

eircom Ltd.

**COMMENTS OF EIRCOM IN RESPONSE TO THE
EUROPEAN COMMISSION DRAFT RECOMMENDATION ON
REGULATED ACCESS TO NEXT GENERATION ACCESS
NETWORKS (NGA)**



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1. Introduction and Summary

eircom welcomes the opportunity to furnish its views on the revised draft of the European Commission's Recommendation on regulated access to NGAs, dated 12 June 2009 ("Second NGA Draft").

eircom is an active member of the European Telecommunications Network Operators' Association ("ETNO") and has contributed to the comments submitted by ETNO in response to both the first and second drafts¹ of the NGA recommendation. Among the key points made by ETNO's submission on the Second NGA Draft are the following:

- *Role of symmetric regulation in the terminating segment:* The Commission should specify, in accordance with expected modifications to Article 12 of the Framework Directive, that access to the terminating segment should be symmetric in principle to ensure a level playing field for investors.
- *Market-led approach to NGA technology and architecture:* The Commission should not prejudge which technology will triumph as the medium for NGA by requiring SMP operators to roll-out specific network solutions in the terminating segment, which would severely distort competition and could lead to under-investment in certain technologies and over-investment in others; nor should the Commission mandate unbundling before it is clear whether it will be technically feasible or economically sustainable from a supply and demand standpoint.
- *Regulatory certainty:* The regulatory principles governing NGA should be clearly defined, over the life of the investment, so that investors can

¹ ETNO Reflection Document in response to the Commission Recommendation on regulated access to Next Generation Access Networks (NGA), 24 July 2009.

make informed investment decisions based on the regulatory and financial risks involved.

- *Proportionate gradation of access remedies and geographic segmentation:* The approach proposed by the Commission in the first draft of the recommendation envisaged a proportionate gradation of remedies; this should be a cornerstone of the final recommendation, which also should recognise the potential importance of sub-national markets to the competitive assessment in a fibre environment.
- *Flexible pricing of wholesale NGA products:* The Commission should not set inflexible pricing obligations but rather should encourage NRAs to determine, on a case-by-case basis, whether cost orientation is necessary to achieve effective competition.
- *New pricing models and margin squeeze analysis:* The final recommendation should take into account the issues of risk premium in WACC and risk sharing pricing models between investors and access seekers; while margin squeeze assessments may be relied upon to detect instances of discriminatory pricing at the wholesale level, the Commission should modify a number of disproportionate and ill-conceived features of the *ex ante* margin squeeze assessment discussed in the draft recommendation.
- *Need for sound market analysis:* The Commission should not prejudge the market definitions that will apply in the case of NGA services and should encourage NRAs to carry out a proper forward-looking demand and supply side substitution analysis before reaching any conclusions on the scope of the relevant market, which should be evaluated on a technology-neutral basis.
- *Efficient migration to NGA:* The blanket five-year migration period specified in the Second NGA Draft is not appropriate; the Commission

should make clear that NRAs should intervene only where commercial negotiations fail, by specifying minimum notice periods for de-commissioning on a case-by-case basis in accordance with the relevant facts and circumstances.

eircom strongly endorses the conclusions – and shares the many concerns – that have been identified in ETNO’s Reflection Document on the Second NGA Draft, which we incorporate by reference in this response. However, because of the critical importance of the Commission’s NGA recommendation to eircom, its customers and, indeed, to economic and social development in Ireland, we wish to supplement the ETNO submission with our own comments by expanding upon the discussion of several issues which we believe would benefit from further elaboration at this time.

Our comments will focus, in particular, on the following points:

- the importance of national circumstances and conditions in developing *ex ante* regulation of NGA in each country;
- the Commission’s unsustainably narrow and technology-specific definition of “NGA”;
- the significance of sub-national markets in an NGA environment;
- the dangers of inflexible and mechanistic *ex ante* margin squeeze tests that fail to take account of the actual market dynamics; and
- the apparent intent behind the proposed recommendation to promote a co-investment approach that could create many more problems than it solves.

2. **The final recommendation should exhort NRAs to take full account of national circumstances when implementing NGA regulation**

The NGA recommendation should achieve a reasonable balance between the need to harmonise regulation across the EU on the one hand and, on the other hand, the need

for national governments and NRAs to address the specific issues and challenges raised by their individual circumstances, including economic, social, geographic and other factors. The Irish situation is a case in point.

The Irish National Context

The Irish economy has been severely affected by the recent economic downturn and faces the same general problems as other Member States, but the problems are compounded. These include economic contraction with declining consumer demand and reduced investment in enterprise. In addition, a chronic deficit in public finances means that economic recovery may take significantly longer than in other Member States and will certainly limit the extent to which the Irish Government can fund ICT infrastructure (within EU State Aid rules).

eircom believes that the development of Next Generation Networks (“NGNs”), including NGAs, is critically important for Ireland’s economic recovery and can have a transformational effect on economic enterprise and society in general. Primarily, it will enable the transformation to a smart economy that will be dependent on externally traded high-value services, especially in the ICT sector. For example, the following ICT developments identified by the Irish Government² will require ubiquitous availability of ultra-band services over fibre and equivalent NGN platforms:

- Roll-out of location-based services using ambient intelligence, pervasive computing, and embedded intelligence;
- Development of intelligent transport systems using Global Positioning Systems and other technologies that manage the flow of people, goods and services, including pay-as-you-go systems for transport, insurance, etc.;
- Technologies for independent living, including embedded sensors;

² Sharing our Future – Ireland 2025 Forfas, July 2009.

- The growing use of biometrics for health and security purposes;
- Transparency and security of supplies, for example, food security and traceability;
- The management of distribution and freight systems using radio frequency identification, etc.;
- Cash-free payment systems;
- Remote tele-services; and
- Virtualisation of work.

However, the NGN/NGA networks required to support these developments have not yet been built in Ireland. It is estimated that the cost of upgrading the Irish access network to an FTTC solution for the top 65 percent of exchanges (reaching approximately one million homes or 68 percent of the population) would be between €400 million and €500 million. It is estimated that that an FTTH solution could cost €2,000 per home for new-build premises and €2,500 per home to retrofit existing premises. The business case for this investment on a national basis is extremely difficult to establish.

Therefore, the primary and immediate objective of public policy supported by the regulatory framework must be to ensure that these NGN/NGA networks are built.

In line with the overall objectives of EU sectoral policy on telecommunications, the Irish Government has decided that NGN/NGA investment will be led primarily by the private sector facilitated by a regulatory regime that encourages investment and the development of sustainable competition³. However, there is also an expectation that Government intervention of some type will be necessary to ensure that NGN/NGA networks will be provided in areas where the commercial case for private investment cannot be made. The particular features of the Irish market (scale, demographic

³ Next Generation Broadband – Gateway to a Knowledge Ireland, June 2009.

density and dispersion) make such Government intervention essential in order to achieve the goal of ubiquitous NGN/NGA networks with minimal digital divide.

Notwithstanding the limited availability of the Government funding referred to above, the degree of State intervention will depend on the level of geographic/demographic coverage that private investment can achieve. In first generation broadband, the Irish Government, with EU Commission approval, introduced a State-funded National Broadband Scheme to in-fill the last 10 percent of the population. In an NGA environment, this is likely to be the final 30 to 40 percent of the population, with Government intervention to be governed by the EU Commission's recent Communication on the application of State Aid rules in relation to rapid broadband deployment. The percentage of the population that will ultimately be able to access NGA networks built by means of private investment will depend to a large extent on the anticipated impacts of regulation.

The secondary objective of public policy therefore should be to ensure that the requirement for State intervention is minimised by encouraging the maximum development of private investment. The regulatory model applied to the investment has a key role to play in achieving this objective.

The Irish Telecommunications Sector

Perhaps because of Ireland's unique geographic/demographic characteristics, including an island setting that provides a very hospitable environment for the use of spectrum, the first-generation broadband market in Ireland is already exhibiting the effects of rapidly developing inter-platform competition. For example:

- Availability and take-up of first generation broadband has improved significantly in the past twelve months and in general, speeds and prices compare favourably with other Member States;
- DSL is declining in terms of its overall platform share of the broadband market (including cable, mobile and Fixed Wireless Access ("FWA")) – approximately 54 percent of all connectivity.

- It is estimated that 3G/HSDPA is available to over 90 percent of the population with overall mobile broadband penetration at 28 percent and growing. In the residential space, a recent survey commissioned by ComReg has found that use of mobile broadband “increased markedly last year with 18 percent of home internet users now using this access method,” as compared to 8 percent in Q2 2008.⁴
- UPC has consolidated what had previously been a fragmented cable television industry and is now at the mid-stage of a three-year programme to upgrade broadband in major urban centres servicing a total customer base of 35 percent of the population, which would equate to approximately 55 percent of the addressable market capable of being served on a commercial basis by wireline NGA (as discussed below).⁵

Although there has recently been significant investment in NGN by fixed and mobile operators, this has so far been mainly focussed on the core network capability. eircom will complete national roll-out of its core NGN network by the end of 2010. The Irish Government has funded the construction of fibre rings (Metropolitan Area Networks) in over 90 cities and towns and State-subsidised services from these networks are used by other fixed and mobile operators to compete with eircom in the provision of broadband services at the wholesale and retail levels on a nationwide basis.

However, it is the deployment of ubiquitous broadband access networks in Ireland that has historically presented the largest obstacle and this challenge will be even greater in the roll-out of NGA. Although the “last mile” issue is not unique to Ireland, the scale and scope of the problem represent far greater challenges than in most other EU countries. This is due primarily to Ireland’s unique demographic structures and

⁴ ComReg Consumer ICT Services Survey Q2, 2009 – http://www.comreg.ie/publications/comreg_consumer_ict_services_survey_q2_2009.583.103431.p.html.

⁵ Irish Communications Market ComReg Quarterly Reports – various at www.comreg.ie.

relatively low population density⁶. Compared to other Member States, a smaller proportion of the Irish population resides in urban areas and, even within these urban areas, the population tends to be lower than in other Member States. In non-urban areas, there is relatively little population clustering and a significantly longer tail of high cost rural customers. As a consequence, the cost of access-line provision in Ireland is estimated to be up to 45 percent higher than in the EU15.⁷

Recently collected data on Ireland's housing stock (*i.e.* habitable residences) provides evidence of the stark reality of the country's NGA investment challenge. The Irish national housing stock totals over 1.9 million units – an increase of over 33 percent since 1997. Detached houses constitute 43 percent of the national housing stock, with just 10 percent being apartment blocks. More than 33 percent of the national housing stock comprises one-off housing (*i.e.* detached housing in the open countryside). Furthermore, the percentage of one-off housing actually increases as one moves towards the more peripheral parts of the country. For example, in 2007 one-off houses represented 40 percent and 47 percent, respectively, of the Western seaboard counties of Mayo and Donegal.⁸

The real addressable market for fibre NGA in Ireland is disproportionately limited compared to other Member States. Therefore, any regulatory framework which predetermines that fixed fibre-based networks will be the only viable technology platform for NGA services in Ireland is flawed. If that regulatory framework further disadvantages the fixed network operator compared to other platforms through the imposition of disproportionate, asymmetric remedies, investment will be difficult to justify outside of densely populated urban areas from a commercial perspective. In particular, if the recommendation confers significant artificial advantages on upgraded mobile broadband (ultimately LTE), upgraded cable (DOCSIS-3.0), WiMax and upgraded copper through LLU by handicapping eircom alone with a heavy regulatory

⁶ Further detailed breakdown of the impact of demography on the economic case for NGA in Ireland is presented by ComReg in D09/56 Next Generation Broadband in Ireland – at www.comreg.ie, July 2009.

⁷ Access Network Cost in Ireland – A presentation by Dotecon to ComReg, 18 November 2008.

⁸ Department of Environment Housing Statistics Annual Report – Various.

overlay, the case for commercial FTTH/FTTC services in any of Ireland's addressable broadband markets will be problematic to say the least.

Despite the many challenges, eircom is confident that all stakeholders can develop a fair and reasonable roadmap for achieving the objective of world-class NGN/NGA in Ireland. eircom invested €1.1 billion in its networks in the past three years, which represented an increase of over 30 percent in investment levels on the previous three-year period. This resulted in a substantial increase in fixed and mobile broadband speeds and availability. More recently, eircom has been addressing key financial challenges arising from the economic downturn by introducing efficiency measures which, *inter alia*, have included significant reductions in pay costs. eircom is confident that if the business case for NGA is sustainable, based on clear customer demand and a fair regulatory regime, it will be in a position to further increase investment levels to develop the NGA network.

Ultimately, signals from policy makers at the EU and national levels that a fair, symmetric, and technology-neutral regulatory regime will be developed for NGA will assist this critical transformation process to move forward. Such a regulatory regime will also help enable all stakeholders to respond to market challenges in a forward-looking manner, while minimising disagreements within the sector over key strategic issues affecting shareholder value and stakeholder interest.

3. **The final recommendation should define NGA to include all forms of high-capacity wired and wireless access**

In light of the discussion above, it is apparent that the definition of NGA upon which the draft recommendation is centred – *i.e.* wireline network solutions only – is unreasonably narrow. This technology-specific focus is not only unrealistic but inherently discriminatory, and thus produces an unnecessarily heavy-handed regulatory result for a single broadband provider in each national market.

In many countries, including Ireland, the time horizon over which the Commission's final NGA recommendation is likely to be implemented is at least five years. As discussed in the previous section, further development of strong inter-platform

broadband competition amongst upgraded fixed telecommunications, cable television, FWA and mobile data networks is already in train. Such end-to-end, infrastructure-based competition should be encouraged under the Commission's leadership. Yet the thicket of onerous NGA obligations contemplated by the Second NGA Draft suggests that the Commission has failed to give due weight to these important developments in crafting the Second NGA Draft.

In this regard, it is interesting to note that the Second NGA Draft includes a presumption that a "regulatory-lite" solution would likely suffice in cases where there are at least three operators competing at the retail level on the basis of their own networks. It is unclear why the Commission has apparently ruled out the possibility that vigorous competition between two such operators would not be sufficient to eliminate, or at least reduce, any asymmetric *ex ante* obligations applicable to one of the two. In any event, the "three-operator" deregulatory trigger set out in the draft recommendation implies that the expected development of self-provided high-speed cable, mobile broadband and FWA networks over the next five years should be given far greater consideration in assessing the costs and benefits of establishing a highly intrusive – and technology-specific – regulatory scheme for NGA. This is all the more important in countries like Ireland that are facing the kinds of economic and demographic challenges described above.

4. **The final recommendation should address issues relating to sub-national NGA markets in a positive and holistic way**

In an NGN/NGA environment, there is an increased potential for competitive conditions to vary significantly in different areas within a national market. As already noted, this is particularly so in countries like Ireland, where there are densely populated urban areas surrounded by a large proportion of territory in which the population is widely dispersed. Such factors may be relevant to the analysis of both Markets 4 and 5.

It is with considerable disappointment, therefore, that eircom has reviewed the relevant language of the Second NGA Draft (recital (49) and para. 46) which would

appear to question the appropriateness of analysis at the sub-national market level in an NGA environment. The final recommendation should make clear that actual or potential competition in sub-national markets from powerful competitors with self-provided networks, including cable television, mobile and FWA, should be considered in this context.

However, in many countries, including Ireland, a number of important subsidiary issues will need to be addressed in parallel by national regulators to ensure that geographically targeted remedies are implemented in a way that does not create a cost/price imbalance in those sub-national markets where competition is less likely to develop. The recommendation should provide guidance on the ways in which national regulators should holistically address these issues.

5. **The final recommendation should establish baseline principles for a fair and proportionate *ex ante* margin squeeze test**

The draft recommendation fails to make the critical link between risk sharing and the promotion of investment on the one hand, and the elements of a test for margin squeeze on the other. In an *ex ante* setting, where the potential for margin squeeze will necessarily have to be assessed on the basis of projected demand, revenues and costs in a new and evolving environment, it will be particularly important to apply the test in a balanced way that takes into account the actual and expected market dynamics. This cannot be accomplished by applying a mechanistic formula using inputs that are effectively skewed to handicap the regulated access provider's ability to compete in downstream markets. The problems with such an approach have already become manifest in some NRAs' attempts to apply an inflexible *ex ante* margin squeeze formula to the current generation of access services.

With the introduction of NGA, these concerns will be magnified as packages of fixed, mobile, Internet and subscription audiovisual services are introduced. It would be completely unfair and disproportionate for a particular NGA provider to be constrained by highly restrictive price floors whilst well-financed and powerful

mobile, cable television and FWA operators are allowed to price competing packages without limitation.

The final recommendation should provide balanced guidance on how national regulators should deal with these difficult and complex issues in a proportionate and non-discriminatory way. In particular the recommendation should make clear that any *ex ante* margin squeeze guidelines adopted by an NRA should be designed to protect *competition* rather than particular individual competitors. The assessment also should take account of actual market circumstances, including the existence of competitive retail packages which confirm the replicability of packages offered by the regulated NGA provider.

6. **The Commission should not pursue a regulatory approach that is in reality a Hobson's Choice**

The Second NGA Draft is a significant departure from the first draft, which appeared to recognise the significant challenges associated with NGA financing and deployment, particularly in the current economic circumstances. The revised draft, by contrast, contains a catalogue of virtually all of the remedies ever devised in connection with the legacy copper loop and appears to contemplate their application *en masse* to an operator caught by the recommendation.

The Commission would appear to have a clear purpose in mind by cutting-and-pasting measures designed for regulating sunk investments onto a scheme for regulating networks that are still in the blueprint stage: *i.e.* to motivate regulated NGA providers to avoid a thicket of onerous and intrusive obligations by pursuing a co-investment solution with the promise of “light touch” regulation. This may turn out to be a Hobson's Choice that could have serious unintended consequences for the sector and society at large.

Co-investment may well prove to be a viable approach for NGN/NGA deployment if freely undertaken on a commercial basis, but it is far from clear whether a consortium approach will actually work in practice in every country. The willingness or ability of alternative operators to make the necessary up-front investments is a major

uncertainty, particularly at this time. Indeed, recent developments⁹ indicate that the main broadband competitors in Ireland do not foresee investor or consumer support in the upgrade to fibre networks and envisage market demands being met by upgraded services over the copper network in the medium term in advance of the launch of wireless LTE services.

The fact of the matter is that even when finance was plentiful, very few alternative network operators in Ireland chose to invest in infrastructure on a graduated basis following the much vaunted “ladder of investment” theory. It is therefore unclear on what basis they would be willing to make up-front co-investments in the roll-out of fibre networks, and the negotiation of these and other complex issues relating to the investment is not likely to be straightforward.

Past experience with joint ventures and consortia amongst competitors in the telecommunications industry in other settings (consider, for example, the largely unsuccessful Concert, GlobalOne and Unisource joint ventures) indicates that this option could result in inordinate delays in the roll-out of fibre-based access. The negotiation of these agreements is likely to require significant time and resources as potential consortium members attempt to come to a meeting of the minds over a range of start-up and business issues (for example, their individual levels of participation, the scope and structure of the venture, the filling of key positions, exit and buy-out options, network architecture, and the selection of network equipment and systems vendors). Neither consumers nor suppliers will be well served by untested commercial solutions that are effectively forced by ill-conceived regulation.

The co-investment model should clearly remain on the table as an option that is neither favoured nor effectively forced. Each such arrangement will need to be reviewed (including potentially under applicable merger control regulations) on a case-by-case basis. However, the final recommendation should focus on articulating

⁹ BT Group PLC signed a deal with Vodafone Group PLC on 22 July 2009 to transfer BT's consumer and small business broadband and voice customers in the Republic of Ireland to Vodafone and will provide Vodafone with wholesale services to help deliver its broadband products over seven years – Dow Jones Newswires, 22 July 2009.

a reasonable, proportionate and graduated framework for regulating (where absolutely necessary) *individual* NGA access providers, taking full account of actual and potential competition provided by other operators with self-provided access networks.

In refining the framework, the Commission should assess the impact of transplanting legacy copper-focussed regulations for application to fibre access networks before these networks are even built – in particular, by imposing the full panoply of available active and passive remedies on the first-mover, non-cable wireline investor in each country, and adding to this regulatory morass a requirement that the regulated operator maintain dual copper and fibre networks for a minimum five-year transition period – will significantly compromise the business case for any widespread investment in fibre in Ireland. The Commission’s final recommendation should therefore remind NRAs that it is incumbent upon them to undertake a full and objective regulatory impact assessment taking local circumstances into account before they impose any remedies on particular NGA networks and services.

7. **Conclusion**

The Second NGA Draft has proved useful insofar as it has sparked a useful debate of the future application of regulation to NGA networks. However, the proposed recommendation in its current form promises to be a potent deterrent to widespread NGA deployment in Europe. A fundamental rethink of the proposal and further consultation are necessary before a final recommendation can reasonably be adopted.