Value:</u>

7.18 Similar to the current DCF model, ComReg proposed to apply the DCF analysis for five years and to include a further three years where the costs and revenues would remain stable to account for the terminal value. Please refer to Chapter 7 (subsection 7.2.4) of the Consultation Document for further details.

5. <u>Operator cost base:</u>

7.19 ComReg discussed the three main options of equally efficient operator ("**EEO**"), reasonably efficient operator ("**REO**") and similarly efficient operator ("**SEO**") in Chapter 7 (subsection 7.2.5) of the Consultation Document.

7.20 In the context of the WBA market ComReg considered in the Consultation Document that the SEO test may be appropriate where we have a number of smaller operators, especially Outside the LEA that are vulnerable to exclusionary behaviour given that they do not share Eircom's economies of scale and that they have no realistic alternative means of provision.

7.21 We considered that a combined (SEO and EEO) test that is consistent with the retail margin squeeze test in the context of NGA may be the most appropriate cost base in the LEA. Similar to the approach for NGA, ComReg proposed that the following retail costs for current generation Bitstream should be based on EEO costs:

- Marketing / Advertising costs
- Billing costs
- Product management costs.

7.22 ComReg was of the preliminary view that there are large operators in the LEA using Eircom’s network (Vodafone, Sky) with an international presence who can take advantage of economies of scale and scope between their operations in Ireland and other countries in which they operate. ComReg considers that the costs above are most susceptible to such scale / scope advantages especially in the context of bundle offers (with fixed voice, mobile voice, broadband, IPTV, etc.) which are more often sold in the LEA. Outside the LEA, ComReg considers that the retail margin squeeze test should be based on a SEO test given the number of smaller operators in this area with a low retail broadband market penetration (✂% or less) in this area.

6. <u>Operator volume base:</u>

7.23 In Chapter 7 (subsection 7.2.6) of the Consultation Document ComReg considered three possible options to adjust the retail margin squeeze test to account for differences in economies of scale between Eircom and the access seekers. These options were:

- 10% market share
- 15% market share
- 25% market share.

7.24 Given that we wish to avoid inefficient entry ComReg was of the preliminary view that a 25% retail broadband market share should be applied when adopting the SEO cost base but we would keep this under review.

7. <u>Appropriate cost standard:</u>

7.25 The options considered by ComReg in Chapter 7 (subsection 7.2.7) of the Consultation Document for the appropriate cost standard included the following:

(i) Average Variable Cost (‘AVC’)

(ii) Average Avoidable Cost (‘AAC’)

(iii) LRAIC

(iv) LRAIC plus

(v) Average Total Cost (‘ATC’).

7.26 Please refer to Chapter 7 (subsection 7.2.7) of the Consultation Document for further details on each of the cost standards above.

7.27 We considered that the AAC cost rule could lead to sub-optimal entry conditions with little entry occurring. This would be to the detriment of competition and, in turn, end-users. In addition, the avoidable costs standard is the relevant measure when assessing whether there are concerns around future exclusion or exit of current efficient competitors from the retail broadband market. Given that this is not the issue, we considered that the ATC approach is the appropriate cost standard for the retail margin squeeze test. To date, the DCF model from the 2006 Retail Minus Decision was based on the ATC costs of Eircom and the recent NGA margin squeeze model also applied the ATC costs of Eircom. Therefore, ComReg was of the preliminary view that the retail margin squeeze test in the context of current generation Bitstream products in the LEA and Outside the LEA should be based on the ATC costs of Eircom.

8. <u>Portfolio or product-by-product:</u>

7.28 In Chapter 7 (subsection 7.2.8) of the Consultation Document we also considered the following options for assessing any potential retail margin squeeze:

- A single product offered by the SMP operator; or
- A number of products as a whole i.e., a portfolio of products.

7.29 ComReg proposed that the retail margin squeeze test in the LEA should be based on a portfolio approach where Eircom should recover the ATC costs for standalone current generation broadband services in aggregate. ComReg considered that the portfolio approach is reasonable given that Eircom is facing some retail competition from other operators in the LEA. This approach also ensures regulatory consistency given that the portfolio approach has also been applied in the Bundles Decision and in the NGA Decision.

7.30 ComReg considered that Outside the LEA the product-by-product approach should be adopted. However, where there is more than one retail offer supported by a single wholesale offer Outside the LEA, Eircom should assess the weighted average retail price against the costs associated with the wholesale offering. However, unlike the portfolio approach described above, it was proposed that Eircom would pass the margin squeeze test on a product-by-product basis where each offer would have to pass its own ATC. Therefore, Eircom would not have the flexibility to price above or below the retail costs on certain retail current generation broadband products Outside the LEA.

7.2.2 Implementation of the retail margin squeeze tests

1. <u>Retail margin squeeze test in the LEA:</u>

7.31 As set out in Chapter 7 (subsection 7.3.1) of the Consultation Document ComReg proposed that in the LEA the retail margin squeeze test should be applied on a portfolio basis by taking the aggregate of retail services (retail revenues) and testing these against the aggregate of the retail and wholesale costs. Therefore, the retail margin squeeze test in the LEA (known as the "**Retail Margin Squeeze test in the LEA**") should ensure that Eircom Retail does not create a retail margin squeeze between:

(i) the retail price of a single current generation retail product which is supported by a single wholesale offering or, the weighted average (by number of subscribers) of the retail products' individual prices where more than one retail product is supported by a single offering, and

(ii) the price for wholesale current generation Bitstream.

7.32 Eircom should ensure that the average of Eircom's retail revenues for its Retail current generation Broadband products recovers the average total retail and wholesale costs across a portfolio of retail products. This should allow Eircom some flexibility to price above or below the retail costs on certain retail broadband products but it must ensure that the weighted average total retail and wholesale costs are covered by the retail current generation broadband revenues.

7.33 ComReg was of the preliminary view that the retail margin squeeze obligation should apply in relation to promotions, discounts and bundles, even if an offer in the WBA market is only planned to be offered for a limited promotional period for the reasons already set out in Chapter 7 (subsection 7.3.1) of the Consultation Document.

2. **Retail margin squeeze test Outside the LEA:**

7.34 As set out in Chapter 7 (subsection 7.3.2) of the Consultation Document, ComReg proposed that Outside the LEA the retail margin squeeze test should be applied on a product-by-product basis. Unlike the portfolio approach described above, Eircom would pass the margin squeeze test on a product-by-product basis Outside the LEA and therefore it would not have any flexibility to price above or below the retail costs on certain retail broadband offers. The retail margin squeeze test Outside the LEA (known as the "**Retail Margin Squeeze test Outside the LEA**") should ensure that Eircom Retail does not create a retail margin squeeze between:

(i) the retail price of a single current generation retail product which is supported by a single wholesale offering or, the weighted average (by number of subscribers) of the retail products' individual prices where more than one retail product is supported by a single offering, and

(ii) the price charged by Eircom for wholesale Bitstream.

7.35 ComReg proposed that the retail margin squeeze obligation should apply in relation to promotions, discounts and bundles Outside the LEA, even if an offer in the WBA market is only planned to be offered for a limited promotional period.

7.2.3 Retail price notification and compliance procedures:

7.36 As set out in Chapter 7 (subsection 7.3.3) of the Consultation Document ComReg was of the preliminary view that Eircom should be required to notify ComReg of all retail prices for new and amendments to existing current generation retail Bitstream products at least 5 working days before the new (or revised) prices are expected to come into effect, by email communication. If the new or amended retail price being notified gave rise to a wholesale adjustment then the notification period to ComReg of 3 months (or 4 months in the case of a wholesale price increase) should also apply.

7.37 At the point of notification of the retail price (as set out above) ComReg proposed that Eircom should also provide ComReg with a statement of compliance for all current generation broadband retail product(s) (new prices and changes to existing prices), demonstrating how it is complying with the retail margin squeeze test(s).

7.38 The statement of compliance would include such material and supporting information as set out in paragraph 7.56 of Chapter 7 (subsection 7.3.3) of the Consultation Document.

7.39 Once ComReg would receive the statement of compliance from Eircom it would assess it within 5 working days. Following the review, ComReg would have a number of options in terms of how it proceeds. These options are set out in paragraph 7.57 of Chapter 7 (subsection 7.3.3.) of the Consultation Document.

7.40 ComReg also pointed out in the Consultation Document that a notification by Eircom to ComReg of a statement of compliance does not mean that the product has been "approved" by ComReg. ComReg considered that assessing products for compliance with the price control obligations is an ongoing process and ComReg would reserves it right to intervene at any stage (even post launch of a product / service) where it believed that Eircom may not be in compliance with its obligations.

7.41 ComReg then asked the following question:

Q. 5 Do you agree with ComReg's preliminary views above in relation to the proposed retail margin squeeze tests including the proposals regarding the notification and compliance procedures for retail prices associated with current generation Bitstream? Please provide reasons for your response.

7.3 Views of Respondents

7.42 There was general agreement among the majority of respondents with regard to the proposed retail margin squeeze tests and the associated notification and compliance procedures for current generation Bitstream. A number of respondents raised some concerns which are set out below.

7.43 **Eircom** made a number of comments as follows:

1) Eircom does not believe that it is appropriate for ComReg to maintain in place a retail-minus regime or impose a retail margin squeeze test as a price control on a wholesale market in the presence of a cost-orientation price control. Eircom claimed that this results in the direct regulation of the retail market which ComReg may not lawfully regulate.

2) Eircom stated that the two key competitors Outside the LEA have larger marketing resources than are available to Eircom and can quickly achieve unit retail costs at the same, or lower, levels than Eircom has achieved. For this reason the NRT should now move to use an EEO assessment for retail costs of Broadband services within multi-service bundles in all areas to allow Eircom to compete in the national retail market.

3) Eircom believe that there is ambiguity regarding paragraph 7.44 of the Consultation Document where ComReg proposes that "*in the LEA, the retail margin squeeze test should be applied on a portfolio basis by taking the aggregate of retail services (retail revenues) and testing these against the aggregate of the retail and wholesale costs. Therefore, the retail margin squeeze test in the LEA (known as the "Retail Margin Squeeze test in the LEA") should ensure that Eircom Retail does not create a retail margin squeeze between*:

> *(i) the retail price of a single current generation retail product which is supported by a single wholesale offering or, the weighted average (by number of subscribers) of the retail products' individual prices where more than one retail product is supported by a single offering, and*
>
> *(ii) the price for wholesale current generation Bitstream."*

Eircom claims that there appears to be a conflict between these two sentences which is re-enforced by paragraph 7.49 of the Consultation Document which states that the test Outside the LEA should be applied on a product-by-product basis but then uses identical wording to expand on this proposal. Eircom requests ComReg that this text should be amended in the final decision instrument to remove any potential ambiguity.

7.44 **Vodafone** stated that if the purpose of the margin squeeze test is to protect those operators who buy wholesale WBA services from Eircom from being squeezed by Eircom at the retail level then the size of the margin required is independent of what other retail competitors there are. If the margin that Eircom is allowed in the LEA is sufficient to protect competition in the LEA then why is it not sufficient outside of the LEA.

7.45 In addition, Vodafone stated that if Eircom is under so little competitive pressure at the wholesale level in the LEA and given that it has been able to maintain its WBA prices above the minimum floors and to cross subsidise into the non-LEA areas (paragraph 5.23), that this strongly indicates that any flexibility that is afforded to Eircom in its retail pricing will not in the first instance be applied to the benefit of wholesale pricing but will be deployed at the retail level to meet competition from its wholesale customers. Vodafone believes that if Eircom was truly concerned with meeting retail competition from alternative infrastructure providers or providers of LLU based WBA it would have already reduced all elements of its retail cost stack including the notional WBA costs it must factor because of the retail bundles price control. Vodafone also stated that it did not support the portfolio approach.

7.46 **Sky** is of view that ComReg should keep the 42-month customer acquisition metric[53] under close review (particularly inside the LEA, where ComReg has indicated there is a higher degree of competition) as competition increases and notes that it may need to be revised, based on trends in customer life moving averages. In addition, the proposed retail broadband market share of 25% should reflect those smaller operators referred to Outside the LEA.

7.47 **BT and ALTO** both agreed with the proposed retail margin squeeze tests absent functional separation and equivalence of input ("**EoI**"). However, they had particular concerns around promotions. BT stated that ComReg need to urgently consult separately on promotions as they are being applied to various markets. BT included some examples of issues that should be consulted on with regard to promotions, including duration of promotions, how discounts on cost oriented products work, potential competition issues around long standing promotions where promotions that are running for a significant time period should perhaps become price points.

7.48 In addition, BT stated that in order to incentivise correct behaviour that the statement of compliance should be underpinned by the penalty of a serious offence under the regulations, similar to the Section 13D(1) procedures.

7.49 **Viatel** supported ComReg's proposed approach except for the portfolio based test. Viatel's comments were as follows:

[53] The 42 month customer lifetime determines the customer churn and calculates a rolling net number of subscribers per month. The level of churn determines the per unit recovery of cost per subscriber.

(1) .Viatel believes that in the case of a portfolio test, a single product can be tailored to squeeze LLU based services but at an overall level may not impact on the portfolio compliance.

(2) Viatel questioned whether 5 days notice is adequate time to assess a new retail price point and compliance with the proposed DCF model.

(3) Viatel questioned the modem cost, originated from Eircom's manufacturer offers, as a SEO player would be unlikely to secure the same discount prices without volume commitment.

(4) Viatel queried the 42 months customer lifetime value as being quite optimistic as it believes the monthly churn rate to be well above 2.38%.

(5) Viatel regretted that ComReg is partially opting for an EEO model in the LEA as it de-facto rules out the emergence of competition from an indigenous medium size operator.

7.4 ComReg's Assessment of Responses

7.50 Having considered the views of respondents, ComReg has set out its views under the relevant subject headings below.

EEO versus SEO costs:

7.51 Eircom believed that an EEO test should be applied nationally on the basis that there are two key competitors Outside the LEA that have larger marketing resources than are available to Eircom and can quickly achieve unit retail costs at the same, or lower, levels than Eircom has achieved. ComReg would like to point out that the retail broadband market share for Eircom Outside the LEA does not support the use of EEO since Eircom has greater economies of scale in that area, i.e., at end of December 2013 Eircom has circa ✂% of the wholesale broadband market and circa ✂% of the retail broadband market Outside the LEA.

7.52 Vodafone stated that if the margin that Eircom is allowed in the LEA is sufficient to protect competition in the LEA then why is it not sufficient outside of the LEA. Sky also stated that the retail broadband market share of 25% should reflect those smaller operators referred to Outside the LEA. ComReg would like to clarify that Outside the LEA Eircom's retail market share compared to OAOs is higher than in LEA which was assessed as part of the consultation process. In the LEA Eircom's retail market share is lower and therefore Eircom's economies of scale at the retail level are closer to that of alternative operators. It is also important to point out that the market share of 25% is a target market share that should be achieved by OAOs in the medium term.

7.53 Viatel regretted that ComReg was partially opting for an EEO model in the LEA as it de-facto rules out the emergence of competition from an indigenous medium size operator. ComReg is of the view that a combination of SEO and EEO is the preferred approach in the LEA on the basis that there are two large operators (Vodafone and Sky) in the LEA using Eircom's network who both have an international presence that can take advantage of economies of scale and scope between their operations in Ireland and other countries in which they operate.

Portfolio versus product by product approach:

7.54 Further to Eircom's point about the allegedly conflicting wording in the Consultation Document for the retail margin squeeze test in the LEA the Decision Instrument at Annex 2 (Section 11.6) of the NGA Decision we have considered the matter and believe that the wording as consulted upon is correctly stated, although other formulations are possible. Under these conditions we think it is better to retain this wording in order to ensure consistency with the Decision Instrument at Annex 2 (Section 11.6) of the NGA Decision which is identical. For the avoidance of doubt, the retail margin squeeze test in the LEA for current generation Bitstream is a portfolio test.

7.55 The following simple example how the portfolio test works.

Description	Product A €	Product B €	Blended (associated with X) €	Product C €	Portfolio
Retail Price	35	25	31.67 (€35 x 60%/90%) + (€25 x 30%/(90%)	50	**33.50** (31.67*90%) + (50*10%)
Retail Product Mix[54]	*60%*	*30%*	*90%*	*10%*	
Wholesale costs : Wholesale product X	-25.00			n/a	**22.50** (25*90%)
Wholesale costs : Wholesale product Y	n/a	n/a	n/a	-30.00	**3.00** (30 x 10%)
Retail costs	-7.00	-7.00	-7.00	-10.00	**7.30** (7 x 90%) + (10*10%)
Margin associated with each wholesale product **(retail price less wholesale cost less retail costs)**	**3.00**	**-7.00**	**-0.33** (€3.00 x 60%/90%) + (€-7.00 x 30%/(90%)	**10.00**	**0.70** (-0.33 x 90% +10 x 10%)[55]

[54] This is the actual or forecast take-up by retail end-users for the product.
[55] Note: there are rounding differences

7.56 It is clear from the example above that Product B when assessed on a standalone (or product-by-product) basis has a negative margin (of €7). However, when a Product A and Product B and Product C are assessed together (on a portfolio basis) while taking into account the retail sales mix for each product, they pass the test with an overall positive margin of €0.70. Therefore, the portfolio test in the LEA allows Eircom some flexibility to price above or below the retail and wholesale costs on certain retail broadband products so long as it ensures that the weighted average total retail and wholesale costs are covered by the retail current generation broadband revenues. ComReg considers that only where the total average revenues are not likely to cover total average retail and wholesale costs should a wholesale (or retail) price change be required to the underlying Bitstream price.

7.57 With regard to Viatel's point that a single product can be tailored to squeeze LLU based services but at an overall level may not impact on the portfolio compliance, ComReg would like to point out that if one product in the overall "portfolio" is creating a squeeze (i.e., Product B in our example above) then this means that the other product(s) in the portfolio are well above their costs (i.e., Product A and Product C in our example above). Therefore, the real question for Viatel is why would it not sell the product(s) (with positive margins) in order to increase its margins.

<u>Other parameters of the retail margin squeeze tests</u>:

7.58 Sky and Viatel both questioned the customer lifetime of 42 months and whether this was the appropriate input to the test. ComReg does not have any robust data from other operators to suggest that the 42 months is unreasonable. However, we will keep this parameter under review throughout the price control period.

7.59 Viatel also believed that the modem cost, originated from Eircom's manufacturer offers, would be unlikely to secure the same discount prices without volume commitment as a SEO player. ComReg would like to clarify that as a starting point the DCF model uses Eircom's retail costs (including modem costs) but these costs are subsequently adjusted to reflect the likely costs that a new retail broadband market entrant would likely occur.

Other issues:

7.60 In relation to Eircom's point that it is not appropriate for ComReg to maintain in place a retail-minus regime as a price control on a wholesale market in the presence of a cost-orientation price control, we consider that it is appropriate to impose both a retail margin squeeze test and a cost orientation obligation in the same market on the basis that each of the controls address different competition problems, which were already identified in the Consultation Document and as set out in Chapter 3 above.

7.61 Vodafone believed that if Eircom was truly concerned with meeting retail competition from alternative infrastructure providers or providers of LLU based WBA it would have already reduced all elements of its retail cost stack including the notional WBA costs it must factor because of the retail bundles price control. ComReg is of the view that if Eircom prices above the floor, then this provides an even greater incentive for other operators to use LLU which is good for infrastructure competition.

7.62 Viatel also questioned whether 5 days notice was sufficient for ComReg to assess the new retail price point and compliance with the DCF model. ComReg would like to point out that 5 days notice is also applied in the context of NGA and Bundles and no issues have arisen to date in this regard. In addition, it is important to note that if ComReg requires further information from Eircom around the notified retail price then ComReg can set a new deadline by which this information must be provided to ComReg. Therefore, the timeframe can be extended if a further extensive review is required.

7.63 With regard to BT's point on promotions, please see our views on promotions and discounts already set out in Chapter 6 (subsection 6.4) of this document. In summary, promotions are acceptable so long as they are not discriminatory or create a margin squeeze. Currently, ComReg are not aware of any margin squeeze issues concerning promotions for wholesale Bitstream. However, if any operator has evidence to the contrary then this should be submitted to ComReg in the context of a potential non-compliance case.

7.64 Further to BT's point that the statement of compliance should be underpinned by the penalty of a serious offence under statues, similar to the Section 13D(1) procedures, ComReg notes that Eircom's SMP obligations are grounded on Regulations 9-13 of the Access Regulations. ComReg also notes that under the Access Regulations, ComReg may issue enforcement proceedings for non-compliance with those obligations. Furthermore, the exercise of its powers under Regulation 13 of the Access Regulations (i.e., to provide a statement of compliance in support of its price control obligations) does not preclude ComReg from issuing an information request, pursuant to

Section 13D of the Communications Regulation Act, for information which it does not otherwise have available to itself.

7.5 ComReg's Final Position

7.65 A detailed justification of the principles of the retail margin squeeze tests, the implementation of the margin squeeze tests and the retail notification and compliance procedures was set out in the Consultation Document. In this Decision Document we have considered the views of respondents and how this would impact on the details of the margin squeeze obligation being imposed on Eircom. ComReg has not restated its justification from the Consultation Document in this Decision Document where no change to the obligations is considered relevant. Please refer to subsection 12.3 and 12.4 in Chapter 12 of this document for a detailed discussion on how the margin squeeze obligation meets our regulatory objectives and also a discussion on the choice of principles for the retail margin squeeze tests.

7.66 We have set out below the obligations that Eircom must comply with as a result of this Decision.

7.5.1 Principles of the retail margin squeeze test:

7.67 The retail margin squeeze principles set out in the Consultation Document remain relevant. In summary, the principles of the retail margin squeeze test as contained in the DCF model are as follows:

Description	Retail margin squeeze test in LEA	Retail margin squeeze test Outside the LEA
Appropriate model type	DCF model	DCF model
Retail costs	Eircom costs as starting point but with some costs adjusted by 25% to reflect new entrant costs[56].	Eircom costs as starting point but with some costs adjusted by 25% to reflect new entrant costs.
WACC	10.21%	10.21%
Time horizon	5 years with a further 3 years to account for terminal value	5 years with a further 3 years to account for terminal value

[56] Sales, product development, help desk and order handling.

Operator cost base	SEO costs with some EEO costs[57].	SEO costs
Operator volume base	25% adjustment to SEO costs	25% adjustment to SEO costs
Appropriate cost standard	ATC	ATC
Portfolio or product-by-product analysis	Portfolio	Product-by-product

7.5.2 Implementation of the retail margin squeeze tests

Retail margin squeeze test in the LEA:

7.68 Eircom should not cause a Retail Margin Squeeze in the Larger Exchange Area between: (i) the retail price of a single Retail Product which is supported by a single wholesale offering or, the weighted average (by number of subscribers) of Retail Products' individual prices where more than one Retail Product is supported by a single offering; and (ii) the price charged by Eircom for wholesale Bitstream. The assessment of the Retail Margin Squeeze in the Larger Exchange Area should be conducted on a portfolio basis with reference to the DCF model

7.69 For the purposes of promotions, discounts and bundles, the obligations above should apply to new and existing retail product(s) and any equivalent wholesale product(s).

Retail margin squeeze test Outside the LEA:

7.70 Eircom should not cause a Retail Margin Squeeze outside the Larger Exchange Area between:- (i) the retail price of a single Retail Product which is supported by a single wholesale offering or, the weighted average (by number of subscribers) of Retail Products' individual prices where more than one Retail Product is supported by a single offering; and (ii) the price charged by Eircom for wholesale Bitstream. The assessment of the Retail Margin Squeeze outside the Larger Exchange Area shall be conducted on a product-by-product basis by reference to the DCF model.

7.71 For the purposes of promotions, discounts and bundles, the obligations above should apply to new and existing retail product(s) and any equivalent wholesale product(s).

[57] The costs that are based on EEO are marketing / advertising, billing costs and product management costs.

7.5.3 Retail price notification and compliance procedures

7.72 The retail price notification and compliance procedures as set out in the Consultation Document remain relevant.

7.73 Eircom should notify ComReg (by email) of all retail prices for new retail products and for retail price amendments to existing retail products no later than 5 working days prior to the date that the new or revised price is to become operative. The notification timelines as set out in Chapter 5 (subsection 5.5.3) of this document should apply with regard to any wholesale price amendments.

7.74 For the purposes of new retail products and for amendments to existing retail products, Eircom should furnish to ComReg, at the same time as it notifies ComReg, a detailed written statement of compliance demonstrating Eircom's compliance and proposed compliance with the price control obligation. The statement of compliance should include the following:

(i) A full and true disclosure of all material facts for the purpose of demonstrating compliance with the price control and the retail margin squeeze test(s) based on the DCF model.

(ii) All relevant supporting documentation for the purpose of demonstrating compliance with the price control and the retail margin squeeze test(s) based on the DCF model.

(iii) Demonstration of how any amendments to the price of the equivalent wholesale offering of an existing product are and will be in compliance with the price control obligation based on the DCF model.

7.75 Upon receipt of the statement of compliance ComReg will review the statement of compliance. Within the 5 working day period ComReg may do one or more of the following things:

(i) Provide Eircom with both (a) an appropriate written view, insofar as possible based on the available information provided by Eircom at that point in time, in relation to the statement of compliance and (b) written confirmation that the making available or offering for sale of the new or existing retail product appears to be in compliance with the retail margin squeeze test(s). However, any such written view or confirmation provided by ComReg is a *prima facie* view and does not fetter ComReg's future discretion in relation to its statutory powers;

(ii) Request any further information from Eircom and set a deadline by which such information shall be provided. Eircom should provide the requested information by the deadline and in such format and to the level of detail as stipulated by ComReg. Upon receipt of the requested information from Eircom and within the 5 working day period above, ComReg may do one or more the of the things referred to in sub-sections (i), (iii), (iv) or (v).

(iii) Inform Eircom in writing that the amendment(s) to either the new or existing retail product would in ComReg's view, not be in compliance with the price control and the retail margin squeeze test(s). This written notification would include reasoning for ComReg's view and would also inform Eircom that the amendment or change will or could result in the issuing of a notification of non-compliance;

(iv) For the purpose of further specifying requirements to be complied with by Eircom relating to the price control and the retail margin squeeze test(s), issue a direction or directions to Eircom, to refrain from making operative the corresponding amendment(s) to the equivalent wholesale offering of any new or existing product, service or facility; or

(v) For the purpose of further specifying requirements to be complied with by Eircom relating to the price control and the retail margin squeeze test(s), issue a direction or directions to Eircom, to refrain from making available or offering for sale, the equivalent wholesale offering of any new product, service or facility.

7.76 For the purposes of promotions, discounts and bundles, the obligations above should apply to new and existing retail product(s) and any equivalent wholesale product(s).

7.77 For the avoidance of doubt, approval in this context means that ComReg is of the view (based on the information provided to it by Eircom) that the notified wholesale Bitstream and BMB product(s) does not appear to breach the obligations set out in this Decision. The granting of approval does not amount to a definitive finding by ComReg that a particular wholesale Bitstream or BMB product is compliant, or will remain compliant in the future, with the margin squeeze obligations set out in this Decision. It should be noted that the granting of approval is strictly without prejudice to ComReg's right to take action (whether pursuant to this Decision and/or pursuant to any of its relevant statutory enforcement powers) in respect of any wholesale Bitstream and BMB products that it believes may be non-compliant with Eircom's regulatory or competition law obligations. It is incumbent on Eircom to ensure that all wholesale Bitstream and BMB products remain compliant with this Decision at all times

Chapter 8

8 Bitstream Ancillary Charges

8.1 Introduction

8.1 In the NGA Decision, ComReg specified that all ancillary charges associated with the provision of WBA would be subject to a cost orientation obligation which included both current generation and next generation services.

8.2 This chapter assesses the relevant ancillary charges associated with current generation WBA to ensure that the charges are in line with Eircom's cost orientation obligation.

8.3 Set out below are ComReg's preliminary views from the Consultation Document, the views of respondents and ComReg's assessment of the responses and our final position.

8.2 ComReg's Preliminary View from the Consultation

8.4 In the Consultation Document ComReg reviewed the Eircom Bitstream Access Reference Offer ("**BARO**") price list[58] (version 7.21), published at that time on the Eircom wholesale website. During the consultation period ComReg requested Eircom to review (or assess) the level of the charges in the table below to ensure that they are in line with its cost orientation obligation and to provide this information to ComReg so that it could assess it for compliance:

Figure 8.1: Ancillary charges in the Eircom BARO price list at the time of Consultation

Description	Price - €	Eircom table number in BARO
Service establishment charge	€8,035	Table 2.1
Connection charges:		

[58] http://www.eircomwholesale.ie/Reference-Offers/BARO/(Version 7.21)

Bitstream IP and MB *Bitstream VC*[59] *Bitstream EA*[60]	€15 €90 €75	Table 2.2
Cessation charge	€15	Table 2.4
Port transfer charge	€15	Table 2.5
Downgrade charge	€15	Table 2.6
Upgrade charge: *24 Mb Bitstream MB upgrade (per port)*	€15	Table 2.7
Bitstream Backhaul Connection Charges: *BCS STM1 and 45M CSH*[61] *BCS STM1 and 45M IBH*[62] *BECS 100M – 10 GB CSH* *BECS 500M and 1Gb IBH*	€16,000 €11,000 €7,500 €5,000	Table 3.1
Bitstream Backhaul Annual Rental Charges: BCS STM – 1 CSH BCS STM – 1 IBH BCS 45M CSH BCS 45M IBH BECS 100M CSH BECS 250M CSH	€40,000 €20,000 €16,250 €3,750 €15,000 €20,000	Table 3.2

[59] Bitstream Virtual Circuits
[60] Bitstream Ethernet Access
[61] Customer site handover
[62] In-building handover

BECS 500M CSH	€25,000	
BECS 500M IBH	€15,000	
BECS 1 Gb CSH	€35,000	
BECS 1 Gb IBH	€25,000	
BECS 10 Gb CSH	€55,000	

8.5 Please refer to paragraphs 8.5 to 8.9 of Chapter 8 in the Consultation Document for a further discussion on what each of the charges in the table above relate to.

8.6 ComReg then asked the following question:

Q. 6 Do you agree with ComReg's preliminary views set out above regarding the assessment of the various Bitstream ancillary charges to ensure that the charges are in line with Eircom's cost orientation obligation? Please provide reasons for your response.

8.3 Views of Respondents:

8.7 There were mixed views from respondents with regard to the assessment of the various Bitstream ancillary charges. A number of respondents raised some concerns which are set out below:

8.8 **Eircom** stated in its response that ComReg proposes to require that the charges for ancillary services to the basic Bitstream port and usage rental facility are cost oriented and that this determination is made in isolation of the form of price control that applies to the basic service. In its response Eircom also proposed changes to the Bitstream ancillary charges as follows:

1) To remove the service establishment charge given that these processes are now automated.

2) To reduce the Bitstream VC connection charge from €90 to €45 and to reduce the Bitstream EA charge from €75 to €35.

8.9 **Vodafone** disagreed with ComReg's preliminary views regarding the assessment of the ancillary charges. Vodafone stated that Eircom should not review the charges, but that ComReg should. Vodafone also added that these charges should not be reviewed as part of the consultation process but they should be reviewed as a matter of course by ComReg in discharge of its functions under Section 10(1)(a) of the Communications Act.

8.10 Vodafone made some high level comments on the ancillary charges under review as follows:

1) Service establishment charge: Whatever about the level of this charge it is arguable that if it is a necessary and unavoidable cost and the causation can be ascribed to a particular operator then it should be a standalone charge.

2) Connection charges: Vodafone believes that if these are cost oriented the six fold difference between the Bitstream MB and Bitstream VC would appear to merit detailed examination by ComReg.

3) Migration charge: While Vodafone agreed with the single migration charge it stated that €15 is a "round" number and that ComReg should review the totality of the efficient costs associated with these transactions and the totality of the revenues to ensure that the common price is set at a level which does not allow Eircom to over recover its costs.

4) BECs charges: Vodafone stated that as these will become redundant from 2014 the only charges in scope are those for connections between the date of the imposition of the obligation and the retirement of the service. ComReg should assess the extent to which these charges have been levied in the relevant period and prioritise the assessment of compliance based on impact on the market and on individual operators.

8.11 **BT** made two main comments as follows with regard to the review of ancillary charges:

1) Bitstream IP and BMB services are designed to bring customer data from the customer premises to central locations within the Eircom network which is core to the product rather than ancillary.

2) For Backhaul Extension Service (BECs) and WEILs, BT stated that these are large connection circuits to join the Eircom Bitstream platform to other operator networks and they agree that these are ancillary services and should be cost oriented.

8.12 **Magnet** and **ALTO** had concerns with regard to the definition of ancillary service relative to the product, e.g. BECs and WEIL are ancillary and cost oriented while BIP and BMB offerings are the core offerings.

8.13 **Viatel** fully supported ComReg's assessment of the connection charges but it believes that a fully independent cost model that confirms that the historic cost accounting data provided by Eircom is a reasonable representation of the actual costs incurred by Eircom in the provision of such services would be extremely helpful.

8.14 **Sky** stated that it would like to better understand the basis for ComReg's view that a €15 charge for migrations would be cost oriented and non-discriminatory, when migration charges for Eircom NGA services (all of which, at least initially, require a 'truck roll') is €2.50. Sky considers that without objective justification, there should be no difference between these charges. Sky also stated that it is important that charges for the same or similar ancillary services for different products be the same, particularly where those products compete in the same market.

8.4 ComReg's Assessment of Responses

8.15 Having considered the views of respondents, ComReg has set out its views in relation to each issue raised under the relevant headings below.

Obligation of cost orientation and review for compliance:

8.16 With regard to Eircom's point about cost orientation, ComReg would like to clarify that the obligation of cost orientation was imposed on all Bitstream ancillary services in the NGA Decision. Therefore, the obligation is already in place. It is not clear to ComReg why Eircom believes that cost orientation is not necessary with regard to the ancillary charges. In particular, even with a margin squeeze test obligation, it is necessary to have cost oriented connection charges to ensure that Eircom is not earning an excessive margin with regard to these one-off charges.

8.17 Vodafone stated that Eircom should not review the ancillary charges but that ComReg should and that these charges should not be reviewed as part of the consultation process but they should be reviewed as a matter of course by ComReg in discharge of its functions under Section 10(1)(a) of the Communications Act. ComReg would like to clarify that it reviews Eircom's regulated charges on an ongoing basis. In the context of this consultation process Eircom was asked to review (or assess) the charges in line with its obligation of cost orientation and to provide a supporting submission to ComReg so that ComReg could subsequently review the submission and assess it for compliance. ComReg subsequently received information from Eircom which was assessed and resulted in some price reductions to the ancillary charges. It is Eircom's responsibility to monitor compliance with its regulatory obligations. We consider that assessing prices for compliance with price control obligations is an ongoing process and ComReg may intervene at any stage (and where necessary exercise our powers under Section 10(1)(a) of the Communications Act) where it believes that Eircom may not be in compliance with its obligations.

Specific issues around Bitstream ancillary charges:

8.18 Vodafone raised some comments around the specific ancillary charges under review as set out at paragraph 8.10 above. In response, ComReg would like to make the following points:

(1) Vodafone questioned whether the service establishment charge was a necessary and unavoidable cost. Following the consultation Eircom has since abolished the service establishment charge.

(2) Vodafone questioned why the Bitstream VC charge was six times higher than the Bitstream MB charge. Eircom has since reduced the Bitstream EA and VC connections by circa 50% as set out in Eircom's Bitstream access reference offer price list on the Eircom Wholesale

website[63]. With regard to the differences in price between a Bitstream MB connection and the Bitstream EA / Bitstream VC connections, as ComReg understands it the Bitstream EA / VC are premium business services and hence the somewhat higher cost.

(3) Vodafone stated that ComReg should review the totality of the efficient costs associated with the transactions regarding the €15 migration charge and the totality of the revenues to ensure that the common price is set at a level which does not allow Eircom to over recover its costs. ComReg agrees with Vodafone that Eircom should not over recover its costs in relation to its current migration charge of €15. It is for Eircom to ensure compliance with its pricing obligations at all times. The current generation migration charge of €15 is based on both soft and hard migration costs associated with migrating between various legacy services. Based on ComReg's assessment these charges are currently in line with costs.

(4) With regard to Vodafone's point that the BECS charges should be reviewed from date of the imposition of the obligation of cost orientation to the time of retirement of the service, we consider that as these charges will be redundant shortly that it is not necessary to carry out a detailed review.

8.19 With regard to BT's comment that the Bitstream IP and BMB services are core to the product rather than ancillary it is worth clarifying that the reference to "ancillary" relates to the charges and not to the services. For example, connection charges and disconnection charges are "ancillary" charges compared with the main rental charge. The term "ancillary" has no relevance in terms of the service being provided in this context.

8.20 ComReg is not clear on the precise issue being raised by Magnet and ALTO regarding definitions of ancillary services. As stated in paragraph 8.19 the only relevance that the term "ancillary" has in the context of this review is that it relates to the review of "connection charges" which we consider "ancillary" to the main rental charges.

8.21 With regard to the point raised by Sky about the difference in the level of the migration charge for NGA and current generation, ComReg would like to point out that the NGA charge of €2.50 is just the administrative charge (or soft migration). The technical work / truck roll (or hard migration) is recovered in the VUA monthly rental charge or charged separately by Eircom to the OAOs where the OAO wants Eircom to install the NTU on their behalf. Please refer

[63] Bitstream price list at http://www.eircomwholesale.ie/Reference_Offers/?selectedtab=wbaro#baro

to Chapter 10 (subsection 10.19) of the NGA Decision for further details. The current generation migration charge of €15 is based on both soft and hard migration costs associated with migrating between various legacy services. In other words this charge is an average cost of migrations spread across the relevant current generation services rather than having different migration charges for different services. ComReg considers that these migration costs are legitimate costs for Eircom to recover.

<u>Other issues</u>:

8.22 With regard to Viatel's point about an independent cost model, ComReg would like to point out that the current Bitstream cost model (as discussed in Chapter 5) is an independent model in that it has been developed by independent consultants (TERA). It is important to note that the ancillary charges discussed in this Chapter are not part of the overall Bitstream cost model but subject to separate spreadsheet modeling exercises outside of the main Bitstream cost model.

8.5 ComReg's Final Position

8.23 ComReg notes the recent changes made by Eircom to a number of its Bitstream ancillary charges which are reflected in the Eircom Bitstream price list on the Eircom Wholesale website[64]. The price changes noted are as follows:

1) Abolishment of the service establishment charge of €8,035.

2) A reduction to the Bitstream VC connection charge from €90 to €45

3) A reduction to the Bitstream EA charge from €75 to €35.

8.24 Monitoring compliance with price control obligations is an ongoing process and ComReg may intervene at any stage where it believes that Eircom may not be in compliance with its obligations.

[64] http://www.eircomwholesale.ie/Reference_Offers/?selectedtab=wbaro#baro

Chapter 9

9 WBA Price Floors

9.1 Introduction

9.1 In the WBA Price Floors Decision ComReg published certain price floors to ensure that the Eircom Bitstream prices in the LEA are not set too low relative to WPNIA (or LLU) products which could discourage efficient investment in access infrastructure (or LLU).

9.2 The current WBA price floors are set out in the WBA Price Floors Decision and are also set out in Figure 9.1 of the Consultation Document.

9.3 In the Consultation Document ComReg reviewed the WBA price floors model and its inputs to ensure that the underlying assumptions remained appropriate. Set out below are ComReg's preliminary views regarding the main changes to the WBA price floors model, the views of respondents and ComReg's assessment of the responses and its final position.

9.2 ComReg's Preliminary Views from the Consultation

9.2.1 Subscriber demand

9.4 As set out in the Consultation Document, the actual subscriber numbers up to June 2012 have been inputted to the WBA price floors model and the forecasts are based on current market trends from ComReg's quarterly report data. In line with the subscriber assumptions in the Bitstream cost model, total DSL subscriptions to broadband services in the WBA price floors model are expected to drop slightly over the price control period but overall remain relatively stable.

9.5 ComReg noted that the update to the subscriber numbers in the WBA price floors model would mean that the total per port charges would decrease by ✂ cent and the per Mbps charge would decrease by ✂ cents.

9.2.2 Updated Backhaul prices

9.6 As set out in the Consultation Document, the WBA price floors model was updated to reflect the most up-to-date Backhaul prices from the leased lines price list[65]. Please refer to Figures 9.2, 9.3 and 9.4 in Chapter 9 of the Consultation Document for an assessment of the price changes to backhaul services since the 2012 WBA Price Floors Decision.

9.7 ComReg noted that when the backhaul price changes were reflected in the WBA price floors model, the total per port charges would fall by ✂ cents and the per Mbps charge would fall by ✂ cents.

9.2.3 Updated ARO prices

9.8 As set out in the Consultation Document there were also some changes to the wholesale prices in the Eircom ARO price list[66] since the WBA Price Floors Decision. These changes included the price for collocation surveys and site inspections / offers. Please refer to Figure 9.5 in Chapter 9 of the Consultation Document for details of these changes.

9.9 ComReg noted that when the ARO price changes were reflected in the Bitstream cost model this would mean that the total per port charges would fall by ✂ cents and the per Mbps charge would remain constant.

9.2.4 Updated price control period

9.10 As set out in the Consultation Document the period / duration of the WBA price floors model has been updated with a starting point from 1st April 2012.

9.11 ComReg noted that this update meant that the per port charge would fall by ✂ cents and the per Mbps charge would fall by ✂ cents.

9.2.5 Usage Levels

9.12 As set out in the Consultation Document ComReg noted that recent figures on BMB usage show that throughput levels are increasing on average at the 95th percentile. Consequently, ComReg considered it reasonable to assume that bandwidth levels will increase over the price control period.

9.13 As such, and in line with the bandwidth assumptions used in the Bitstream cost model, ComReg revised its WBA price floors calculation to take account of the increasing bandwidth usage by end-users.

65 http://www.eircomwholesale.ie/Reference-Offers/Documents/Network-Price-List-V5-7_Unmarked/
66 http://www.eircomwholesale.ie/Reference-Offers/Documents/ARO-price-list-v6-6/

9.14 A sensitivity analysis of 16 bandwidth scenarios from 150 kbps to 300 kbps was used in the model to create an average bandwidth level upon which the WBA price floors should be calculated over the price control period.

9.15 ComReg noted that the proposed revised bandwidth resulted in an increase to the total per port charges of ✂ cents (due to the higher apportionment of the fixed cost at higher usage levels) and a drop in the Mbps charge by €✂.

9.2.6 Revised WBA price floors

9.16 On the basis of the proposed changes above, the revised WBA price floors set out in the Consultation Document were as follows:

Price control	Monthly minimum price floor ex VAT
Monthly port cost per user	€4.34
Monthly Backhaul costs per user – Fixed	€1.57
Monthly Backhaul cost per Mbps – variable raised at the 95^{th} percentile of the 5 minute readings in any calendar month.	€5.60

9.17 ComReg explained that under the current charging regime, a usage level of 100kbps at the 95^{th} percentile would result in the price floor of €4.55 + €1.33 + (€8.14 * 0.1 Mbps) = €6.67 per month.

9.18 By implementing the proposed revisions discussed above, this would mean that for 100kbps at the 95^{th} percentile peak, the revised Bitstream price floor would be €4.34 + €1.57 + (€5.60 * 0.1 Mbps) = €6.45 per month, an overall decrease of €0.22 cents.

9.19 Therefore, ComReg proposed that the current WBA price floors that were already in place should remain in place given that the changes above would not appear to result in any overall material difference and may not yet be sufficiently stable to merit a change.

9.20 ComReg then asked the following question:

Q. 7	Do you agree that the current level of Bitstream price floors should remain in place? Please provide reasons for your response.

9.3 Views of respondents

9.21 There were mixed views among respondents with regard to ComReg's proposal that the WBA price floors should remain at their current levels. While Viatel, Magnet and Vodafone generally agreed with ComReg, BT and ALTO stated that the Bitstream price floor should be higher while Eircom stated that irrespective of the level of the change in the price floor that it should be applied in order to maintain the correct signals to potential investors in the market. Some of the main points raised by the respondents are set out below.

9.22 **Eircom** reiterated some of ComReg's statements from the WBA Price Floors Decision where ComReg stated in the Decision Instrument at Section 4.5 that "*The minimum price floors……….may be amended from time to time by ComReg*". In addition, Eircom was of the view that the difference indicated by ComReg was in fact a lot higher based on Eircom's calculation of the revised WBA price floors. Eircom pointed out that in particular the average BMB throughput in August 2013 was 186kbps and that this resulted in a reduction of twice that stated by ComReg in the Consultation Document. Eircom also stated that the reduction in the WBA price floors is of importance to Eircom in an environment where Eircom is subject to significant competitive constraints from services provided on alternative infrastructure and on LLU services. Eircom also highlighted the point that the key driver for the Bitstream price floor is to ensure economic space between LLU and Bitstream while ensuring that there was a "place" for each in the market. Eircom believed that the ComReg proposal not to amend the Bitstream price floor when a review of the model inputs results in the requirement for such an amendment is inconsistent and contrary to this objective.

9.23 **Vodafone** stated that it is not possible to comment substantively as only Eircom and ComReg have access to the WBA price floors model itself and that the information asymmetry means that operators must take at face value the summary figure which ComReg presents as being the revised output from the model. However, Vodafone agreed with ComReg's approach that there is little to be gained by a downward revision of the WBA price floors at this point.

9.24 **BT** stated that the price floor should be higher to cover their fully allocated costs but it did not provide detailed justification to back up the revised price floor number suggested by it in its response. BT separately made a confidential submission to ComReg which set out why their view the WBA price floors should not be updated which results in a lower floor than those published in ComReg D06/12.

9.25 While **Magnet** agreed with ComReg it stated that the WBA price floors model should be reviewed on an on-going basis to ensure that the inputs and assumptions are reasonable compared with actual information.

9.4 ComReg's Assessment of Responses

9.26 Having considered the views of respondents, ComReg has set out its views under the relevant subject headings below.

<u>Level of change in the WBA price floors</u>:

9.27 While BT stated that the price floors should be higher it provided no details to ComReg to justify its position. Therefore, ComReg sees no reason to further amend the inputs of the WBA price floors as a result of BT's comments. In respect to the separate confidential response received from BT, ComReg has fully considered BT's views submitted therein and it considers that no amendment to the relevant inputs to the WBA price floors are required. However, given the recent levels of increased throughput experienced by operators in a relatively short-period of time, ComReg is currently considering how the WBA price floors should take this into account (see also paragraph 9.32).

9.28 With regard to the point raised by Eircom that the reduction in the price floor should be ✂ cents rather than ✂ cents ComReg would like to point out that Eircom has only assessed one factor.

9.29 It is important to note that Eircom should ensure that the WBA price floors model is kept up-to-date at all times and that any significant changes to the inputs and / or parameters of the model should be reflected in the WBA price floor levels. ComReg will review any changes to the WBA price floors model for reasonableness. In particular and in line with the obligations set out in the NGA Decision, Eircom has an obligation to review the usage levels for current generation and next generation services on a quarterly basis and to update the associated models where appropriate.

Transparency:

9.30 While we note Vodafone's point that it was not possible to provide a substantive response given that it does not have access to the WBA price floors model, we consider that we shared the main changes to the model at the time of the consultation which should allow interested parties to provide their views. For obvious reasons of confidentiality and commercial sensitivity of the data concerned we were unable to publish any further details around the changes to the WBA price floors model.

Ongoing review of the WBA price floors model:

9.31 With regard to Magnet's point about an ongoing review of the Bitstream cost model, we consider that the recent review of the WBA price floors model as part of this consultation as well as the recent Call for Input regarding the usage / throughput rates is timely given that the WBA Price Floors Decision was only published in 2012. Eircom is responsible for ensuring that it complies with its price control obligations including any significant changes to underlying cost models. Therefore, Eircom should ensure that the WBA price floors model is kept up-to-date and that any significant changes to the inputs and / or parameters of the model should be reflected in the WBA price floor levels.

9.5 ComReg's Position

9.32 Since publication of the Consultation Document, ComReg issued a Call for Input, ComReg Document No 14/18, requesting *inter alia* the views from interested parties regarding the future evolution of broadband usage and the implications for throughput rates. Eircom's Next Generation Network is used to carry, amongst other services, bitstream traffic for current generation and NGA broadband services. A number of responses received from interested parties highlighted the current divergence in average speeds and pricing between current generation and NGA broadband services. ComReg is currently considering those responses and intends to publish an information notice in due course. Consequently, ComReg considers that it would not be appropriate at this time to publish an update to the minimum WBA price floors until the responses to the Call for Input have been fully considered.

Chapter 10

10 Appropriate Market 4 Access Input for Standalone Broadband ("SABB")

10.1 Introduction

10.1 As set out in the Consultation Document, up until 1 July 2013 the wholesale Bitstream service provided by Eircom could only be purchased with a plain old telephony service ("POTS") based Bitstream service. From 1 July, Eircom now offers a SABB service which allows an ADSL / ADSL2plus service to be delivered over a 2-wire copper pair without a POTS or voice telephony service.

10.2 As this SABB service is no longer supported by the SB-WLR service and its associated price (currently €18.02 Outside the LEA or €15.02 in the LEA[67]), we consider that it is necessary to assess the relevant underlying cost contribution from the access network for this service.

10.3 In the Bundles Decision, ComReg specified that Eircom should not create a margin squeeze between the WBA market and the WPNIA market in order to ensure a sufficient economic space between the price for LLU and Bitstream. As a result the concept of a minimum price floor was put in place in the Bundles Decision which Eircom must comply with when setting the price for SABB. The current margin squeeze test between WPNIA and WBA (which determine the minimum price floor for SABB) in the Bundles Decision uses the LLU price as the key input into the SABB price floor to ensure an OAO using the LLU service is in a position to profitably replicate the Eircom wholesale and retail standalone broadband service.

10.4 In the Bundles Decision ComReg specified that the price at which Eircom sells or offers a Downstream Regulated Wholesale Service[68] must be greater than the sum of:

(i) the ULMP cost stack, and

[67] Where the line is hosted on an Eircom exchange which is determined to be within the LEA — as published by ComReg from time to time or the exchange has been marked as 'Ready For Order' as per the NGA 'Advanced PreQual File' process. The broadband enabling wholesale products in scope are all variants of current generation broadband products (existing Bitstream and Line Share) and next Generation (Bitstream Plus and Virtual Unbundled Access) broadband products.

[68] Downstream Regulated Wholesale Service means a regulated wholesale service which is sold or offered by Eircom to OAOs downstream from the WPNIA Market and contains a ULMP component (examples of such Downstream Regulated Wholesale Services include, for example, SB-WLR and Naked WBA (Bitstream) DSL).

(ii) the unavoidable costs of a REO that must be incurred in order to provide a service equivalent to the relevant Downstream Regulated Wholesale Service.

10.5 Please refer to Chapter 10 in the Consultation Document or Chapter 7 of the Bundles Decision for the LLU cost stack used to calculate the appropriate minimum price floor for the ULMP component in a SB-WLR product or a SABB (Naked WBA (Bitstream) DSL) product.

10.6 In the Consultation Document we put indicative unit costs on the various cost components in order to determine an indicative minimum price floor level for SABB. However, we clarified that the numbers used were for illustrative purposes only and they would require a more in-depth review in the event of a margin squeeze investigation. Please refer to Figure 10.1 of the Consultation Document for further details as well as a discussion around the main inputs costs associated with the price floor for SABB.

10.7 The remainder of this Chapter looks at ComReg's preliminary views from the Consultation Document regarding the proposal of cost orientation for SABB Outside the LEA, the views of respondents, ComReg's assessment of the responses and ComReg's final position.

SABB Outside the LEA:

10.2 ComReg's Preliminary Views from the Consultation

10.8 In the Consultation Document ComReg considered that the current LLU price of €9.91 may not be the appropriate cost based input for SABB Outside the LEA as the appropriate LLU cost input for SABB should be supported with the relevant cost oriented LLU access input based on the copper access model ("CAM"). ComReg noted that this could give rise to a change in the costing methodology (from the current BU-LRAIC+) on the basis that the prospects for investment by other entrants Outside the LEA may be limited. ComReg stated that it would consult on the appropriate costing methodology for LLU and SLU over the next 12 – 18 months, including consideration on whether BU-LRAIC+ remains appropriate nationally or whether an alternative is more appropriate going forward.

10.9 Outside the LEA, ComReg considered that Eircom may price excessively for SABB services, given that there is little or no alternative infrastructure competition in this area. In summary, Outside the LEA there are fewer access alternatives available and Eircom's prices do not appear to be constrained at a wholesale or retail level in this area to a similar extent to the LEA. Therefore, ComReg's objective is to protect those operators and, ultimately, end-users in rural areas from excessive prices where they decide to purchase a broadband only service from Eircom.

10.10 In order to avoid the risk of Eircom setting an excessive price for SABB Outside the LEA, ComReg proposed that the obligation of cost orientation should apply to Eircom.

10.11 In the absence of data regarding actual costs for the provision of SABB we considered that in the interim Eircom should price SABB Outside the LEA on no more than:

- SB-WLR price *less* the costs avoided by not providing a voice service

10.12 We considered that so long as Eircom price its SABB product in line with the proposal above that we would not take any compliance action in the interim.

10.13 ComReg then asked the following question:

Q. 8 Do you agree with ComReg's preliminary views above with regard to the imposition of an obligation of cost orientation for SABB Outside the LEA? Please provide reasons for your response.

10.3 Views of Respondents

10.14 There was general agreement among all of the respondents with regard to the proposed imposition of an obligation of cost orientation for SABB Outside the LEA. In addition, a number of respondents also stated that a margin squeeze test should be implemented with regard to SABB in the LEA and Outside the LEA.

10.15 **Eircom** stated that it agrees that setting a price ceiling based on the costs of delivering SABB Outside the LEA would address any potential risk that Eircom set SABB prices at an excessive level in that part of the market. Eircom also agreed with the ComReg rationale that the SB-WLR price reduced by the costs avoided by not providing the voice service is the best available surrogate for the cost of copper loops outside the LEA. However, Eircom pointed out that the current SB-WLR line rental is a nationally averaged price which does not necessarily reflect the actual cost of delivering the service Outside the LEA. Eircom also raised the point that in the absence of modeled costs, it is premature to impose an obligation of cost orientation on the provision of SABB Outside the LEA.

10.16 **Vodafone, BT, Magnet** and **ALTO** stated that in addition to the obligation of cost orientation that a margin squeeze test aligned with the LEA and Outside the LEA should also be considered to ensure that other providers are not foreclosed from using the SABB product as Eircom could potentially undercut other network operators who have to pay various additional costs.

10.4 ComReg's Assessment of Responses

10.17 Having considered the views of respondents, ComReg has set out its views on each issue raised under the relevant subject headings below.

Cost orientation obligation absent a cost model:

10.18 Further to Eircom's point that in the absence of modeled costs, it is premature to impose an obligation of cost orientation on the provision of SABB Outside the LEA, ComReg considers that it is appropriate to impose a cost orientation obligation for SABB Outside the LEA for the reasons already set out in the Consultation Document, mainly regarding concerns of excessive pricing by Eircom. While we recognise that we do not have a cost model to substantiate a cost oriented SABB charge we hope to have completed the Access Network Review over the next 12 – 18 months, which will include a cost based charge for SABB. Therefore, at a later date we will further specify the obligation of cost orientation regarding SABB (pursuant to Regulation 13 and 18 of the Access Regulations) based on a modelled rate. In the interim and in the absence of such a model to support the cost oriented charge for SABB we consider that it is reasonable that Eircom should price SABB Outside the LEA on no more than SB-WLR price *less* the costs avoided by not providing a voice service.

Margin squeeze test:

10.19 A number of the OAOs stated that a margin squeeze obligation should also be imposed on Eircom with regard to SABB. The current DCF model as discussed in Chapter 7 allows ComReg to assess whether Eircom is creating a retail margin squeeze between the retail price of its SABB product compared with the associated retail and wholesale costs for SABB, both in the LEA and Outside the LEA. Therefore, in line with the retail margin squeeze tests in Chapter 7 Eircom should not be allowed to offer or price its SABB retail product below the relevant retail and wholesale costs of providing SABB in either of those two areas in line with the current DCF model. In addition and as noted in subsection 10.1 above, Eircom is also subject to a minimum price floor with regard to the price that it can charge for SABB in order to protect investment in LLU, as previously set out in the Bundles Decision.

10.5 ComReg's Final Position:

10.20 A detailed justification for imposing a cost orientation obligation for SABB Outside the LEA was set out in the Consultation Document. In this Decision Document we have considered the views of respondents and how this would impact on the details of the obligations being imposed on Eircom. ComReg has not restated its justification from the Consultation Document in this Decision Document where no change to the obligations is considered relevant. We have set out below the details of the obligations that Eircom must comply with as a result of this Decision.

10.21 ComReg has decided that the price(s) charged by Eircom to any other Undertaking for SABB provided Outside the LEA should be cost oriented.

10.22 In the absence of a cost model, Eircom should price SABB Outside the LEA based on no more than:

- SB-WLR price *less* the costs avoided by not providing a voice service.

Chapter 11

11 Decision Instrument

1. STATUTORY POWERS GIVING RISE TO THIS DECISION INSTRUMENT

1.1. This Direction and Decision Instrument ("Decision Instrument") is made by the Commission for Communications Regulation ("ComReg") and relates to the market for wholesale broadband access as identified by the European Commission in its Recommendation of 17 December 2007 on relevant product and services markets within the electronic communications sector susceptible to *ex ante* regulation[69] ("the Recommendation") and as defined by ComReg in ComReg Decision D06/11.

1.2. This Decision Instrument is made:

(i) Pursuant to Regulations 8, 9, 13 and 18 of the Access Regulations;

(ii) Having had regard to sections 10 and 12 of the Communications Regulation Act 2002 (as amended)[70] and Regulation 16 of the Framework Regulations[71] and Regulation 6 of the Access Regulations[72];

(iii) Having, where appropriate, pursuant to Section 13 of the Communications Regulation Act 2002 (as amended) complied with policy directions made by the Minister for Communications, Marine and Natural Resources[73];

(iv) Pursuant to and having regard to the Significant Market Power ("SMP") designation on Eircom in the market for wholesale broadband market and the obligations contained in ComReg Decision D06/11;

(v) Having had regard to the reasoning and analysis set out in ComReg Document No.10/56 and, where relevant, the responses thereto;

(vi) Having had regard to the reasoning and analysis set out in ComReg Document No. 13/90 and having taken account of submissions received from interested parties in response to ComReg Document No. 13/90 following public consultation pursuant to Regulation 12 of the Framework Regulations;

[69] European Commission Recommendation of 17 December 2007 on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services (OJ L 344, 28.12.2007, p. 65).

[70] Communications Regulation Act 2002 (No. 20 of 2002), as amended by the Communications Regulation (Amendment) Act 2007 (No. 22 of 2007), the Communications Regulation (Premium Rate Services and Electronic Communications Infrastructure) Act 2010 (No. 2 of 2010) and the Communications Regulation (Postal Services) Act 2011 (No. 21 of 2011).

[71] European Communities (Electronic Communications Networks and Services) (Framework) Regulations 2011 (S.I. No. 333 of 2011).

[72] European Communities (Electronic Communications Networks and Services) (Access) Regulations 2011 (S.I. No. 334 of 2011.

[73] Policy Directions made by the Minister for Communications, Marine and Natural Resources on 21 February, 2003 and 26 March, 2004.

(vii) Having notified the draft measure and the reasoning on which the measure is based to the European Commission, the Body of European Regulators for Electronic Communications (BEREC) and national regulatory authorities in other EU Member States pursuant to Regulations 13 and 14 of the Framework Regulations and having taken the utmost account of comments made by those parties; and

(viii) Having taken utmost account of the European Commission's recommendation of 11 September 2013[74] on non-discrimination obligations and costing methodologies to promote competition and enhance the broadband investment environment[75].

1.3. The provisions of ComReg Decision D06/11, ComReg Document No.10/56, ComReg Document No. 13/90 and the final decision entitled "Wholesale Broadband Access – Price control obligation in relation to current generation Bitstream" (Decision D11/14, Document No. 14/73) shall, where appropriate, be construed together with this Decision Instrument.

PART I – GENERAL PROVISIONS (SECTIONS 2 AND 3 OF THE DECISION INSTRUMENT)

2. DEFINITIONS AND INTERPRETATION

2.1. In this Decision Instrument, unless the context otherwise suggests:

"Access" shall have the same meaning as under Regulation 2 of the Access Regulations;

"Access Regulations" means the European Communities (Electronic Communications Networks and Services) (Access) Regulations 2011 (S.I. No. 334 of 2011);

"Additional Financial Information" means the information, as determined by ComReg, that shall be provided by Eircom on an annual basis in accordance with the Decision Instrument annexed to ComReg Decision D08/10 and has the same meaning as set out in Section 2.1 of that Decision Instrument;

"Associated Facilities" shall have the same meaning as under Regulation 2 of the Framework Regulations

"Authorisation Regulations" means the European Communities (Electronic Communications and Network Services) (Authorisation) Regulations, 2011 (S.I. No. 335 of 2011);

"Bitstream" means a wholesale product provided in the Market;

[75] Commission Recommendation of 11 September 2013 on consistent non-discrimination obligations and costing methodologies to promote competition and enhance the broadband investment environment (C(2013) 5671 final).

"Bitstream Cost Model" means the model, as amended from time to time, used by ComReg and Eircom to assess Eircom's compliance with the obligations contained in Sections 4.1 to 4.5 of this Decision Instrument. The operation and details of the Bitstream Cost Model are more particularly described in Chapter 6 of the final decision entitled "Wholesale Broadband Access – Price control obligation in relation to current generation Bitstream" (Decision D11/14, Document No. 14/73);

"Bitstream Managed Backhaul" means a form of Bitstream provided in the Market;

"Bundle" for the purpose of this Decision Instrument means a package of retail products or retail services, consisting of more than one service, which is on offer or on sale by Eircom;

"ComReg Decision D01/06" means ComReg Document No. 06/01 entitled "Retail minus wholesale price control for Wholesale Broadband Access Market" dated 13 January 2006;

"ComReg Decision D08/10" means ComReg Document No. 10/67 entitled "Accounting Separation and Cost Accounting Review of Eircom Ltd." dated 31 August 2010;

"ComReg Decision D06/11" means ComReg Document No. 11/49 entitled "Market Review: Wholesale Broadband Access" dated 8 July 2011;

"ComReg Decision D03/13" means ComReg Document No. 13/11 entitled "Next Generation Access ("NGA") Remedies for Next Generation Access Markets" dated 31 January 2013;

"ComReg Decision D04/13" means ComReg Document No. 13/14 entitled "Price Regulation of Bundled Offers: Further specification of certain price control obligations in Market 1 and Market 4" dated 8 February 2013;

"ComReg Document No. 10/56" means the document entitled "Wholesale Broadband Access – Consultation and draft decision on the appropriate price control" dated 15 July 2010;

"ComReg Document No. 13/90" means the document entitled "Wholesale Broadband Access: Price control obligation in relation to current generation Bitstream" dated 19 September 2013;

"DCF Model" means the discounted cash flow model, as amended from time to time, used by ComReg and Eircom to monitor Eircom's compliance with the Retail Margin Squeeze tests regarding Current Generation WBA contained in Section 6 of this Decision Instrument and is based on the following parameters;

(i) 'Retail Margin Squeeze in the Larger Exchange Area' which is based primarily on an SEO cost base with some costs based on an EEO cost base, as described in subsection 7.5, Chapter 7 of ComReg Decision D11/14 and is calculated based on a portfolio of products by taking into account the average total costs.

(ii) 'Retail Margin Squeeze outside the Larger Exchange Area' which is based on a SEO cost base and is calculated on a product-by-product basis.

"Discount" means an offer or sale of a product at less than its standard price, for example, a price reduction, including a volume related price reduction, a rebate, a reimbursement, a refund, a set-off and any other similar words or expressions;

"Effective Date" means the date set out in Section 11.1 of this Decision Instrument;

"Eircom" means Eircom Limited and its subsidiaries, and any Undertaking which it owns or controls, and any Undertaking which owns or controls Eircom Limited and its successors and assigns;

"Equally Efficient Operator cost base" or **"EEO cost base"** is a cost base which is derived from Eircom's costs and is based on Eircom's scale of operations;

"Framework Regulations" means the European Communities (Electronic Communications Networks and Services) (Framework) Regulations 2011 (S.I. No. 333 of 2011);

"Historical Cost Accounts" means the historical cost accounts which Eircom is required to publish in accordance with ComReg Decision D08/10;

"Larger Exchange Area" or **"LEA"** has the meaning as set out in Section 2.1 of the Decision Instrument contained in Annex 3 of ComReg Decision D04/13;

"(the) Market" means the market for wholesale broadband access. The Market is more particularly described in Section 4 of the Decision Instrument annexed to ComReg Decision D06/11;

"Other Authorised Operator(s)" or **"OAO"** means an Undertaking that is not Eircom, providing an electronic communications network or an electronic communications service authorised under Regulation 4 of the Authorisation Regulations;

"Point of Handover" means the physical point at which two networks are interconnected;

"Promotion" means an offer in respect of a product which is available for a finite period of time and which offers a tariff reduction;

"Retail Margin Squeeze in the Larger Exchange Area" as described in Section 6 of this Decision Instrument means the setting of a retail price in the Larger Exchange Area either based on a single product which is supported by a single wholesale offering or, the weighted average (by number of subscribers) of the retail products' individual prices where more than one product is supported by a single offering by Eircom for a current generation retail broadband product(s) which does not allow another operator, relying on current generation Bitstream to provide the same or similar retail product(s) at sufficient margin by reference to the sheet entitled "Control Sheet" in the DCF Model;

“Retail Margin Squeeze outside the Larger Exchange Area” as described in Section 6 of this Decision Instrument means the setting of a retail price outside the Larger Exchange Area either based on a single product which is supported by a single wholesale offering or, the weighted average (by number of subscribers) of the retail products’ individual prices where more than one product is supported by a single offering by Eircom for a current generation retail broadband product(s) which does not allow another operator, relying on current generation Bitstream to provide the same or similar retail product at sufficient margin by reference to the sheet entitled “Control Sheet” in the DCF Model;

“**Retail Product**” for the purposes of this Decision Instrument means any Eircom current generation retail broadband product on offer or on sale which uses Eircom’s network equipment to transmit data signals and shall include existing current generation retail products and new current generation retail products;

“Similarly Efficient Operator cost base” or **“SEO cost base”** is a cost base which means the costs of a hypothetical efficient operator which shares the same basic cost function as Eircom but which does not enjoy the same economies of scale and scope as Eircom;

“SMP” means Significant Market Power;

“SMP obligations” means the obligations set out in Regulation 9 to 14 of the Access Regulations;

“Standalone Broadband” means ADSL/ADSL2plus service delivered over a 2-wire copper pair without a Public Switched Telephone Network voice telephony service;

“Undertaking” has the meaning set out in Regulation 2 of the Framework Regulations;

“WBA” means wholesale broadband access comprising non-physical or virtual network access including Bitstream access at a fixed location. It includes Current Generation WBA and Next Generation WBA and is synonymous with the Market;

“Wholesale Broadband Access Reference Offer” or “WBARO” is the offer of contract by Eircom to OAOs in relation to Current Generation WBA (currently the WBARO version 7.23). For the avoidance of doubt the WBARO includes the documents which are expressly referred to as being part of the WBARO. For the avoidance of doubt, however, to the extent that there is any conflict between the WBARO and Eircom’s obligations now set out herein, it is the latter which shall prevail;

“(Current Generation) WBA” means WBA provided over Eircom’s current generation copper access network infrastructure and its Associated Facilities (including self-supply by Eircom for the purpose of serving its downstream markets) that is copper based;

“(Next Generation) WBA (NGA)” means WBA provided over next generation access network infrastructure and its Associated Facilities (including self-supply by Eircom for the purpose of serving its downstream markets) that is based on new or upgraded infrastructure, including (but not limited to) fibre and/or a combination of copper and fibre access technology, capable of supporting broadband access services with enhanced characteristics compared to current generation access infrastructure; and

"Wholesale Product" means any offering in the WBA market.

3. SCOPE AND APPLICATION

3.1. This Decision Instrument applies to Eircom in respect to activities falling within the scope of the Market.

3.2. This Decision Instrument is binding upon Eircom and Eircom shall comply with it in all respects.

PART II – SMP OBLIGATIONS (SECTIONS 4 TO 7 OF THE DECISION INSTRUMENT)

4. COST ORIENTATION PRICE CONTROL OBLIGATION

4.1. Pursuant to Regulations 8 and 13(1) of the Access Regulations, Eircom is subject to a cost orientation obligation with regard to the monthly rental charges for current generation Bitstream and Bitstream Managed Backhaul products and services which are provided within the Market.

4.2. Without prejudice to the generality of Section 4.1 and pursuant to Regulations 8 and 13 of the Access Regulations, Eircom shall ensure that it recovers no more than its total actual incurred cost adjusted for efficiency (plus a reasonable rate of return) associated with the provision of current generation Bitstream and Bitstream Managed Backhaul nationally, in line with the Bitstream Cost Model. Such costs are to be derived from Eircom's Historical Cost Accounts, forecasted forward over the duration of the Bitstream Cost Model.

4.3. Without prejudice to the generality of Sections 4.1 and 4.2 and pursuant to Regulations 8 and 13 of the Access Regulations, Eircom shall ensure that it recovers no more than its actual incurred cost, adjusted for efficiency (plus a reasonable rate of return) associated with the provision of current generation Bitstream and Bitstream Managed Backhaul outside the LEA which shall be calculated in line with the Bitstream Cost Model. Such costs shall be derived from Eircom's Historical Cost Accounts, forecasted forward over the duration of the Bitstream Cost Model.

4.4. Pursuant to Regulations 8 and 13 of the Access Regulations and in accordance with the timelines contained in the transparency obligations set out in Section 10.3 of the Decision Instrument annexed to ComReg Decision D06/11 (as amended by Section 5.1 of this Decision Instrument) Eircom shall notify ComReg before it increases or introduces a new price for the monthly rental charge(s) for current generation Bitstream and Bitstream Managed Backhaul outside the LEA.

At notification, Eircom shall furnish ComReg with a detailed written submission demonstrating that the proposed new or increased charge(s) comply with the obligations contained in Sections 4.1 and 4.3 of this Decision Instrument. The submission shall make full and true disclosure of all material facts for the purpose of demonstrating that the proposed new or increased charge(s) comply with Sections 4.1 and 4.3 herein. Upon receipt of the submission, ComReg shall review the submission and within one (1) month, communicate to Eircom its decision whether to give or withhold approval to implement the proposed new or increased charge(s). Such approval shall not be unreasonably withheld by ComReg. Eircom shall not implement any new or increased charge(s) for Bitstream and Bitstream Managed Backhaul outside the LEA without having received such approval from ComReg. Prior to the expiry of the one (1) month period, ComReg may seek further information from Eircom to inform its decision as to whether approval to implement the new or increased charge(s) should be given or withheld. If such further information is not provided by Eircom within ComReg‘s timeline or to the standard required by ComReg, approval to implement the proposed new or increased charge(s) shall be withheld pending the required information being made available to ComReg for review and consideration. Upon receipt of the requested information, ComReg will proceed to make a decision as to whether approval for implementation of the new or increased charge(s) should be granted or withheld. The periods referred to in this Section 4.4 may be varied with the agreement of ComReg or at ComReg’s discretion.

4.5. Pursuant to Regulations 8 and 13 of the Access Regulations and without prejudice to Sections 4.1, 4.2 and 4.3 of this Decision Instrument and its obligations contained in the Decision Instrument attached to ComReg Decision D08/10, Eircom shall submit annually to ComReg a written statement reconciling the costs it actually incurs in the provision of Bitstream and Bitstream Managed Backhaul for the preceding financial year with the forecasted costs and revenues contained in the Bitstream Cost Model. Eircom shall provide a written statement explaining the extent, if any, of any such discrepancy between the actual costs and revenues and the forecasted costs and revenues in the Bitstream Cost Model over the duration of the Bitstream Cost Model. The written statement referred to in this Section 4.5 shall be provided to ComReg in accordance with the procedure which governs the provision of Additional Financial Information contained in the Decision Instrument annexed to ComReg Decision D08/10 and shall be provided no later than seven months after the end of Eircom’s financial year.

4.6. Pursuant to Regulations 8 and 13(1) of the Access Regulations, the price(s) charged by Eircom to any other Undertaking for Standalone Broadband provided outside the LEA shall be cost oriented.

5. TRANSPARENCY OBLIGATIONS TO SUPPORT PRICE CONTROL OBLIGATIONS

5.1. Pursuant to Regulations 8, 9 of the Access Regulations Section 10.3 of the Decision Instrument annexed to ComReg Decision D06/11 is hereby amended by the insertion of the following wording after the wording already contained in that Section:-

"*Eircom shall unless otherwise agreed by ComReg, make publicly available and publish on Eircom's publicly available wholesale website at least three (3) months in advance of coming into effect, any proposed amendments or changes to the WBARO, resulting from a price increase to an existing Current Generation WBA product, service or facility. Eircom shall notify ComReg in writing by email with the information to be published at least one (1) month in advance of any such publication taking place, that is, three (3) or four (4) months (as appropriate) prior to any amendments or changes coming into effect. The periods referred in this Section may be varied with the agreement of ComReg or at ComReg's discretion*."

5.2. In accordance with Section 10.1 of the Decision Instrument annexed to ComReg Decision D06/11 Eircom shall have an obligation of transparency as provided for by Regulation 9 of the Access Regulations in respect of Access. Without prejudice to the generality of Section 10.1 and Section 10.3 of the Decision Instrument annexed to ComReg Decision D06/11 (now amended pursuant to Section 5.1 of this Decision Instrument) pursuant to Regulations 9 and 13 of the Access Regulations Eircom shall unless otherwise agreed by ComReg, make publicly available and publish on Eircom's publicly available wholesale website at least three (3) months in advance of coming into effect, any proposed amendments or changes to the WBARO, resulting from a price increase to an existing Current Generation WBA product, service or facility. Eircom shall notify ComReg in writing by email with the information to be published at least one (1) month in advance of any such publication taking place, that is, three (3) or four (4) months (as appropriate) prior to any amendments or changes coming into effect. The periods referred in this Section may be varied with the agreement of ComReg or at ComReg's discretion. For the avoidance of doubt, except as expressly varied in this Decision Instrument, Section 10.3 of the Decision Instrument of ComReg Decision D06/11 shall otherwise be unaffected and shall continue to remain in force.

6. RETAIL MARGIN SQUEEZE PRICE CONTROL OBLIGATION

6.1. The Direction in this Section is issued pursuant to Regulations 13 and 18 of the Access Regulations, for the purpose of further specifying requirements to be complied with by Eircom relating to the obligation not to cause a margin / price squeeze pursuant to Regulation 13 of the Access Regulations and Section 12.4 of the Decision Instrument annexed to ComReg Decision D06/11.

6.2. Eircom is directed not to cause a Retail Margin Squeeze in the Larger Exchange Area between: (i) the retail price of a single Retail Product which is supported by a single wholesale offering or, the weighted average (by number of subscribers) of Retail Products' individual prices where more than one Retail Product is supported by a single offering; and (ii) the price charged by Eircom for wholesale Bitstream. The assessment of the Retail Margin Squeeze in the Larger Exchange Area shall be conducted on a portfolio basis by reference to the DCF Model.

6.3. Eircom is directed not to cause a Retail Margin Squeeze outside the Larger Exchange Area between:- (i) the retail price of a single Retail Product which is supported by a single wholesale offering or, the weighted average (by number of subscribers) of Retail Products' individual prices where more than one Retail Product is supported by a single offering; and (ii) the price charged by Eircom for wholesale Bitstream. The assessment of the Retail Margin Squeeze outside the Larger Exchange Area shall be conducted on a product-by-product basis by reference to the DCF Model.

6.4. Eircom shall notify ComReg (by email) of all retail prices for new Retail Products and for retail price amendments to existing Retail Products no later than 5 working days prior to the date that the new or revised price is to become operative (for the avoidance of doubt the timelines set out at Section 5.1 of this Decision Instrument and Section 10 of the Decision Instrument annexed to D06/11 shall not apply in this respect, where no wholesale price amendment is required).

6.5. For the purposes of new Retail Products and for amendments to existing Retail Products, Eircom shall furnish to ComReg, at the same time as it notifies ComReg in accordance with Section 6.4 of this Decision Instrument, a detailed written statement of compliance demonstrating Eircom's compliance and proposed compliance with the price control obligation, as more specifically referred to in Section 6.2 and / or Section 6.3 of this Decision Instrument. The statement of compliance shall include the following:

(i) A full and true disclosure of all material facts for the purpose of demonstrating compliance with the price control and the obligation referred to in Section 6.2 and / or Section 6.3 of this Decision Instrument, which is based on the Retail Margin Squeeze test in the DCF Model;

(ii) All relevant supporting documentation for the purpose of demonstrating compliance with the price control and the obligation referred to in Section 6.2 and / or Section 7.70 of this Decision Instrument and which is based on the Retail Margin Squeeze test in the DCF Model; and

(iii) Demonstration of how any amendments to the price of the equivalent wholesale offering of an existing product are and will be in compliance with the price control and the obligations referred to in this Decision Instrument, based on the DCF Model.

6.6. Upon receipt of the statement of compliance referred to in Section 6.5, ComReg shall review the statement of compliance. Within the 5 working day period referred to in Section 6.4, ComReg may do one or more of the following things:

(i) Provide Eircom with both (a) an appropriate written view, insofar as possible based on the available information provided by Eircom at that point in time, in relation to the statement of compliance referred to in Section 6.5; and (b) written confirmation that the making available or offering for sale of the new or existing Retail Product appears to be in compliance with Eircom's obligations at Section 6.2 and / or Section 6.3 of this Decision Instrument. However, any such written view or confirmation provided by ComReg is a prima facie view and does not fetter ComReg's future discretion in relation to its statutory powers;

(ii) Request any further information from Eircom and set a deadline by which such information shall be provided. Eircom shall provide the requested information by the deadline and in such format and to the level of detail as stipulated by ComReg. Upon receipt of the requested information from Eircom and within the 5 working day period referred to in Section 6.4, ComReg may do one or more of the things referred to in sub-sections (i), (iii), (iv) or (v) of this Section 6.6;

(iii) Inform Eircom in writing that the amendment(s) to either the new or existing Retail Product would in ComReg's view, not be in compliance with the price control obligation and the obligation referred to in Section 6.2 and / or Section 6.3 of this Decision Instrument, giving reasons therefor and also more specifically inform Eircom that the amendment or change if made operative will or could result in the issuing of a notification of non-compliance under Regulation 19(1) of the Access Regulations;

(iv) For the purpose of further specifying requirements to be complied with by Eircom relating to the price control and the obligation referred to in Section 6.2 and / or Section 6.3 of this Decision Instrument, issue a direction or directions to Eircom under Regulation 18 of the Access Regulations, to refrain from making operative the corresponding amendment(s) to the equivalent wholesale offering of any existing or new product, service or facility; or

(v) For the purpose of further specifying requirements to be complied with by Eircom relating to the price control and the obligation referred to in Section 6.2 and / or Section 6.3 of this Decision Instrument, issue a direction or directions to Eircom under Regulation 18 of the Access Regulations, to refrain from making available or offering for sale, the equivalent wholesale offering of any new product, service or facility.

6.7. For the purposes of Promotions and Discounts and Bundles, the obligations contained in this Section 0 shall apply in respect to new and existing Retail Product(s) and any equivalent Wholesale Product(s).

7. MISCELLANEOUS PRICE CONTROL OBLIGATIONS

7.1. Pursuant to Regulations 8 and 13 of the Access Regulations, Eircom shall review the usage rates (based on Kbps peak hour usage) for Current Generation WBA products and services on a quarterly basis. In the event of a discrepancy between the usage rates specified in (i) the DCF Model and the Bitstream Cost Model and (ii) the actual usage rates experienced by Eircom, Eircom shall update the DCF Model and the Bitstream Cost Model for any amendments as a result of its review, as appropriate.

7.2. Pursuant to Regulations 8 and 13 of the Access Regulations, Section 4.2 of the Decision Instrument annexed to ComReg Decision D03/13 amended Section 12.6 of the Decision Instrument annexed to D06/11 by the insertion of the additional subsection as contained in that Section 4.2. For the avoidance of doubt, the reference to “ancillary services” in the new Section 12.6 includes In-building handover and In-span handover which are referred to in Section 7.2 of the Decision Instrument annexed to ComReg Decision D06/11 and defined in Section 2.1 of the Decision Instrument annexed to ComReg Decision D06/11.

PART III – OBLIGATIONS AND EFFECTIVE DATE (SECTIONS 8 TO 11 OF THE DECISION INSTRUMENT)

8. STATUTORY POWERS NOT AFFECTED

8.1. Nothing in this Decision Instrument shall operate to limit ComReg in the exercise and performance of its statutory powers or duties conferred on it under any primary or secondary legislation (in force prior to or after the Effective Date of this Decision Instrument) from time to time.

9. MAINTENANCE OF OBLIGATIONS

9.1. Unless expressly stated otherwise in this Decision Instrument, all obligations and requirements contained in Decision Notices and Directions made by ComReg applying to Eircom and in force immediately prior to the Effective Date of this Decision Instrument, are continued in force by this Decision Instrument and Eircom shall comply with same.

9.2. If any section, clause or provision or portion thereof contained in this Decision Instrument is found to be invalid or prohibited by the Constitution, by any other law or judged by a court to be unlawful, void or unenforceable, that section, clause or provision or portion thereof shall, to the extent required, be severed from this Decision Instrument and rendered ineffective as far as possible without modifying the remaining section(s), clause(s) or provision(s) or portion thereof of this Decision Instrument, and shall not in any way affect the validity or enforcement of this Decision Instrument or other Decision Instruments.

10. AMENDMENT AND WITHDRAWAL OF EXISTING OBLIGATIONS

10.1. Pursuant to Regulations 8, 9 and 13 of the Access Regulations, ComReg Decision D01/06 shall be withdrawn from the date on which Sections 4, 5, 6 and 7 of this Decision Instrument takes effect.

10.2. Pursuant to Regulations 8 and 13 of the Access Regulations, Section 12.3 of the Decision Instrument annexed to ComReg Decision D06/11 shall be amended from the date on which Sections 4, 5, 6 and 7 of this Decision Instrument takes effect with the removal of the following wording:

"Prices charged by Eircom to any other undertaking for Access to or use of those products, services or facilities referred to in section 7 shall be subject to the existing obligations as set out in ComReg Decision D01/06 (Retail Minus Wholesale Price Control for the WBA Market) dated 13th January 2006 (ComReg Decision D01/06) and any other obligations applying to Eircom in force immediately prior to the effective date of this Decision Instrument."

10.3. Pursuant to Regulations 8 and 9 of the Access Regulations, Section 10.3 of the Decision Instrument annexed to ComReg Decision D06/11 shall be amended as set out in this Decision Instrument from the date on which Sections 4, 5, 6 and 7 of this Decision Instrument takes effect.

11. EFFECTIVE DATE

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

Kevin O'Brien

Commissioner

The Commission for Communications Regulation

THE 8 DAY OF JULY 2014

12 Regulatory Impact Assessment

12.1 Introduction

11.1 A RIA is an analysis of the likely effect of proposed new regulation or regulatory change. The RIA should help identify regulatory options, and should establish whether proposed regulation is likely to have the desired impact. The RIA is a structured approach to the development of policy, and analyses the impact of regulatory options on different stakeholders.

11.2 ComReg's approach to the RIA is set out in the Guidelines published in August 2007 in ComReg Document Nos. 07/56 & 07/56a. In conducting the RIA, ComReg takes into account the RIA Guidelines[76], issued by the Department of An Taoiseach in June 2009 under the Government's Better Regulation programme. Section 13(1) of the Communications Regulation Act 2002 requires ComReg to comply with Ministerial Policy Directions. The Policy Direction issued in February 2003[77] requires that, before deciding to impose regulatory obligations on undertakings, ComReg shall conduct a RIA in accordance with European and international best practice and otherwise in accordance with measures that may be adopted under the Government's "Better Regulation" programme.

11.3 In conducting the RIA, ComReg has regard to the RIA Guidelines, while recognising that regulation by way of issuing decisions e.g. imposing obligations or specifying requirements in addition to promulgating secondary legislation, may be different to regulation exclusively by way of enacting primary or secondary legislation. Our ultimate aim in conducting a RIA is to ensure that all measures are appropriate, proportionate and justified. To ensure that a RIA is proportionate and does not become overly burdensome, a common sense approach will be taken towards a RIA. As decisions are likely to vary in terms of their impact, if after initial investigation, a decision appears to have relatively low impact then ComReg may carry out a lighter RIA in respect of those decisions. ComReg considered that a RIA was necessary in relation to the current pricing decision given that we are imposing the obligation of cost orientation on Eircom for Bitstream services both nationally and Outside the LEA.

[76] See "Revised RIA Guidelines How to Conduct a Regulatory Impact Analysis", June 2009. http://www.betterregulation.ie/eng/Developments in Better Regulation Policy/Revised RIA Guidelines.pdf.

[77] Ministerial Policy Direction made by the Minister of Communications, Marine and Natural Resources on 21 February 2003.

12.2 Steps for assessing regulatory options

11.4 In assessing the available regulatory options, ComReg's approach to the RIA follows five steps as follows:

Step 1: describe the policy issue and identify the objectives

Step 2: identify and describe the regulatory options

Step 3: determine the likely impacts on stakeholders

Step 4: determine the likely impacts on competition

Step 5: assess the likely impacts and choose the best option.

11.5 The principles applied when assessing and selecting remedies are:

- Does current regulation achieve objectives as effectively as possible?
- Are changes to regulation required to improve regulation in these markets?
- The impact of the changes
- Assessing the impacts and choosing the best option.

11.6 In choosing remedies we have taken account of Regulation 8(6) of the Access Regulations, Section 12 of the Communications Regulation Act, Regulations 9 and 13 of the Access Regulations and Regulation 16 of the Framework Regulations. Set out below is a discussion on how each of the relevant objectives from the Access and Framework Regulations and the Communications Regulations Act are addressed in the context of the pricing approach set out in this Decision Document.

12.3 Step 1 - Describe the policy issue and identify the objectives

11.7 An important consideration for this RIA is the scope of the further specification of the margin squeeze obligation and the imposition, amendment and withdrawal of the price control and the transparency obligations contained in the WBA Market Decision.

11.8 In setting out our decision, ComReg has had regard to its relevant statutory functions, objectives and obligations, as set out in section 12 of the Communications Regulation Act 2002 (as amended), Regulation 16 of the Framework Regulations and in Regulations 8, 9 and 13 of the Access Regulations. These are discussed in some detail below.

11.9 In the LEA one of the key regulatory objectives is to ensure investment by alternative operators is not foreclosed or dis-incentivised. This objective is addressed by the WBA Price Floors Decision. In addition, another key regulatory objective in the LEA is to ensure that competitors have sufficient retail margin to be in a position to replicate the retail offers of Eircom. The retail margin squeeze test in the LEA has been addressed in Chapter 7 of this Decision Document.

11.10 Outside the LEA, the key regulatory objective is to prevent Eircom from pricing excessively. Given the absence of competing infrastructure Outside the LEA and given that there are no wholesale or retail constraints on Eircom in this area we consider that an obligation to prevent excessive pricing is appropriate. By applying the historic cost accounting ("**HCA**") methodology which uses Eircom's costs (adjusted for efficiency plus a reasonable rate of return). This should allow Eircom to recover any money invested in maintaining or upgrading its network on the basis that Eircom will have the assurance that what it spends can be recouped over the price control period – particularly Outside the LEA (e.g., operating expenditure adjusted for efficiencies associated with maintenance expenditure and any relevant depreciation charges associated with capital expenditure). Therefore, Eircom's investment incentives are not negatively affected by this Decision in fact are likely to be enhanced Outside the LEA. In order to provide transparency and pricing certainty to other operators relying on Bitstream we consider that it was appropriate to impose an obligation that Eircom should not recover any more than its actual costs adjusted for efficiencies in the area Outside the LEA. Currently, the retail minus price control does not provide such certainty to entrant operators in the area Outside the LEA. This is a very important consideration in our view. In addition, our objective Outside the LEA is also to ensure that other operators in this area have sufficient retail margin to compete with Eircom. The retail margin squeeze test Outside the LEA has been addressed in Chapter 7 of this Decision Document.

12.3.1 Regulation 8 of the Access Regulations

11.11 Regulation 8(6) of the Access Regulations provides that: *Any obligations imposed in accordance with this Regulation shall –*

(a) Be based on the nature of the problem identified,

(b) Be proportionate and justified in light of the objectives laid down in section 12 of the Act of 2002 and Regulation 16 of the Framework Regulations, and

(c) Only be imposed following consultation in accordance with Regulation 12 and 13 of the Framework Regulations.

<u>Based on the nature of the problem identified</u>:

11.12 In the WBA market review, in ComReg Document No 10/81[78], ComReg identified the competition problems associated with the WBA market. The competition problems identified by ComReg as part of the WBA market review included excessive pricing, exclusionary / predatory behaviour and as well as concerns around vertical leverage. Please refer to ComReg Document 10/81 and the WBA Market Decision for a discussion on the competition problems associated with the WBA market. The competition problems associated with the WBA market have also been summarised in Chapter 3 of this Decision Document. ComReg considers that there has been no unforeseen and material change to the conclusions of the WBA market review with regards to SMP designation or competition problems. ComReg considers that the pricing approach set out in Chapter 5 of this document should address the specific competition problems noted in the WBA market review.

<u>Proportionate and justified</u>:

11.13 ComReg considers that the pricing approach set out in this Decision Document is proportionate and justified. This Decision will not result in any immediate changes to current generation Bitstream prices. Instead this Decision provides transparency to the industry insofar as Eircom can recover no more than its actual Bitstream costs (adjusted for efficiency plus a reasonable rate of return) nationally but also in the area Outside the LEA. In addition, this Decision should provide reasonable price certainty and predictability to operators in the WBA market. In particular, Outside the LEA the obligation of cost orientation based on HCA costs ensures that Eircom cannot increase the Bitstream prices Outside the LEA or introduce the price for a new Bitstream monthly rental charge without demonstrating to ComReg that any revised (or new) prices are based on no more than the actual local costs adjusted for efficiencies (plus a reasonable rate of return) in that area. This is a very important consideration in our view which means that Eircom cannot price excessively for broadband services in rural areas where there is no cost justification.

11.14 The retail margin squeeze test is similar to the current "retail minus" pricing approach already in place, except the retail margin squeeze test now takes account of the prospective varying structural and competitive conditions between the LEA and Outside the LEA. The retail margin squeeze approach also ensures consistency with the retail margin squeeze approach already in place in the NGA Decision and the Bundles Decision as well as ensuring technological neutrality between current generation and next generation services in the WBA market.

[78] Consultation and Draft Decision – Market Review: Wholesale Broadband Access (Market 5); 1 October 2010.

11.15 While it may take Eircom some time to gather local cost information for the specific area Outside the LEA we consider that given the materiality of Bitstream revenues earned by Eircom (as per its published Regulated Accounts), the benefit to other operators and ultimately end-users should outweigh any cost.

11.16 We consider that the notification and approval procedure for Bitstream price increases and / or new current generation Bitstream products introduced by Eircom Outside the LEA is proportionate and reasonable. This allows ComReg sufficient time to understand the proposed price increases and / or proposed new prices and to assess whether the prices increases / new prices comply with Eircom's obligation with regard to the recovery of no more than local efficient costs (plus a reasonable rate of return) in the area Outside the LEA, while also ensuring compliance with the overriding national cost orientation obligation. It also allows OAOs to assess the likely impact of the changes in terms of its business case and to allow the OAOs time to notify its customers of a price increase, where appropriate.

11.17 For SABB Outside the LEA, ComReg considers that Eircom may price excessively for SABB services given that there is little or no alternative infrastructure competition in this area. Therefore, ComReg's objective is to protect those operators and, ultimately, end-users in rural areas from excessive prices where they decide to purchase a broadband only service from Eircom. In order to avoid the risk of Eircom setting an excessive price for SABB Outside the LEA, ComReg is of the view that the obligation of cost orientation should apply to Eircom. In the absence of data regarding actual costs for the provision of SABB we consider that it is proportionate and justified that in the interim Eircom should price SABB Outside the LEA on no more than the SB-WLR price *less* the costs avoided by not providing a voice service.

11.18 ComReg also considers that the pricing approach is justified based on the detail, reasoning and information provided in this Decision Document which demonstrates how we have reached our final position on the appropriate price control for current generation Bitstream services. Please refer to Chapter 5 in particular with regard to the justification for our pricing approach. However, in line with Regulation 8(6)(c) of the Access Regulations we have considered responses to consultation and, based on those responses, we have amended some of our views from the consultation in this Decision Document.

12.3.2 Section 12 of the Communications Regulations Act

11.19 Our objectives as set out in Section 12 of the Communications Regulations Act aim to:

(i) Promote competition and in particular to encourage efficient investment in infrastructure and promoting innovation;

(ii) Contribute to the development of the internal market;

(iii) Promote the interests of users within the Community and in particular to encourage access to the internet at a reasonable cost to end-users.

<u>Promote competition:</u>

11.20 The retail margin squeeze approach will allow Eircom to meet competition at the retail level within the LEA. To date Eircom had the flexibility to reduce retail prices but had not done so to the extent it could have (to the WBA price floors). There is evidence to suggest that Eircom might reflect the competition it faces inside the LEA increasingly in its wholesale prices going forward. Therefore, the risk of wholesale prices being too high inside the LEA may be reduced and for operators reliant on Bitstream as an input, the pricing approach allows for lower wholesale charges which can therefore improve the OAOs ability to compete in the retail broadband market. This view is supported by our consultants, Oxera, as set out in ComReg Document No 13/90a.

11.21 In addition, the retail margin squeeze test in the LEA should protect operators that rely on LLU and line share wholesale inputs. This is particularly important in the LEA where most unbundling activity takes place. The WBA Price Floors Decision prevents Eircom from setting prices too low in the LEA, given that it may discourage the emergence of infrastructure-based competition (i.e., LLU competition) which could result in competition in downstream markets based solely on Eircom's network inputs such as Bitstream. Insofar as ComReg aims to promote LLU-based broadband competition, it is necessary to ensure a sufficient economic space between Bitstream and LLU, which can be achieved through the WBA price floors. The retail margin squeeze principles to be applied in the LEA for current generation Bitstream are compatible with the recent NGA Decision, where competitive conditions also differed geographically. In that context, competition is protected by ensuring sufficient economic space between VUA and Bitstream plus, the NGA equivalents of LLU and Bitstream respectively.

11.22 So long as wholesale Bitstream prices Outside the LEA do not exceed local efficient costs (plus a reasonable rate of return), we are of the view that competition Outside the LEA should not be immediately threatened. Without regulation, the prospects for increased competition in current generation services Outside the LEA are limited, and therefore the impact on competition may be minimal. ComReg considers that the pricing approach Outside the

LEA should protect end-users from excessive pricing and preserve Bitstream as a form of broadband competition in these areas. The form of price control should permit Eircom to recover its investment where this is economically rational, and hence provide regulatory certainty to current and potential entrants as well as Eircom.

11.23 In addition, the retail margin squeeze test protects a number of smaller operators Outside the LEA that make up about ✂% (of the ✂% retail broadband market in that area) but who have low market penetration (✂% or less with the exception of Vodafone) and who are vulnerable to exclusionary behaviour given that they do not share Eircom's economies of scale and that they have no realistic alternative means of provision.

<u>Encouraging efficient investment in infrastructure and promoting innovation</u>:

11.24 New investment in current generation networks in the LEA are likely to be limited, given the nature of competition from competing platforms and Eircom's focus on NGA products in this area.

11.25 ComReg considers that consistency of regulation across wholesale products is also important to investment decisions. The retail margin squeeze test for current generation Bitstream is consistent with the retail margin squeeze test in place in the recent NGA Decision which should provide signals for efficient investment in both types of infrastructure. If the approach was inconsistent between current generation WBA and NGA WBA services it may create distortions in investment.

11.26 The WBA price floors provide the appropriate investment incentives (build or buy signals) for those operators considering investing in LLU or other infrastructure operators that are planning to invest.

11.27 The use of the HCA methodology as a result of this Decision will allow Eircom to recover any money invested in maintaining or upgrading its network on that basis that Eircom will have the assurance that what is spends can be recouped over the price control period - particularly Outside the LEA. Therefore, Eircom's investment incentives are unlikely to be affected. In addition, the cost orientation price control will lead to reasonable price stability for other operators' investment plans. While we will review cost recovery annually this may not lead to price changes. We plan to only allow price changes which we felt were likely to be sustainable and where Eircom are clearly materially under / over recovering its costs over a reasonably extended period. Therefore, our annual review is not intended to be a static point in time review but rather where cost recovery issues are apparent a more detailed dynamic assessment will be necessary and possibly consultation with industry may be required where price changes are proposed. It is important that any one-off reductions or increases to historic costs do not give ruse to distortions in the market.

<u>Promoting the interests of users within the Community</u>:

11.28 Safeguarding efficient competitors from possible below cost selling by the SMP operator in respect of current generation Bitstream services should help to facilitate greater regulatory certainty for longer-term competitive entry and expansion. This should have positive implications for the price, choice and quality of services ultimately delivered to end-users. In addition, this Decision Document provides regulatory certainty to the industry and to end-users that if Eircom was to increase Bitstream prices Outside the LEA (subject to ComReg's prior approval) and / or launch new current generation Bitstream products that the prices for Bitstream and BMB monthly rentals could not exceed the actual incurred costs adjusted for efficiency plus a reasonable rate of return.

<u>Encourage access to the internet at a reasonable cost to end-users</u>:

11.29 ComReg is required to take all reasonable measures to encourage access to the internet at reasonable cost to users. The national cost orientation obligation ensures that Eircom's level of recovery of costs is restricted to no more than the actual incurred cost adjusted for efficiency plus a reasonable rate of return which should ensure that Bitstream prices are reasonable nationally. In addition, any changes to Bitstream prices Outside the LEA should be pre-approved by ComReg and should not exceed actual incurred costs adjusted for efficiency (plus a reasonable rate of return), while also ensuring compliance with the overriding national cost orientation obligation. This should gives assurances to OAOs that Bitstream prices Outside the LEA should not be excessive. This point is also considered below in the context of Regulation 13 of the Access Regulations.

11.30 In considering whether the HCA methodology or the BU-LRAIC+ methodology was more appropriate, ComReg assessed whether BU-LRAIC+ methodology would give rise to higher prices in the absence of alternative network competition. ComReg considered that in the absence of alternative network competition Eircom may "sweat" its assets in areas Outside the LEA resulting in excessive pricing relative to its actual investment without any benefit to end users in terms of alternative platform based investment. Given the extent of depreciated assets (i.e., DSLAMs and BRAS) in Eircom's core network and the fact that these assets may not be replaced by Eircom, the BU-LRAIC+ methodology could give rise to significant increases in wholesale and retail legacy broadband prices Outside the LEA. This would be detrimental to end-users and wholesale operators that have no alternative options for broadband provision other than purchasing these services from Eircom. Based on

ComReg's assessment of costs, the BU-LRAIC+ costs are higher than the HCA costs for active broadband equipment (i.e., BRAS and DSLAMs), nationally. For these reasons as well as the reasons already discussed throughout this Decision Document, the HCA methodology was deemed the most appropriate approach for the price control period.

11.31 The retail margin squeeze tests should also provide a sufficient margin to those operators that do not currently have the same economies of scale / scope as Eircom, especially those smaller operators Outside the LEA who have low retail broadband market penetration. Our approach should ensure that these smaller operators Outside the LEA can continue to serve its customers in the more rural areas at a reasonable price. The retail margin squeeze test should also protect operators that rely on LLU and line share wholesale inputs. This is particularly important in the LEA where most unbundling activity takes place.

11.32 For SABB services Outside the LEA, ComReg considers that end-users in rural areas need to be protected from excessive prices where they decide to purchase a broadband only service from Eircom. On that basis ComReg is of the view that the obligation of cost orientation should apply to Eircom. In the absence of data regarding actual costs for the provision of SABB we consider that in the interim Eircom should price SABB Outside the LEA on no more than the SB-WLR price less the costs avoided by not providing a voice service.

12.3.3 Regulation 13 of the Access Regulations

11.33 Regulation 13(1) of the Access Regulations provides that ComReg may:

impose on an operator obligations relating to cost recovery and price controls, including obligations for cost orientation of prices and obligations concerning cost accounting systems, for the provision of specific types of access or interconnection in situations where a market analysis indicates that a lack of effective competition means that the operator concerned may sustain prices at an excessively high level or may apply a price squeeze to the detriment of end-users.

11.34 The requirements set out in Regulation 13(1) of the Access Regulations have been addressed in Chapter 3 and also at paragraphs 12.9 and 12.10 above for both cost orientation and the obligation not to cause a price squeeze.

11.35 Regulation 13(2) of the Access Regulations provides that:

To encourage investments by the operator, including in next generation networks, the Regulation shall, when considering the imposition of obligations *under paragraph (1), take into account the investment made by the operator which the Regulator considers relevant and allow the operator a reasonable rate of return on adequate capital employed, taking into account any risks involved specific to a particular new investment network project*.

11.36 As set out in Chapter 5 and in Chapter 6, the national cost orientation obligation allows Eircom to recover its actual incurred costs adjusted for efficiency plus a reasonable rate of return.

11.37 The objective of the Bitstream cost model, unlike the WBA price floors model, is not to stimulate alternative operator investment where it is clear no commercial operator might invest, but to ensure Eircom do not materially over or under recover its actual costs adjusted for efficiency (including a reasonable rate of return) nationally. Eircom's current WACC of 10.21% is used as a proxy for determining the reasonable rate of return for Eircom's investment in Bitstream services. Eircom's WACC is currently the subject of a separate consultation in ComReg Document No 14/28.

11.38 The HCA methodology uses Eircom's costs, which will allow Eircom to recover any money invested in maintaining or upgrading its network on the basis that Eircom will have the assurance that what it spends can be recouped over the price control period – particularly Outside the LEA. Therefore, Eircom's investment incentives are unlikely to be affected.

11.39 In addition, our approach as set out in Chapter 5 also allows Eircom the opportunity annually to demonstrate if there is a material over / under recovery of its actual Bitstream costs adjusted for efficiency. This provision should also ensure consistency with the requirements of Regulation 13(2) of the Access Regulations.

11.40 The retail margin squeeze test applied in the LEA is based on a combination of SEO and EEO costs while the retail margin squeeze test Outside the LEA is based on SEO costs only. This has been discussed in some detail in Chapter 7. The EEO costs are consistent with a cost orientation obligation as they ensure cost recovery for Eircom i.e., EEO costs are based on Eircom's actual costs (adjusted for efficiency). The SEO costs on the other hand means an operator which shares the same basic cost function as Eircom but does not have the same economies of scale and scope as Eircom. Therefore, the SEO costs take account of the fact that other operators have not reached the same economies of scale and scope as Eircom and this needs to be reflected in the replicability/margin squeeze test. The SEO costs are based on Eircom's costs as a starting point as the information available is more reliable and robust given Eircom's regulatory accounting obligations. Eircom's costs are then adjusted to reflect the lower level of economies of scale and scope. In principle, ComReg believes that the OAOs costs should be used in the test but accurate verifiable OAO data is difficult to obtain. Therefore, in the absence of robust and audited OAO cost data ComReg uses Eircom's audited costs as a starting point for the cost estimation for OAOs. The current Eircom WACC of 10.21% is also applied to costs in the DCF Model which should allow for a reasonable rate of return in line with Regulation 13(2) of the Access Regulations.

11.41 For SABB and until the cost model for the access network is completed as part of the Acess Network Review we consider that as a proxy in the interim period that the SABB price Outside the LEA should be based on no more than the SB-WLR price less the costs avoided by not providing a voice service. At a later date we will further specify the obligation of cost orientation regarding SABB (pursuant to Regulation 18 of the Access Regulations) based on a modeled rate.

11.42 Regulation 13(3) of the Access Regulations provides that:

The Regulator shall ensure that any cost recovery mechanism or pricing methodology that ComReg imposes under this Regulation serves to promote efficiency and sustainable competition and maximise consumer benefits. *In this regard, the Regulator may also take account of prices available in comparable competitive markets.*

11.43 Each of these key objectives outlined in Regulation 13(3) are discussed briefly below.

<u>Promote efficiency</u>:

11.44 A cost oriented price control aims to ensure that prices do not exceed an appropriate level of efficient costs where there is a risk that competitive pressure alone will not achieve this outcome.

11.45 Efficiency can be thought of in a number of ways including:

- Allocative efficiency: Where prices of different products result in an optimum allocation of resources to end-users;
- Productive efficiency: The cost of producing the products is minimised; and
- Dynamic efficiency: The efficiency of investor and customer behaviour over time.

11.46 ComReg believes that any price control imposed needs to strike a balance between these forms of efficiency. Productive and allocative efficiency are essentially static concepts taking into account the level of costs to deliver products at a single point in time. In terms of productive efficiency, ComReg believes that the sequential nature of investment decisions, when assessing whether the level of costs reported is efficiently incurred, needs to be considered in the price control. This has been reflected in Chapter 6 of this document where ComReg has made some efficiency adjustments to Eircom's actual Bitstream costs.

11.47 Investment decisions are not made with perfect foresight and may be constrained by previous decisions (for example, the location / site of existing network equipment). Furthermore, ComReg considers that a price control also needs to take account of dynamic effects. In particular, it is important that regulated operators have an expectation that they can make a reasonable return on investments over time and that efficient entry and ongoing efficient investment are encouraged. The cost orientation obligation allows Eircom to recover a reasonable rate of return based on Eircom's current WACC at 10.21%, on top of its actual incurred costs adjusted for efficiency.

11.48 In the future, Eircom may consider investing further in ADSL / ADSL2+ in those exchanges Outside the LEA that are currently not broadband enabled if the expected return on its investment is sufficient. This could enable customers in those areas to enjoy the higher download speeds already available to other customers. As set out above and in Chapter 6, the pricing approach and the annual reviews of the Bitstream cost model ensures that any actual investments made by Eircom may be recovered by Eircom where it provides the actual costing information to ComReg.

<u>Promote sustainable competition:</u>

11.49 Please refer to paragraphs 12.20 to 12.23 above for a detailed discussion on the impacts on competition.

<u>Maximise consumer benefits</u>:

11.50 Please refer to paragraphs 12.28 and 12.32 above with regard to the benefits to end-users.

11.51 Regulation 13(4) of the Access Regulations provides that:

"*Where an operator has an obligation under this Regulation regarding the cost orientation of its prices, the burden of proof that charges are derived from costs, including a reasonable rate of return on investment shall lie with the operator concerned*……"

11.52 Annually, Eircom is required to review its actual Bitstream costs and revenues from its Regulated Accounts and reconcile these to the Bitstream cost model to ensure that there is no material over / under recovery of its national Bitstream costs. This mechanism should ensure that Eircom can flag any potential material over / under recovery to ComReg during the price control period so that its national Bitstream rentals are reflective of efficient costs (including a rate of return). In the event that Eircom proposes to increase its Bitstream and BMB monthly rental prices Outside the LEA or introduce a new Bitstream product in that area, it must seek prior approval from ComReg and demonstrate to ComReg that the increased / new price(s) recover no more than the actual incurred costs adjusted for efficiency (plus a reasonable rate of return) associated with that area while also ensuring that it complies with the overriding national cost orientation obligation. Therefore, ComReg considers that at any point Eircom can make a case to ComReg where it believes that there is a material over / under recovery of its national Bitstream costs adjusted for efficiency (as derived from the Bitstream cost model) and this ensures that the onus lies with Eircom in line with Regulation 13(4) of the Access Regulations. However, it is important to note that price changes will only be allowed where we consider that these changes are likely to be sustainable over a reasonably extended period.

12.3.4 Regulation 16 of the Framework Regulations

11.53 While some of the main requirements / objectives of Regulation 16 of the Framework Regulations have already been addressed above as part of the discussion on Regulation 8 of the Access Regulations, Section 12 of the Communications Regulation Act and / or Regulation 13 of the Access Regulations, set out below is some other key requirements associated with Regulation 16 which have not been addressed so far as part of the discussions above.

<u>Contributing to the development of the internal market (BEREC and European Union):</u>

11.54 Further to Regulations 13 and 14 of the Framework Regulations, the draft measures were also made accessible to the Commission, the Body of European Regulators for Electronic Communications ("**BEREC**") as well as other national regulatory authorities ("**NRAs**") in other EU Member States. The Commission submitted a number of comments to ComReg. These comments as well as our consideration of them are set out in Annex 4.

11.55 We note that the comments provided by the Commission were provided pursuant to Article 7 (3) of the Framework Directive and that the proposed measure does not create a barrier to the single market nor is it incompatible with Community law.

11.56 We have also considered the points raised by the Commission in its Phase II investigations with a number of European Regulators regarding their costing approach for setting broadband prices in the WPNIA market and the WBA market as well as the Opinion of BEREC in relation to these investigations.

11.57 As part of our assessment of the appropriate price control relevant to Bitstream services in the WBA market we have taken into account the Commission Non-discrimination and Costing Methodologies Recommendation. We note that we do not have the ability, at present, to implement aspects of the Non-discrimination and Costing Methodologies Recommendation (notably paragraphs 32 to 34 regarding the valuation of existing civil engineering assets) although we have initiated the Access Network Review, as discussed earlier in this document. This review is intended to be completed in 2015.

Promoting regulatory predictability by ensuring a consistent regulatory approach over appropriate review periods:

11.58 The retail margin squeeze approach for current generation Bitstream is consistent with the pricing approach for NGA and Bundles. This should ensure regulatory consistency and predictability over the price control period.

11.59 While we plan to review Eircom's cost recovery annually this may not lead to price changes. Price changes will only be allowed where these changes are likely to be sustainable and where Eircom are clearly materially under / over recovering its costs over a reasonably extended period. This should lead to reasonable price stability and predictability in the WBA market. It is important to note that any price reductions proposed by Eircom must comply with the WBA Price Floors Decision.

Taking due account of the variety of conditions relating to competition and end-users that exist in the various geographic areas within the State*:*

11.60 As set out in detail in Chapter 4 of this document, we recognise that there may be varying structural and competitive conditions prospectively between the LEA (Urban areas) and Outside the LEA (rural areas). This was established in the Bundles Decision. Our approach for current generation Bitstream takes into account a differentiation of the price control between the LEA and Outside the LEA in order to address the relevant competition problem(s) in the particular areas. Please refer to Chapter 4 for details on the varying conditions between the LEA and Outside the LEA.

11.61 Regulation 16(2) of the Framework Regulations requires that ComReg applies objective, transparent, non-discriminatory and proportionate regulatory principles. The obligations contained in the Decision Document are:

- objectively justifiable, in that in the relevant market the obligations facilitate and encourage fair, reasonable and timely access to Eircom's network and therefore promotes competition to the benefit of end users;

- not unduly discriminatory, in that Eircom (and no other operator) has been found to have SMP in the relevant market;

- proportionate, in that it is targeted at addressing the market power that Eircom holds in the relevant market and allows Eircom to recover its costs (including a reasonable rate of return on capital employed); and

- transparent, in that the obligation is clear in its intention to ensure that Eircom sets the prices which it charges operators for current generation WBA products and services (including SABB) in accordance with the requirements set out in this Decision Document to avoid excessive prices and the imposition of a margin squeeze.

12.3.5 Regulation 6 of the Access Regulations:

11.62 Regulation 6 of the Access Regulations requires that ComReg encourages and ensures access that meets the criteria set out below. Each of these criteria has been considered in the context of ComReg's other obligations which is set out above. In summary, the obligations contained in the Decision Document:

- promotes efficiency, in that the relevant access prices are set by way of efficient costs which will prevent Eircom from passing any inefficiently incurred costs to OAOs through excessive prices - see paragraphs 12.44-12.48 above for further analysis.

- promotes sustainable competition, in that the obligations prevent excessive pricing and ensure a sufficient margin to enable OAOs to compete in the retail market. See paragraphs 12.20-12.23 above for further analysis.

- promotes efficient investment and innovation, in that Eircom may recover its costs (including a reasonable rate of return on capital employed) while OAOs' investment is also protected. See paragraphs 12.24-12.27 above for further analysis.

- gives the maximum benefit to end users, in that market entry and competition is promoted at the wholesale level which enables OAOs to effectively compete at the retail level. ComReg considers that this is best approach to maximising the benefits to end users of broadband services. The geographic dimension also protects end users in less competitive areas of the country from excessive pricing. See paragraphs 12.28-12.32 above for further analysis.

12.4 Step 2 - Identify and describe the regulatory options

11.63 In the context of determining the most appropriate price control to adopt in relation to current generation Bitstream services ComReg has considered a number of options under the following headings:

- Options on the form of price control
- Options for determining appropriate costing methodology
- Options for determining the appropriate principles for the retail margin squeeze tests
- Options for determining Eircom's usage / throughput charge Outside the LEA.

12.4.1 Options on the form of price control

11.64 According to Regulation 13(1) of the Access Regulations, ComReg may impose obligations relating to cost recovery and price controls, including obligations for cost orientation of prices and obligations concerning cost accounting systems for the provision of specific types of access or interconnection.

11.65 The main forms of price control that were considered in relation to current generation Bitstream products and services were:

- Regulatory Forbearance
- Cost orientation
- Retail minus / retail margin squeeze test.

11.66 Please refer to Chapter 5 of this document and the Consultation Document for consideration of the above options as well as a further discussion below.

12.4.2 Options for determining appropriate costing methodology

11.67 The following two options were considered in terms of the appropriate costing methodology for the Bitstream cost model:

- BU-LRAIC+
- TD-HCA but dimensioned based on engineering and capacity rules.

11.68 Please refer to Chapter 6 of this document and the Consultation Document for a detailed discussion on the costing methodology options.

12.4.3 Options for determining appropriate principles for the retail margin squeeze test

11.69 The following were the main options for determining the appropriate principles for the margin squeeze tests:

(i) **Cost base**: The retail margin squeeze tests (in the LEA and Outside the LEA) should be based on either:

- A SEO (or REO) cost base, which assumes that entrants are currently not likely to be as efficient as Eircom given that they cannot achieve the same scale
- An entire EEO approach once the OAOs have achieved sufficient scale to encourage efficient entry or
- A combination of SEO and EEO costs.

(ii) **Cost standard**: The retail margin squeeze tests (in the LEA and Outside the LEA) should take account of either:

- The LRAIC+ costs
- The ATC costs.

(iii) **Assessment basis**: The retail margin squeeze tests (in the LEA and Outside the LEA) should take account of either:

- The portfolio level of aggregation to allow Eircom the flexibility to efficiently price discriminate on individual products so long as Eircom recovers the overall costs across the portfolio of current generation retail broadband products.
- The product-by-product assessment.

11.70 Please refer to Chapter 7 of this document and the 2013 Consultation Document Bitstream Consultation for a detailed discussion on the principles for margin squeeze test.

12.4.4 Options for determining Eircom usage / throughput charges Outside the LEA

11.71 The main options considered by ComReg for determining the appropriate usage / throughput charge Outside the LEA are as follows:

Option 1: Eircom's current charging mechanism for usage would remain in place.

Option 2: Eircom could charge no more than the long run incremental costs associated with the usage of a particular OAO which is over and above the average usage allowed for in the Bitstream cost model.

11.72 Please refer to Chapter 6 of this document and the Consultation Document for a detailed discussion on the usage charging mechanism.

12.5 Step 3 - Determine the likely impact on stakeholders

11.73 This section summarises the impact of the options above on the various stakeholders. We consider the potential impact that could be incurred by Eircom in complying with the set of obligations as well as the potential benefits that would accrue to Eircom, its wholesale customers, and end users.

11.74 The likely impact on stakeholders is discussed under the following headings:

- Form of Price Control
- Appropriate Costing Methodology
- Principles for the margin squeeze test
- Determine the appropriate usage / throughput charge Outside the LEA.

A. Form of price control:

Option 1: Regulatory Forbearance

b) Impact on Eircom:

- Eircom would have complete flexibility in terms of its pricing approach for WBA products and services.

c) Impact on OAOs:

- OAOs could be subject to excessive prices and / or subject to a price squeeze between wholesale and retail broadband prices given that no price controls are in place.

d) Impact on end-users:

- This could mean less choice for end-users as some operators may be forced out of the retail broadband market (by excessive wholesale prices and / or no margins between retail and wholesale prices) especially in more rural areas of the country.
- End-users could be subject to higher prices than necessary.

Option 2: Cost Orientation

a) Impact on Eircom:

- This approach ensures that Eircom recovers no more than its actual national Bitstream costs adjusted for efficiency and a reasonable rate of return.

- The national cost orientation obligation allows Eircom to cross subsidise from the LEA into the area Outside the LEA.

- This option means that Eircom has to demonstrate to ComReg that any price increases Outside the LEA or new products introduced in that area do not exceed local costs adjusted for efficiency plus a rate of return outside the LEA, while also ensuring compliance with the overriding national cost orientation obligation.

- This option allows Eircom to recover local costs Outside the LEA subject to pre-approval by Eircom and demonstration to ComReg that the prices are reflective of actual local costs adjusted for efficiency outside the LEA, while also ensuring compliance with the overriding national cost orientation obligation.

b) Impact on OAOs:

- This approach gives OAOs certainty about price levels for Bitstream services, especially Outside the LEA.

- The Bitstream cost model seems to suggest that there is cross subsidisation from the LEA into the areas Outside the LEA which means that it is likely that the prices Outside the LEA are currently below the actual local costs adjusted for efficiency in that area which means that OAOs Outside the LEA are benefiting from potential lower wholesale Bitstream costs.

- Outside the LEA, OAOs have certainty that prices cannot exceed local efficient costs (plus a rate of return) where Eircom justifies such a price increase or introduces a new current generation Bitstream product in that area.

c) Impact on end-users:

- This approach should ensure that end-users are not subject to excessive prices.

Option 3: Retail margin squeeze test

a) Impact on Eircom:

- This approach should ensure that Eircom does not set its retail or wholesale prices in such a way that it could squeeze other smaller operators especially Outside the LEA.

- The retail test chosen for the LEA allows Eircom pricing flexibility given competition from LLU operators and cable infrastructure.

b) Impact on OAOs:

- The retail margin squeeze test should be sufficient to ensure that entry is possible at prices that are consistent with the outcome of a competitive process.

- Where Eircom reduces the wholesale price in order to comply with the margin squeeze test, then the OAOs should benefit from lower wholesale prices.

- The retail margin squeeze test should protect operators that rely on LLU and line share as wholesale inputs, especially in the LEA.

c) Impact on end-users:

- This option should encourage broadband competition to the benefit of end-users. However, a retail margin squeeze on its own would not prevent excessive pricing from Eircom.

B. Appropriate costing methodology

Option 1: A BU-LRAIC+ approach

a) Impact on Eircom:

- This approach may allow Eircom to recover the cost of Bitstream investments that have not taken place / are not likely to take place.
- This approach could prevent Eircom from recovering investments that it efficiently incurred in the past but which would be needed for a new entrant today.
- This approach sends the correct investment signals to the marketplace.

b) Impact on OAOs:

- This approach could mean that the OAOs would be paying for the cost of investments in Bitstream that Eircom has not made or not likely to make which would lead to increases in wholesale prices Outside the LEA.
- This approach may not be appropriate given that in the medium term there is limited prospect for entry in certain areas of the country (i.e., Outside the LEA) as OAOs are predominantly acting as resellers and more dependent on using Eircom’s infrastructure.
- This approach sends the correct investment signals to the marketplace.

c) Impact on end-users:

- This approach in the absence of alternative network competition may encourage Eircom to "sweat" is assets Outside the LEA resulting in excessive prices relative to active investment without any benefit to end-users in terms of alternative platform based investment.

Option 2: A TD-HCA approach dimensioned based on engineering and capacity rules

a) Impact on Eircom:

- This approach should ensure that Eircom does not materially under / over recover its costs as the value is linked to the actual investment made adjusted for efficiency. Therefore, the HCA methodology allows Eircom to recover any money invested in maintaining or upgrading its network which should ensure that Eircom's investment incentives are unlikely to be affected.

- This approach should ensure that Eircom does not price excessively, especially Outside the LEA where it can recover no more than local efficiently incurred costs plus a reasonable rate of return.

b) Impact on OAOs:

- This approach should lead to reasonable price stability and predictability which should help operators' investment plans.

- This approach should ensure that OAOs are only paying for the actual Bitstream investments made by Eircom.

c) Impact on end-users:

- This approach should ensure that retail prices only reflect actual Bitstream investments that have taken place.

C. Principles for the margin squeeze tests

Cost base:

Option 1: Retail margin squeeze test is based on an EEO cost base

a) Impact on Eircom:

- In general, an entire EEO assumption for the retail margin squeeze test would imply that entrants could achieve similar economies of scale as Eircom. EEO is likely to assume lower retail costs for Eircom thereby requiring a lower retail margin between the wholesale broadband access cost and the respective Eircom retail price. Depending on the Eircom Retail price this could provide a higher wholesale broadband access charge.

- For Eircom the EEO assumption (compared to SEO) is likely to reduce competition in the retail broadband market and/or increase its return from the supply of WBA services.

- EEO approach is more consistent with cost orientation and ensures overall cost recovery for Eircom.

b) Impact on OAOs:

- An entire EEO cost base would make entry more difficult for new entrants, as the resulting gap between wholesale prices and retail prices would be lower, but may incentivise them to invest in their own infrastructure.

c) Impact on end-users:

- In the long-run an entire EEO test could result in (marginally) higher retail prices and less choice, as it could discourage OAOs to enter the retail broadband market, due to the higher resulting wholesale input prices or lower retail prices which are not replicable by OAOs due to the lower downstream margins to recover retail costs. It could also result in a greater concentration of players in certain geographic areas as no OAO could compete using wholesale products provided over Eircom's network.

Option 2: Retail margin squeeze test is based on a SEO cost base

a) Impact on Eircom:

- The SEO assumes higher costs (compared to EEO) for Eircom so allowing a lower wholesale access charge to be set by Eircom.

- The SEO should promote competition from OAOs who would face lower wholesale input costs from Eircom. This could increase the willingness of OAOs to enter the retail broadband market using Eircom wholesale inputs.

b) Impact on OAOs:

- The SEO assumes that entrants have not yet gained sufficient economies of scale as Eircom. By using the SEO cost standard in the margin squeeze test, the resulting wholesale prices (assuming Eircom retail prcies remain constant) would be lower compared to a margin squeeze based on the EEO cost standard. This approach may be more appropriate Outside the LEA.

- The SEO test may be more appropriate Outside the LEA given that there are a large number of smaller operators Outside the LEA that only have a 5% or lower retail broadband market penetration.

- This approach should encourage entry to the retail broadband market and allow existing smaller operators to grow their customer base, by giving rise to a greater space between retail prices and wholesale prices that enable OAOs to supply wholesale and retail services more competitively based on Eircom wholesale inputs.

c) Impact on end-users:

- Likely to result in the medium/long-term (marginally) lower retail prices and more choice, due to higher levels of competition from OAOs, compared to EEO. As competition at the retail level becomes more entrenched it may be possible to move to EEO which may see more price benefits for end-users.

Option 3: The retail margin squeeze test is based on a combination of SEO and EEO costs

a) Impact on Eircom:

- The SEO / EEO assumes higher costs (compared to an entire EEO) for Eircom so allowing a lower wholesale access charge to be set by Eircom.

- The SEO / EEO should promote competition from OAOs, who would face lower wholesale products from Eircom. This could increase the willingness of OAOs to enter the retail broadband market using Eircom wholesale inputs.

- This approach takes account of the fact that there are large operators in certain parts of the country i.e., the LEA, with an international presence who can take advantage of economies of scale and scope between their operations in Ireland and other countries in which they operate. Therefore, this approach takes account of the fact that there are certain retail costs which are more susceptible to such scale / scope advantages especially in the context of bundle offers (with fixed voice, mobile voice, broadband, IPTV, etc.) which are more often sold in the retail broadband market, for example, advertising costs.

b) Impact on OAOs:

- The SEO / EEO take account of the fact that entrants in general have not yet gained sufficient economies of scale as Eircom.
- This approach would mean that smaller operators, especially Outside the LEA, would have less margins to compete with Eircom (the dominant operator in that area) and therefore these smaller operators may find it difficult to grow their customer base and compete with Eircom.

c) Impact on end-users:

- A combination of SEO and EEO costs provides a higher gap between retail and wholesale prices than an EEO test which provides lower prices and more choice, due to higher levels of competition from OAOs.

Cost standard:

Option 1: Retail margin squeeze test is based on 'LRAIC plus'

a) Impact on Eircom:

- This approach should allow Eircom to recover all of its average efficiently incurred directly attributable variable and fixed costs and an apportionment of joint and common costs.

b) Impact on OAOs:

- This approach should allow the recovery of the relevant common costs, as well as fixed and variable costs. This is the calculus faced by an operator when deciding whether to enter or expand a market. This should also ensure efficient entry, compared with the ATC cost standard.

c) Impact on end-users:

- This approach should allow the promotion of sustainable competition by OAOs to the benefit of end-users.

Option 2: Retail margin squeeze test is based on ATC

a) Impact on Eircom:

- This approach means a larger margin between products is likely to mean easier entry potentially by an inefficient operator. If retail prices are constrained, the low wholesale charges could undermine the recovery of investment. Changes to assumptions that limit Eircom's pricing flexibility are likely to harm Eircom's ability to match retail prices of alternate platform providers.

- ATC has been used to date for current generation Bitstream products under the 2006 Retail Minus Decision and it is also used for NGA pricing.

b) Impact on OAOs:

- This approach may promote further entry given that it includes the costs of 'LRAIC plus' and some additional common costs. However, the ATC may encourage inefficient entry.

c) Impact on end-users:

- This approach may mean additional competition could reduce prices or improve choice.

Portfolio or product-by-product:

Option 1: Portfolio

a) Impact on Eircom:

- This approach allows Eircom flexibility in its retail pricing, enabling Eircom to price some retail products above and others below ATC. This is likely to imply discounting on products where the competition is most intense, provided that other products are priced higher, such that the overall average revenue matches ATC. This flexibility may mean that Eircom can experiment with price discrimination for different product offerings which may improve efficiency, and under certain conditions, can be welfare maximising.

- This approach is very relevant in the LEA where Eircom faces a retail pricing constraint from alternative infrastructures.

b) Impact on OAOs:

- This approach should encourage efficiency and promote competition between operators in the LEA.

c) Impact on end-users:

- This approach may mean that some end-users in the LEA may be subject to lower retail prices and improved efficiencies.

Option 2: Product-by-product

a) Impact on Eircom:

- This approach should ensure sufficient margin for each Bitstream offer, but would restrict the ability of Eircom to price products as flexibly as they would under the portfolio approach. Each product would need to be priced at a retail level to meet the ATC requirement, which would limit the ability of Eircom to adjust pricing in response to market knowledge, in particular during the early stage of take up of next generation products.

- This approach is more relevant Outside the LEA where Eircom is not constrained at a wholesale or retail level and where Eircom may be more likely to adjust prices for certain customers and / or in certain areas.

b) Impact on OAOs:

- This approach may enhance entry and competition, particularly for entrants that may lack economies of scope.

c) Impact on end-users:

- There may be some gains from improved competition of a product-by-product approach, but these may be offset by a reduction of efficiency.

D. Determine appropriate usage / throughput charge Outside the LEA:

Option 1: Eircom's current charging mechanism would remain in place

a) Impact on Eircom:

- Eircom may over-recover the cost of carrying additional operator traffic on its core network.

b) Impact on OAOs:

- OAOs have to monitor and manage their high usage customer base.

- Given the significant additional cost to OAOs of the current charging mechanism, OAOs may have to pass on these costs to their high bandwidth customers which act as a disincentive to end-users to use high bandwidth services.

- Given the current high wholesale charge for usage from Eircom, this may impact on smaller operators' margins where these operators do not pass on the additional usage cost to their customers. Lower margins mean low profits for these smaller operators with high bandwidth customers.

c) Impact on end-users:

- High bandwidth users may be penalised with high charges for excess usage which acts as a disincentive to end-users to use high bandwidth services.

Option 2: Eircom could only charge operators for the long run incremental cost of usage / throughput above the average usage

a) Impact on Eircom:

- This approach would ensure that Eircom only recovers the incremental costs associated with carrying traffic on its core network, above the average usage already accounted for in the Bitstream cost model.

b) Impact on OAOs:

- This approach should ensure that OAOs with high usage customers are not penalised by higher costs from Eircom.

- This approach should mean a lower wholesale usage cost which should allow OAOs who do not pass on the usage cost to their customers more margin to compete at a retail level.

c) Impact on end-users:

- This approach should not penalise those end-users that use high bandwidth services.

12.6 Step 4 - Assess the likely impact on competition:

11.75 This is discussed at paragraphs 12.20 to 12.23 above.

12.7 Step 5 - ComReg's Assessment of Responses and Final Position:

11.76 In general, the majority of respondents agreed with the analysis and conclusions reached by ComReg in its RIA. However, a number of issues were raised by some of the respondents which are set out below.

11.77 Vodafone stated that while it had some concerns about the exact form and implementation of the price control, it welcomed the move towards a cost orientation obligation in the WBA market. Vodafone also stated that it welcomed the fact that the retail margin squeeze test is not independent of the RFNA market and is underpinned by obligations attached to each regulated component of a bundle.

11.78 Eircom in general agreed with the substance of the draft decision but Eircom disagreed with the regime of continuous modifications to the market remedies rather than regular market reviews. In particular Eircom refers to Section 12.10 of the RIA where ComReg states that it "*considers that the proposed pricing approach set out in subsection 5.2 of this document should address the specific competition problems noted in the WBA market review*". Eircom stated that it does not believe that ComReg is in the position to say so without having conducted first a market review that will enable it to assess the present [emphasis added] state of the market, not that applied two years ago or more. ComReg has already addressed the point regarding the market review at paragraph 5.38 in Chapter 5.

11.79 Eircom also referred to Section 12.4 of the Consultation Document and in particular Step 2 on "*identify and describe the regulatory options*" where Eircom believe that one of the most feasible options for ComReg to consider would be to update its market analysis prior to setting a remedy. ComReg has already addressed the point regarding the market review at paragraph 5.38 in Chapter 5.

11.80 Eircom also claimed that much of the RIA is just a succession of opinions with no supporting bases for these opinions. As an example Eircom refers to ComReg's proposal that Eircom should "*reconcile the Bitstream cost model with their Regulated Accounts to ensure that there is no material under / over recovery of efficient costs*" and that in ComReg's opinion the likely impact of this on Eircom is that "*This should not be an overly burdensome exercise given that Eircom provide Bitstream costing information to ComReg annually as part of its AFIs in line with the accounting Separation requirements as set out in ComReg Decision D08/10*". Eircom stated that placing additional obligations on Eircom should not be simply dismissed as not being "*overly burdensome*". ComReg considers that the benefit of this exercise outweighs the cost to Eircom as it allows Eircom to assess if it has materially under /over recovered its costs during the financial year. This measure allows Eircom to recover any money invested in maintaining or upgrading its network and therefore gives Eircom the assurance that what is spends can be recouped over the price control period.

11.81 Eircom also had issue with ComReg's proposal at 12.13 of the Consultation Document where ComReg is requiring Eircom to gather localised costs. Eircom stated that while ComReg concedes in this case that "*it may take Eircom some time to gather such information*", ComReg's view that "*the benefit to other operators and ultimately consumers should outweigh any cost*". ComReg consider that this measure ensures that in the event that Eircom proposes to increase Bitstream prices Outside the LEA or introduce a price for a new Bitstream monthly rental charge that the onus is with Eircom to provide geographic data to ComReg so as to demonstrate that the increased price (or new price) would recover no more than the actual incurred costs adjusted for efficiency associated with the specific area Outside the LEA. This measure should ensure that Eircom cannot price excessively in such a way that it could raise input costs to retail operators and ultimately raise prices to end-users. Excessive pricing could exploit retail broadband users harm competition where the excessively priced WBA input would make it more difficult to compete in related markets, e.g. in downstream markets where operators rely on the upstream input to compete. Therefore ComReg considers that any cost associated with provision of localised costs should outweigh the benefit to other wholesale operators and retail end-users, especially Outside the LEA.

11.82 Following an assessment of the points raised by respondents in response to the consultation as well as our consideration of the views expressed by the Commission as set out in detail in Annex 4, we consider that the approach set out in this Decision Document ensures that the price control in each area (LEA and Outside the LEA) is tailored to the specific market conditions and competition problems identified in each area.

11.83 We consider that this Decision Document achieves the following:

a) **Price stability and predictability**: The obligation of cost orientation based on HCA costs ensures that Eircom cannot increase the Bitstream prices Outside the LEA (or introduce a price for a new Bitstream product) without demonstrating to ComReg that any revised (or new) prices are based on no more than the actual local costs adjusted for efficiencies (plus a reasonable rate of return) in that area Outside the LEA. The current retail minus price control does not provide any price certainty to entrant operators in the area Outside the LEA. This is an important consideration in our view. This is addressed in Chapter 5 of this document.

b) **Promotes investment**: The obligation of cost orientation (based on the HCA methodology) should help operators' investment plans. While we will review cost recovery annually we plan to only allow price changes which are sustainable and where Eircom are either materially under / over recovering its costs such that the cost orientation obligation is clearly breached. The HCA methodology will allow Eircom to recover any money invested efficiently in maintaining or upgrading its network on the basis that Eircom will have the assurance that what it spends can be recouped over the price control period. This is addressed in Chapter 5 of this document.

c) **Highlights the continued importance of WBA price floor:** The WBA price floor prevents Eircom from setting its Bitstream prices so low that they might foreclose alternative investment (LLU and NGA) by other operators. The WBA price floors therefore remain important so as to protect other operators investing or considering investing in broadband services. This is addressed in Chapter 9 of this document.

d) **Takes account of the views of Industry**: All of the respondents to the Consultation Document supported our view that cost orientation based on the HCA methodology was appropriate for setting current generation Bitstream prices. This Decision is important to many of the operators in the Irish market and therefore it should be implemented without any delay. This is addressed in Chapters 5 and 6 of this document.

e) **Consistency of approach across networks**: We have recently initiated the review of Eircom's access network prices (for LLU, SLU, Line Share, WLR and Naked DSL) which should be completed by mid-2015. The access network review will take utmost account of the Commission Recommendation on Non-discrimination and Costing

Methodologies. We will take account of the outcome of that review in the context of this Decision, where appropriate.

f) **Ensures retail margin for operators competing with Eircom**: The retail margin squeeze test in Chapter 7 should ensure that competitors have sufficient retail margin and be in a position to replicate the retail offers of Eircom. This should be good for competition and innovation. This is addressed in Chapter 7 of this document.

11.84 To conclude, the revised price control set out in this Decision Document should maintain prices at an efficient level to the benefit of end-users and at a level which encourages ongoing efficient entry and investment decisions by other operators while also ensuring that the SMP operator (Eircom) makes a reasonable return on its efficient investment. It is important to note that this Decision Document will not result in any immediate changes to current generation Bitstream prices. Instead this Decision provides transparency to the industry insofar as Eircom can recover no more than its actual Bitstream costs (adjusted for efficiency plus a reasonable rate of return) nationally but also in the area Outside the LEA. In addition, this Decision should provide reasonable price certainty and predictability to operators in the WBA market. In particular, Outside the LEA the obligation of cost orientation based on HCA costs ensures that Eircom cannot increase the Bitstream prices or introduce a price for a new Bitstream product Outside the LEA without demonstrating to ComReg that any revised (or new) prices are based on no more than the actual local costs adjusted for efficiencies (plus a reasonable rate of return) in that area. This is a very important consideration in our view which means that Eircom cannot price excessively for broadband services in rural areas where there is no cost justification. This Decision Document also clearly set outs the regulatory framework for current generation Bitstream services for the foreseeable future.

Annex: 1 Legal Basis

Obligations relating to the market for Wholesale Broadband Access:

A 1.1 By ComReg Decision No. D06/11[79], and pursuant to Regulations 25 and 26 of the 2011 Framework Regulations[80], ComReg designated Eircom as having significant market power ("SMP") on the market for wholesale broadband access (the "WBA" market).

A 1.2 Pursuant to Regulation 8 of the 2011 Access Regulations[81] where an operator has been designated has having a significant market power on a relevant market as a result of a market analysis carried out in accordance with Regulation 27 of the 2011 Framework Regulations, the Regulator shall impose on such operator such obligations set out in Regulation 9 to 13 of the Access Regulations as appropriate.

A 1.3 Among other obligations under Sections 10 and 12 of the Decision Instrument annexed to ComReg Decision D06/11, and pursuant to Regulation 9 and 13 of the 2011 Access Regulations ComReg imposed obligations on Eircom in respect of Current Generation Wholesale Broadband Access. Among others, the following obligations were imposed: (i) obligations of transparency pursuant to Regulation 9 of the 2011 Access Regulations; and (ii) obligations of relating to price control and cost accounting pursuant to Regulation 13 of the 2011 Access Regulations.

A 1.4 The amendment, imposition, withdrawal and further specification of SMP obligations in relation WBA Market is more particularly set out in the Decision Instrument contained in Chapter 11 of this Decision.

[79] Document No 11/49 entitled "Response to Consultation and Decision; Market Review: Wholesale Broadband Access" dated 8 July 2011.
[80] European Communities (Electronic Communications Networks and Services) (Framework) Regulations 2011 (S.I. No. 333 of 2011) (the "2011 Framework Regulations").
[81] European Communities (Electronic Communications Networks and Services) (Access) Regulations 2011 (S.I. No. 334 of 2011) (the "2011 Access Regulations").

Consultation Requirements:

A 1.5 Regulation 12(3) of the 2011 Framework Regulations provides that, except in cases falling within Regulation 13(8) (i.e., exceptional cases involving urgency), before taking a measure which has a significant impact on a relevant market, ComReg must publish the text of the proposed measure, give the reasons for it, including information as to which of ComReg's statutory powers gives rise to the measure, and specify the period within which submissions relating to the proposal may be made by interested parties. Regulation 12(4) states that ComReg, having considered any representations received under Regulation 12(3), may take the measure with or without amendment. Regulation 12 implements Article 6 of the Framework Directive.

A 1.6 Regulation 13(3) of the 2011 Framework Regulations provides that, upon completion of the consultation provided for in Regulation 12, where ComReg intends to take a measure which falls within the scope of Regulation 26 or 27 of the Framework Regulations, or Regulation 6 or 8 of the Access Regulations, and which would affect trade between Member States, it shall make the draft measure accessible to the Commission, BEREC and the NRAs in other Member States at the same time, together with the reasoning on which the measure is based. Regulation 13 implements Article 7 of the Framework Directive.

Annex: 2 Operator responses – other points

A 2.1 Set out below are the views of respondents on Q.9 of the consultation on the draft decision instrument.

Q.9 Do you believe that the draft text of the proposed Decision Instrument is from a legal, technical and practical perspective, sufficiently detailed, clear and precise with regards the specifics proposed? Please explain your response and provide details of any specific amendments you believe are required.

A 2.2 Eircom made a number of points on the draft decision instrument as follows:

(i) Section 2 on "Definitions and Interpretations" seems excessively wordy and quite repetitive and redundant.

(ii) "Bitstream Managed Backhaul" should be defined as "means a form of Bitstream provided in the market".

(iii) Inconsistencies in terminology between references to this Decision Instrument i.e., some references to "*DXX/XX"*, some references to "*DXX/13"* and others to "*this Decision Instrument*".

(iv) In Section 4.2, ComReg sets out a national obligation of cost orientation. Section 4.3 uses very similar language to set out cost obligation Outside the LEA but it does not specify the costs to be considered in this instance. Eircom proposed that further detail be added to clarify this point.

(v) Section 4.4 amends the transparency obligations of the Decision Instrument in D06/11. However, the reference to the introduction of new prices is unnecessary as the notice period proposed is identical to that already in place in D06/11.

(vi) Eircom proposed that Section 4.6 (on SABB) and Section 4.7 (on usage charges) should be deleted from the final decision instrument.

(vii) Sections 5.1 and 5.2 do not specify that the increased notification period in relation to price increases only applies Outside the LEA.

(viii) Section 6.2 is internally conflicted and Eircom request that the text is amended.

A 2.3 BT and ALTO also raised some issues on the draft decision instrument as follows:

(i) The cost orientation obligation is dependent on good quality financial information. ALTO and BT stated that they have concerns that this information will be based on estimates and models and errors could lead to an unreasonable balance of LEA and Outside the LEA costs and consequential market distortions. BT believed that the operation of the lower layer inputs needs to be built into the remedies.

(ii) With regard to Section 4.1, BT is concerned that the national cost orientation obligation could undermine the existing WBA price floor.

(iii) With regard to Section 4.3, ALTO and BT are concerned that the cross subsidy of costs may flow in the opposite direction, from Outside the LEA to help Eircom reduce its prices inside the LEA. ALTO stated that cross subsidisation from Outside the LEA to the LEA should be prohibited.

(iv) With regard to Section 4.6 on SABB, ALTO and BT stated that a margin squeeze test should also be applied to ensure that other operators are not foreclosed from using SABB.

(v) With regard to Section 4.7 on usage charges, ALTO stated that ComReg is foreclosing the opportunity to invest Outside the LEA and that ALTO members' see that as a disappointing development but they that understand the purpose.

(vi) With regard to Section 5.2, ALTO and BT stated that if ComReg is to apply discretion to shorten notification periods it should be cognisant of not causing others to breach their Users Rights obligations such as customer notifications.

A 2.4 ComReg has addressed each of the points raised by the individual operators below.

A 2.5 With regard to each of the points raised by **Eircom**, ComReg has set out its position below:

(i) With regard to Eircom's point that the section of the Decision Instrument relating to definitions and interpretations was excessively wordy, repetitive and redundant, ComReg has reviewed the scope and detail of this section. Following its review, ComReg remains satisfied that the definitions used are appropriate and necessary. ComReg believes that the use of defined terms assists in setting out, in clear and precise terms, the detail of the measures.

(ii) With regard to Eircom's point on the definition of Bitstream Managed Backhaul, ComReg has amended the definition in the Decision Instrument to reflect Eircom's suggested change.

(iii) Further to Eircom's point about inconsistencies in terminology in draft decision instrument, ComReg has amended these inconsistencies where appropriate.

(iv) With regard to Eircom's point that in Section 4.3 of the draft decision instrument we did not specify the costs to be considered Outside the LEA, ComReg has now reflected (in Section 4.3 of the Decision Instrument) similar text to that set out in Section 4.2 of the Decision Instrument with regard to the use of Eircom's Historical Cost Accounts for determining the appropriate costs Outside the LEA.

(v) In response to Eircom's point that the notification period of three months for the introduction of new prices is unnecessary as the notice period proposed is identical to that already in place in D06/11, ComReg would clarify that the obligation of three months notice in ComReg Decision D06/11 is set on the basis of Regulation 9 of the Access Regulations regarding the transparency obligation. However, for completeness in the context of this Decision Instrument we are also placing the obligation of three months notice on Eircom on the grounds of Regulation 13 of the Access Regulations relating to the price control obligation.

(vi) Further to Eircom's point that Section 4.6 (on SABB) and Section 4.7 (on usage charges) of the draft decision instrument should be deleted, ComReg considers that Section 4.6 of the Decision Instrument regarding the cost orientation obligation for SABB Outside the LEA remains relevant for the reasons already discussed in Chapter 10. ComReg has deleted the obligation regarding usage charges at Section 4.7 of the Decision Instrument for the reasons set out in Chapter 6.

(vii) With regard to Eircom's point that Sections 5.1 and 5.2 of the draft decision instrument do not specify that the increased notification period in relation to price increases only applies Outside the LEA, ComReg would like to clarify that the obligations at Section 5.1 and 5.2 of the Decision Instrument remains relevant on the basis that an additional one months notice is required for price increases, nationally, and not just specific to the area Outside the LEA. This is consistent with the obligations set out in the NGA Decision (Section 11.15 of the Decision Instrument set out in Annex 2) for price increases.

(viii) In response to Eircom's point that Section 6.2 of the draft decision instrument regarding the retail margin squeeze test is internally conflicted, ComReg considers that Section 6.2 is clear that the Retail Margin Squeeze Test in the LEA is based on a portfolio approach, which is also consistent with the wording used for the retail margin squeeze test for NGA as set out in the NGA Decision. Please see further discussion on this point at Chapter 7 (subsection 7.4) above.

A 2.6 With regard to each of the points raised by **BT** and **ALTO**, ComReg has set out its position below:

(i) With regard to the issue on the quality of information used for the Bitstream cost model please refer to ComReg's position as set out in paragraph 5.40 in Chapter 5.

(ii) Further to the issue raised on the national cost orientation obligation and its potential impact on the WBA price floor in the LEA please refer to paragraph 5.39 in Chapter 5.

(iii) In response to the point on cross subsidisation of costs from Outside the LEA to the LEA, as already discussed in Chapter 5 of the Consultation Document, currently it appears that Eircom are under recovering its costs Outside the LEA and over-recovering its costs in the LEA therefore the cost subsidy is from the LEA into the area Outside the LEA. In any event, any price reductions in the LEA (as a result of a cross subsidy in the opposite direction) cannot breach the WBA price floors.

(iv) With regard to the obligation of a margin squeeze test for SABB, please refer to our position as set out in Chapter 10 of this Decision Document.

(v) ALTO raises an issue with Section 4.7 of the draft Decision Instrument on usage charges. However, it appears that ALTO's response on the usage charges is contradictory. While it disagreed with our proposal in its response to the draft decision instrument (Question 9), in its response to Question 3 (Chapter 6) on usage charges ALTO stated that it "… *agrees that action needs to be taken to militate against excess usage charges outside the LEA*….". In any event the obligation regarding usage charges has been removed from the final Decision instrument for the reasons already set out in Chapter 6 above.

(vi) ComReg has noted BT's points that if ComReg is to apply discretion to shorten notification periods it should be cognisant of not causing others to breach their Users Rights obligations such as customer notifications.

Annex: 3 European Commission Response Letter

EUROPEAN COMMISSION

Brussels, 3.4.2014
C(2014) 2354 final

Commission for Communications
(COMREG)

Block DEF,
Abbey Court,
Irish Life Centre,
Lower Abbey St.,
Dublin 1
Ireland

For the attention of:
Mr Kevin O'Brien
Chairperson of the Commission

Fax: +35318788193

Dear Mr O'Brien,

Subject: Commission Decision concerning Case IE/2014/1571: Wholesale broadband access in Ireland — price control remedies

Comments pursuant to Article 7(3) of Directive 2002/21/EC

I. PROCEDURE

On 4 March 2014, the Commission registered a notification from the Irish national regulatory authority, the Commission for Communications (ComReg),[1] concerning price control remedies in the wholesale broadband access (WBA) market[2] in Ireland.

The national consultation[3] ran from 19 September to 20 November 2013.

On 11 March 2014, a request for information[4] (RFI) was sent to ComReg and a response was

1 Under Article 7 of Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services (Framework Directive), OJ L 108, 24.4.2002, p. 33, as amended by Directive 2009/140/EC, OJ L 337, 18.12.2009, p. 37, and Regulation (EC) No 544/2009, OJ L 167, 29.6.2009, p. 12.

2 Corresponding to market 5 in Commission Recommendation 2007/879/EC of 17 December 2007 on relevant product and service markets within the electronic communications sector susceptible to *ex ante* regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services (Recommendation on Relevant Markets), OJ L 344, 28.12.2007, p. 65.

3 In accordance with Article 6 of the Framework Directive.

4 In accordance with Article 5(2) of the Framework Directive.

received on 14 March. A conference call was held on 21 March.

Pursuant to Article 7(3) of the Framework Directive, national regulatory authorities (NRAs), the Body of European Regulators for Electronic Communications (BEREC) and the Commission may make comments on notified draft measures to the NRA concerned.

II. DESCRIPTION OF THE DRAFT MEASURE

II.1. Background

The market for wholesale broadband access in Ireland was previously notified to and assessed by the Commission under case IE/2011/1207[5]. The relevant product market included:

(i) wholesale broadband access provided over an extensive or ubiquitous current generation DSL/copper network; and

(ii) wholesale broadband access provided over an extensive or ubiquitous next-generation fibre network.

Although ComReg found that competition conditions were more developed in areas where DSL and cable networks overlap than in the rest of Ireland, it had difficulty in demarcating stable market boundaries at sub-national level and defined the market as national in scope.

For both current and next-generation bitstream, the following remedies were imposed:

(i) access;

(ii) non-discrimination;

(iii) transparency;

(iv) accounting separation; and

(v) price control and cost accounting.

However, the remedies (apart from accounting separation) for next-generation products were defined only in general terms. Price control for current generation bitstream would continue to be based on ‘retail minus’[6] pending ComReg’s pricing review.[7] The Commission commented on the need to conduct a new analysis also covering the market for wholesale access to the local loop (market 4) and invited ComReg to analyse markets 4 and 5 together, thus ensuring a coherent approach to NGA regulation.

In a subsequent case, IE/2012/1295,[8] ComReg notified its ‘price floors decision’, in which it set minimum prices for current generation wholesale broadband access based on the ‘reasonably efficient operator’ (REO) approach in order to minimise the risk of a margin squeeze with regard to wholesale shared unbundled access[9] and ensure that the appropriate incentives to invest in full unbundling were maintained. ComReg also stated that the existing

---

5 C(2011) 3530.

6 The ‘retail minus’ decision was notified to the Commission under Case IE/2005/0313, SG-Greffe (2005) D/207603.

7 Prices for NGA bitstream products were notified under Case IE/2012/1404 (‘NGA decision’), where ComReg introduced price flexibility by way of margin-squeeze tests for NGA services in the WBA market. The cost standard for the retail margin-squeeze test refers to a ‘similarly efficient operator’ (SEO), i.e. an operator which shares the same basic cost function as Eircom but does not yet enjoy the same economies of scale and scope. The ‘reasonably efficient operator’ (REO) test is similar to the SEO standard.

8 C(2012) 1775.

9 ComReg did not determine the minimum price floors on the basis of full unbundled access, given the limited take-up of that product.

obligation not to margin/price squeeze between current generation WBA products and WBA resale/end-to-end components ('White Label Broadband') would be tested by means of the 'similarly efficient operator' (SEO) approach. This was intended to give alternative providers an incentive to favour bitstream over resale or end-to-end WBA. The Commission did not comment.

Under Cases IE/2012/1381-1382[10] (concerning the modification of remedies on the retail market for access to the public telephone network at a fixed location and the wholesale market for network infrastructure access[11]), ComReg notified its 'bundles decision', in which it specified the existing obligation not to bundle unreasonably, i.e. the net revenue test. ComReg found it appropriate to apply different remedies in the retail access market in different geographical areas, i.e. 'Larger Exchange Area' (LEA)[12] and 'Outside the Larger Exchange Area' (*Outside the LEA*).

The Commission invited ComReg to strengthen its analysis of all relevant structural and behavioural factors to justify that existing variations of competitive conditions that led ComReg to proposing differentiated remedies were not strong and stable enough to justify the definition of sub-national markets.

II.2. Description of the draft measure

The notified draft measure relates to price control measures to be imposed on the current generation (legacy) bitstream for the period to the end of 2016.[13] The proposed price control concerns only core network costs (mainly DSLAM, BRAS and transmission costs) of the bitstream, since all access network costs are recovered through narrowband rather than broadband services.[14]

The measure puts particular emphasis on the pricing approach *Outside the LEA*, where (according to ComReg) concerns as to excessive pricing are particularly pertinent. Thus, ComReg proposes a price control obligation which would be implemented differently in different areas, i.e. the LEA and *Outside the LEA*, as previously defined in the bundles decision. ComReg explains in this respect that:

(i) the LEA comprises those exchange areas with cable infrastructure (UPC), LLU-based competition and, prospectively, the potential for the roll-out of NGA; and

(ii) *Outside the LEA* is characterised by less/no infrastructure-based competition and is unlikely to become competitive prospectively. Eircom is the main provider of wholesale fixed bitstream services in these less urbanised areas, with over 90 % market share[15] and a 58 % market share at retail level.

---

10 C(2012) 8836.

11 Corresponding, respectively, to markets 1 and 4 in the Commission Recommendation on Relevant Markets.

12 LEA reflect those areas where uptake of unbundled services (whether LLU and/or virtual unbundling in NGA) is likely to be viable and those areas which prospectively are more likely to permit a greater degree of competition, including from other platforms such as cable, and where regulation should adapt to prospective changes. The measure sets out different criteria ComReg would use when identifying exchanges included in the LEA.

13 ComReg intends to review the appropriate price control for current generation bitstream before the end of 2016, by which time it will also have concluded a new market analysis for current market 5. It has initiated a review of access prices, including the appropriate costing methodology, to take place in 2014-15 and take account of the Commission's Recommendation on non-discrimination obligations and costing methodologies.

14 In this respect, ComReg clarifies that the proposed price control does not concern civil engineering costs in the access network.

15 In the LEA, Eircom has around 80 % market share at wholesale level.

Differentiated cost-orientation remedy based on HCA

ComReg proposes to replace the current 'retail minus' price regulation by a national cost-orientation obligation, requiring the SMP operator Eircom to ensure that it recovers no more than the actual costs (adjusted for efficiency, plus a reasonable return) incurred in the provision of WBA nationally. This obligation will be complemented by a margin-squeeze test as outlined further below.

In addition, ComReg proposes to impose a separate obligation requiring Eircom not to recover more than the actual costs (adjusted for efficiency, plus a reasonable rate of return) incurred in the provision of WBA *Outside the LEA*. Moreover, Eircom would not be allowed to increase its current bitstream rental prices *Outside the LEA* without ComReg's prior approval. ComReg finds that Eircom may have an incentive to cross-subsidise between *Outside the LEA* and the LEA, which would distort competition inside the LEA and cause users *Outside the LEA* to pay excessive prices. ComReg sees this risk as justifying a specific cost-orientation obligation *Outside the LEA*.

Given the margin-squeeze test against retail prices, ComReg does not find that a similar cost-orientation obligation is necessary for the LEA, as Eircom faces competitive pressure (from LLU providers and the cable operator UPC).

The cost-orientation obligation is proposed to be based on historic cost accounting (HCA) since ComReg believes that this will ensure reasonable price stability[16] and allow Eircom to recover any money invested in maintaining or upgrading its network. ComReg expresses concern that price control based on BU-LRAIC+ may encourage Eircom to 'sweat' its assets *Outside the LEA*, resulting in excessive pricing relative to its actual investment without any benefit to end-users in terms of alternative platform-based investment. ComReg further cites low population density *Outside the LEA*, where alternative fixed networks are very unlikely to be deployed and no commercial NGA roll-out is expected.[17]

ComReg does not expect the national cost-orientation (recovery of no more than costs inside and outside the LEA) to lead to wholesale price changes within the LEA. In its response to the RFI, it explains that if the HCA-based cost-orientation led to prices below the CCA-based price floor, Eircom would be bound by the price floor decision.[18] ComReg further explained during the conference call that if the margin-squeeze test resulted in prices below the price floor,[19] it would consider lowering the price floor.

ComReg plans to mandate price changes only where Eircom would be clearly under- or over-recovering its costs over a reasonably extended period. Thus, it argues, the results of the margin-squeeze price control will, under present circumstances, prevail within and *Outside the LEA* unless Eircom proposes significant price changes; this is more likely to occur *Outside the LEA*.

Margin-squeeze test for LEA/Outside the LEA

In addition to the cost-orientation obligations, ComReg proposes a retail margin-squeeze test,

---

16 ComReg states in its draft measure that its assessment shows that BU-LRAIC+ costs are higher than HCA costs for active broadband equipment on a national basis. Disaggregated costs between LEA and *Outside the LEA* are not available. However, in its response to the RFI, ComReg explains that the cost model results for 2013-14 for the CCA and HCA methodologies are similar, while costs based on the CCA methodology increase *Outside the LEA* over the next few years.

17 For *Outside the LEA*, ComReg states that it is very likely that NGA investment will happen only through state intervention under the National Broadband Plan.

18 See ComReg 13/90, which sets out ComReg's detailed analysis in relation to the draft measure and should, according to ComReg, be read in conjunction with the decision (Chapter 9, p. 114).

19 During the conference call, ComReg confirmed to the Commission that the price floor is national, and thus applicable also *Outside the LEA*.

since it finds that Eircom has an incentive, and is able, to set retail prices at a level relative to its own wholesale process that could foreclose competition. The test will be similar to the previously imposed 'retail minus' price regulation, since the appropriate margin is determined on the basis of the same 'discounted cash flow' (DCF) model.

For *Outside the LEA*, the margin squeeze test is proposed to be based on an SEO test using Eircom's costs as a starting point and adjusting them to reflect the more limited economies of scale and scope of a hypothetical entrant with 25% retail market share. Each retail offer is proposed to be assessed on a product-by-product basis to ensure that it covers the relevant associated retail and wholesale costs.

In the LEA, the margin squeeze test is proposed to be more flexible since Eircom faces retail constraints from cable and LLU operators. Here, it is proposed that the test be based on a mix of the SEO and 'equally efficient operator' (EEO) approaches.[20] ComReg considers that a portfolio approach is reasonable in the LEA (unlike *Outside the LEA*), since Eircom faces retail competition there from large retail broadband providers. This is also consistent to what has previously been mandated in the bundles decision (which first introduced the distinction between LEA and *Outside the LEA*) and the NGA decision (which considered Eircom as sufficiently constrained in its retail pricing in areas where NGA is likely to be rolled out to be granted some pricing flexibility).

Pricing of stand-alone broadband products

Since 1 July 2013, Eircom has provided stand-alone broadband access not requiring a PSTN subscription. The wholesale equivalent was launched recently and is subject to price control in the WBA market. Since the naked DSL is purchased without wholesale line rental (WLR), ComReg needs to assess the cost relating to the access network. Consequently, it proposes to include a cost-orientation obligation for *Outside the LEA* which will be further specified at a later stage.[21] In the meantime, the price should not exceed the price for WLR adjusted for avoidable costs associated with the voice service (e.g. line cards).

Finally, to support the above price control measures, ComReg proposes to adjust the transparency obligation.

III. COMMENTS

The Commission has examined the notification and the additional information provided by ComReg and has the following comments:[22]

Promoting efficient broadband investment and ensuring a consistent approach to access price regulation

The Commission notes that ComReg's proposed cost-orientation obligations based on HCA would not apply automatically and would, if at all, more probably be applied *Outside the LEA*[23]. This implies that price regulation would *de facto* be based on the proposed margin-squeeze tests (based on the same DCF model as that used for the current 'retail minus' price regulation). The test is designed to be more flexible inside than *Outside the LEA*, reflecting the difference in competitive constraints between the two areas.

---

[20] ComReg considers that a full EEO standard is not appropriate at this time, since there are currently no entrants in the Irish market which exhibit equal or almost equal economies of scale to Eircom.

[21] In the context of ComReg's ongoing work on the access network model, due for completion by 2015.

[22] In accordance with Article 7(3) of the Framework Directive.

[23] In the LEA, where Eircom faces competition, the price is more likely to be determined by the margin-squeeze test than the currently proposed cost-orientation obligation.

The Commission also understands that if the margin-squeeze test led to wholesale prices at or below the price floor, ComReg considers that the price floor would probably need to be lowered. In this respect, the Commission notes that price regulation based on a margin-squeeze test could result in wholesale prices below the cost of providing the relevant service. This is especially true in the LEA, where there is infrastructure competition and competitors may set their prices according to a different cost structure, network topology and age. While the Commission understands from ComReg that such a scenario is unlikely in the short term, it cannot be excluded that, over the medium term, as a result of intensifying retail competition in the LEA, the margin-squeeze test may lead to prospectively lower wholesale access prices, which would not send the appropriate build-or-buy signals or provide sufficient incentives to invest in alternative or established infrastructures.

In relation to this, the Commission is concerned that the proposed use of HCA in calculating the cost-orientated price (albeit only as regards core network elements) does not allow the SMP operator a sufficient and stable return on investment *Outside the LEA*, where it is most likely that the cost-orientation will actually apply. While taking note of ComReg's explanation that no commercial NGA deployment is expected *Outside the LEA*, the Commission would like to stress the importance of maintaining the correct build-and-buy signals in order not to foreclose potential investment altogether, including from new market players. In this context, the Commission would point to the possible market entry as announced by the electricity distribution operator ESB.

Moreover, the continued use of margin-squeeze-based pricing is also problematic *Outside the LEA*, because it is not suitable for preventing excessive wholesale pricing absent retail competition and makes it difficult to predict which form of price control will eventually apply and what the actual wholesale price level would be.[24]

The Commission therefore invites ComReg to reassess the appropriateness of the proposed margin-squeeze tests and HCA methodology for valuing core network elements and consider whether a cost-oriented price regulation, applying to both the access and the core network and based on a proper cost model, as outlined in the Commission's Recommendation on non-discrimination and costing methodologies,[25] would better meet the regulatory objectives of preventing excessive pricing and incentivising investment.

To this end, the Commission invites ComReg to reconsider the imposition of cost-oriented prices based on HCA at this stage, and incorporate the pricing review with respect to the core network in its ongoing access network review, which is understood to be following the principles set out in the Commission's Recommendation on non-discrimination and costing methodologies.

Clear and consistent regulation of broadband markets in Ireland

In its response to the RFI, ComReg explains that Eircom would be bound by the WBA price floor decision in the event of the HCA-based cost-orientation leading to prices below the current cost-based price floor in the LEA. The Commission notes, however, that the proposed measure does not explicitly state whether the WBA price floor would also remain valid *Outside the LEA*. In addition, the notified measure

24 Changes in price levels are normally considered to be material changes to the nature or scope of a remedy that have an appreciable impact on the market and should therefore be notified under Article 7(3) of the Framework Directive.

25 Commission Recommendation of 11 September 2013 on consistent non-discrimination obligations and costing methodologies to promote competition and enhance the broadband investment environment, OJ L 251, 21 September 2013, p. 13.

points to the price floor being national in scope, while the related consultation document and ComReg's response to the RFI seem to suggest that it is applicable only for the LEA.

The Commission therefore calls on ComReg to set out clearly in the finally adopted measure how the proposed differentiated cost-orientation obligation and margin-squeeze tests will interact with the WBA price floor in both the LEA and *Outside the LEA*, in order to increase transparency and predictability with regard to the regulated prices.

Pursuant to Article 7(7) of the Framework Directive, ComReg shall take the utmost account of the comments of other NRAs, BEREC and the Commission and may adopt the resulting draft measure; where it does so, shall communicate it to the Commission.

The Commission's position on this particular notification is without prejudice to any position it may take *vis-à-vis* other notified draft measures.

Pursuant to Point 15 of Recommendation 2008/850/EC,[26] the Commission will publish this document on its website. The Commission does not consider the information contained herein to be confidential. You are invited to inform the Commission[27] within three working days following receipt whether you consider that, in accordance with EU and national rules on business confidentiality, this document contains confidential information which you wish to have deleted prior to such publication.[28] You should give reasons for any such request.

Yours sincerely,

For the Commission,
Robert Madelin
Director-General

CERTIFIED COPY
For the Secretary-General,

Jordi AYET PUIGARNAU
Director of the Registry
EUROPEAN COMMISSION

---

[26] Commission Recommendation 2008/850/EC of 15 October 2008 on notifications, time limits and consultations provided for in Article 7 of Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services, OJ L 301, 12.11.2008, p. 23.

[27] Your request should be sent by email: CNECT-ARTICLE7@ec.europa.eu or fax: +32 2 298 87 82.

[28] The Commission may inform the public of the result of its assessment before the end of this three-day period.

Annex: 4 ComReg's consideration of the comments raised by the European Commission

A 4.1 On 4 March 2014, we notified the Commission of our draft measures in line with Article 7 of the Framework Directive. On 11 March 2014 we received a request for information ("RFI") from the Commission seeking additional information and clarifications from ComReg regarding the notified measure on Bitstream pricing. ComReg provided its response to the RFI on 14 March 2014.

A 4.2 On 4 April 2014 the Commission issued its response letter to ComReg following ComReg's notification of its draft measures regarding the price control obligation for current generation Bitstream services. In its letter the Commission expressed a number of views as follows: (a copy of the Commission letter is set out in Annex 3 above).

Promoting efficient broadband investment and ensuring a consistent approach to access price regulation:

a) The Commission understands that if the margin-squeeze test led to wholesale prices at or below the price floor, ComReg considers that the price floor would probably need to be lowered. In this respect, the Commission notes that price regulation based on a margin-squeeze test could result in wholesale prices below the cost of providing the relevant service. According to the Commission, this is especially true in the LEA, where there is infrastructure competition and competitors may set their prices according to a different cost structure, network topology and age. While the Commission understands from ComReg that such a scenario is unlikely in the short term, it cannot be excluded that, over the medium term, as a result of intensifying retail competition in the LEA, the margin-squeeze test may lead to prospectively lower wholesale access prices, which would not send the appropriate build-or-buy signals or provide sufficient incentives to invest in alternative or established infrastructures.

b) In this regard, the Commission is concerned that the proposed use of HCA in calculating the cost-orientated price (albeit only as regards core network elements) does not allow the SMP operator a sufficient and stable return on investment Outside the LEA, where it is most likely that the cost-orientation will actually apply. While taking note of ComReg's explanation that no commercial NGA deployment is expected Outside the LEA, the Commission stressed the importance of maintaining the correct build-and-buy signals in order not to foreclose potential investment altogether, including from new market players. In this context, the Commission referred to the possible market entry as announced by the electricity distribution operator ESB.

c) The Commission also flagged that the continued use of margin-squeeze-based pricing is, in its opinion, also problematic Outside the LEA, because it is not suitable for preventing excessive wholesale pricing absent retail competition and makes it difficult to predict which form of price control will eventually apply and what the actual wholesale price level would be.

d) The Commission invited ComReg to reassess the appropriateness of the proposed margin-squeeze tests and HCA methodology for valuing core network elements and consider whether a cost-oriented price regulation, applying to both the access and the core network and based on a proper cost model, as outlined in the Commission's Recommendation on non-discrimination and costing methodologies, would better meet the regulatory objectives of preventing excessive pricing and incentivising investment.

e) The Commission invites ComReg to reconsider the imposition of cost oriented prices based on HCA at this stage, and incorporate the pricing review with respect to the core network in its ongoing access network review, which is understood to be following the principles set out in the Commission's Recommendation on non-discrimination and costing methodologies.

Clear and consistent regulation of broadband markets in Ireland:

f) The Commission also called on ComReg to set out clearly in the finally adopted measure how the proposed differentiated cost-orientation obligation and the margin-squeeze tests will interact with the WBA price floor in both the LEA and Outside the LEA, in order to increase transparency and predictability with regard to the regulated prices.

A 4.3 Further to the views expressed by the Commission and in line with Regulation 14(2) of the Framework Regulations we have taken utmost account of the views expressed by the Commission as set out in detail below.

a) In the letter of 4 April 2014 (p. 4) the Commission states that if the margin squeeze test resulted in prices below the price floor, ComReg would consider lowering the price floor. However, we can clarify that this is not the intention. If standalone Bitstream prices decrease, the WBA price floors would not reduce as a result, in fact the floors are there to prevent the Bitstream prices from reducing to a level that they might foreclose alternative investment by other operators. The only scenario where the WBA price floors could reduce would be where the inputs in the WBA price floors model such as the LLU price were to decrease. Any such changes would however require ComReg review and/or approval.

b) The Commission is concerned that the proposed use of HCA in calculating the cost-orientated price (albeit only as regards core network elements) does not allow the SMP operator a sufficient and stable return on investment Outside the LEA. To clarify, the reason for choosing the HCA methodology as opposed to the BU-LRAIC+ is mainly due to the fact that in the absence of alternative network competition the BU-LRAIC+ approach may encourage Eircom to “sweat” its assets in areas Outside the LEA resulting in excessive pricing relative to its actual investment without any benefit to end users in terms of alternative platform based investment.

The BU-LRAIC+ approach permits the recovery of hypothetical costs which may not have been actually incurred. Given the extent of depreciated assets (i.e., DSLAMs and BRAS) in Eircom’s core network and the fact that these assets may not be replaced by Eircom, the BU-LRAIC+ methodology could give rise to significant increases in wholesale and retail legacy broadband prices Outside the LEA. This would be detrimental to end-users and wholesale operators that have no alternative options for broadband provision other than purchasing these services from Eircom. While BU-LRAIC+ may be useful in setting appropriate “build or buy” signals for other networks this consideration is less important Outside the LEA (rural areas) in Ireland at least.

We consider that the obligation of cost orientation (based on the HCA methodology) should help operators’ investment plans. While we will review cost recovery annually we plan to only allow price changes which are sustainable and where Eircom are either materially under / over recovering its costs such that the cost orientation obligation is clearly breached. The HCA methodology will allow Eircom to recover any money invested efficiently in maintaining or upgrading its network on the basis that Eircom will have the assurance that what it spends can be recouped over the price control period. It is also important to point out that this Decision on current generation Bitstream will not impact on NGA investment such as that of the ESB as ultimately the WBA Price Floors Decision provides the appropriate “build or buy” incentives in that regard.

c) In the letter of 4 April 2014 (p.6) the Commission state that the use of the margin squeeze based pricing is also problematic Outside the LEA because it is not suitable for preventing excessive pricing absent retail competition. To clarify, the imposition of the obligation of cost orientation is being imposed to ensure the issue of excessive pricing is addressed explicitly. The retail margin squeeze test is to ensure that competitors have sufficient retail margin and be in a position to replicate the retail offers of Eircom. The retail margin squeeze does not prevent Eircom from setting its wholesale prices above cost.

d) The Commission is of view that ComReg should reassess the appropriateness of the proposed margin-squeeze tests and HCA methodology for valuing core network elements and consider whether a cost-oriented price regulation, applying to both the access and the core network and based on a proper cost model, as outlined in the Commission’s Recommendation on non-discrimination and costing methodologies, would better meet the regulatory objectives of preventing excessive pricing and incentivising investment. The Commission invites ComReg to reconsider the imposition of cost oriented prices based on HCA at this stage, and incorporate the pricing review with respect to the core network in its ongoing access network review. In this regard ComReg has considered its position but in the interim and until such time as the Access Network Review is complete we believe that the cost orientation obligation should be imposed in the WBA market for the following reasons:

   i) **Price certainty**: ComReg considers that the obligation of cost orientation based on HCA costs ensures that Eircom cannot increase the Bitstream prices or introduce a price for a new Bitstream product Outside the LEA without demonstrating to ComReg that any revised (or new) prices are based on no more than the actual local costs adjusted for efficiencies (plus a reasonable rate of return) in that area Outside the LEA. The current retail minus price control does not provide any price certainty to entrant operators in the area Outside the LEA. This is a very important consideration in our view as ComReg currently would have no regulatory tools to prevent Eircom from increasing rural prices where there is no cost justification for such a change.

ii) **Access network review**: As already set out in our notification letter to the Commission we have initiated the review of Eircom's access network prices (for LLU, SLU, Line Share, WLR and Naked DSL) which should be completed by mid-2015. The access network review will take utmost account of the Commission Recommendation on Non-discrimination and Costing Methodologies. Therefore, we are carrying out the necessary reviews of the access network as prescribed by the Commission in its response letter. The Decision being made in this instance does not impact any Access network prices, rather the prices relate to active broadband equipment in the main.

iii) **Usage charges**: Given the recent issues raised by operators early this year in the context of Eircom's current generation and next generation usage charges, we believe that the imposition of the obligation of cost orientation allows us to ensure that the prices charged by Eircom for usage are in line with efficient costs over the medium to long term. Currently there is no legal basis for ComReg to intervene where operators make claims that prices are excessive unless it is clear there is a retail margin squeeze.

iv) **Industry views**: All of the respondents to the Consultation Document supported our view that cost orientation based on the HCA methodology was appropriate for setting current generation Bitstream prices. Our proposed measures are important to many of the operators in the Irish market and we should therefore not delay in implementing these measures in the market place as soon as possible.

e) The Commission also called on ComReg to set out clearly in the finally adopted measure how the proposed differentiated cost-orientation obligation and margin-squeeze tests will interact with the WBA price floor in both the LEA and Outside the LEA, in order to increase transparency and predictability with regard to the regulated prices. To clarify, Eircom must ensure that it does not set its Bitstream prices below the national WBA price floors. In fact the WBA price floors are in place to prevent the Bitstream prices from reducing so low that they might foreclose alternative investment by other operators. As such, Eircom is required to ensure that it complies with both the retail margin squeeze test (see Chapter 7) and the WBA Price Floors Decision. If, for competitive reasons, it wishes to reduce retail prices, then complying with both tests may require it to reduce both WBA prices and prices for services that are inputs to the WBA price floors model (such as LLU). However, any such changes would require ComReg review and/or approval.