eircom Ltd.

Response to Ofcom consultation

Future broadband -

Policy approach to next generation access

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EXECUTIVE SUMMARY

- eircom is eager to engage with Ofcom in the development of a regulatory environment, which will not distort economic incentives and will encourage the scale of investments in network and services that Northern Ireland (NI) requires.

- The time is now for efficient for next generation access (NGA) investment to take place in the United Kingdom (UK), including NI. eircom rejects Ofcom's preliminary conclusion that the UK is in a "pre-investment period," with uncertainty surrounding the commercial case for investment.

- eircom supports the key goal of "improved communications networks, maintaining technological pace with the best in Europe in terms of increased internet connectivity speed, capacity and availability" in the Northern Ireland *Executive's Building a Better Future -- Draft Investment Strategy 2008-2018*. eircom see itself as one of the "private sector partners" working with the Northern Ireland (NI) Government in meeting the challenge of delivering its largest ever investment programme.

- eircom has views counter to Ofcom's that government funding to achieve public policy objectives creates "artificial incentives." Given the crucial importance of broadband for economic development and the creation of a knowledge and information-based society, public authorities must provide economic stimuli to prevent a 'digital divide' between urban areas, which attract private sector investment, and rural and scarcely populated areas.

- eircom reminds Ofcom that the BT Group plc's Undertakings of 2005 ("the Undertakings") apply in Northern Ireland, except for the operational separation of an Access Service Division, such as Openreach. As Ofcom explains, for example, the Undertakings already require BT Group plc ("BT") in NI (and Openreach elsewhere in the UK) to provide access to any fibre deployed on an equivalence of inputs basis.

- eircom is pleased to note Ofcom's commitment that access obligations and other regulatory remedies would be imposed through a combination of market reviews, as mandated by the European Union Regulatory Framework, and any undertakings given to Ofcom by BT. eircom finds positive the statement: "Ofcom does not presume that any organisation that invests in next generation access services will have market power."

- eircom strongly agrees with Ofcom's view that that anyone who makes investments in next generation access is likely to face significant commercial risks. Access obligations imposed on a significant market power (SMP) operator making such investments thus should reflect these risks in order to provide appropriate incentives for the investment in the first place.

- Any risk-adjusted price controls or regulatory forbearance, which would result from Ofcom's consideration of new and emerging markets and proportionality, should not made conditional on the introduction of anchor product regulation.

- eircom calls upon Ofcom to consider the proposed amendment of Article 12 of the Framework Directive to impose a symmetrical obligation to <u>any</u> operator to negotiate sharing of facilities under reasonable requests from another operator.

GENERAL REMARKS

eircom's deployment of next-generation technology in its core and access networks – both in Ireland and NI -- is based on a commercial business case. Network operators, such as eircom, have to modernise networks to adapt to technological innovation and the obsolescence of older-generation technology. Such operators need to plan and procure the technology and then deploy it effectively and efficiently while maintaining legacy services and networks. This, of course, requires major investment.

Costs for the rollout of these networks, which will mostly take the form of either fibre-to-the-curb (FTTC) and fibre to the-home (FTTH) or -office (FTTO) networks, are significantly determined by the extent of civil works required for the rollout. According to estimates, the share of civil works in rollout costs for NGAs accounts for up to 70% of the investment. These investments have risks and, for a period, will even increase costs as legacy networks continue to be used in parallel to NGN platforms.

eircom thus would like to engage constructively with Ofcom in the development of a policy environment that will not distort economic incentives and will encourage the scale of investments in network and services that Ireland requires.

Import of regulatory forbearance

eircom is pleased to note Ofcom's commitment that access obligations and other regulatory remedies would be imposed through a combination of market reviews, as mandated by the European Union Regulatory Framework, and any undertakings given to Ofcom by BT. eircom finds positive the statement: "Ofcom does not presume that any organisation that invests in next generation access services will have market power."

The temptation by Ofcom to over-regulate next-generation wholesale and retail services with access and price regulation must be resisted. Such regulatory intervention would send a clear signal to investing companies that there is a significant recurring regulatory cost premium in operating in the UK market.

Investing network operators, such as eircom, when faced with the threat of access regulation in a high-risk investment environment, such as NGA networks, are calling for regulatory forbearance as the best way to ensure that their investment risk is taken into account. In such situations, market conditions then will determine the right return on investment. Network operators will grant access to their networks on commercially attractive terms to ensure network utilisation and render their offers more attractive to wholesale customers. National competition authorities, if any, can deal with long-term competition concerns, in the context of an *ex post* control of communications markets.

As per one of the findings of two LECG economists, Kalmus and Wiethaus, stated in a recent article[1] examining the relationship between investment in new infrastructure by telecoms operators and the access conditions to such infrastructure:

> "*ex post*, i.e., once the investment is made, it is welfare maximising for the regulator to force access to the upgraded infrastructure at cost. In other words, if the investment is already there, then cost based access is optimal, <u>but if the infrastructure first needs to be deployed at high cost, such a policy is sub-optimal</u>. This may provide an explanation for regulatory policy: in the past, regulation was mostly on legacy assets, which existed before regulation was introduced and, moreover, which were built by state-owned monopolists. In such a setting, cost based regulation can be beneficial. However, when investments need to be made, such a policy is no longer appropriate." [our emphasis]

[1] Philip Kalmus and Lars Wiethaus, LECG, "Access Conditions, Investment and Welfare," November 2006. This article is an appendix to the above-cited IDATE and LECG report

RESPONSE TO CONSULTATION QUESTIONS

Question 1: When do you consider it would be timely and efficient for next generation access investment to take place in the UK?

The time is now. eircom would challenge Ofcom's preliminary conclusion that the UK is in a "pre-investment period," with uncertainty surrounding the commercial case for investment for NGA network deployments.

Next generation broadband services are now being deployed in a number of countries around the world, including in most of Western Europe. To date, no UK operator has indicated an intention to deploy a national NGA network. Given the high capital costs involved and the substantial commercial risk in deploying a NGA network, it is likely that, even in more densely populated areas, there will only be a limited number of scale operators providing these services[2]. This was highlighted in a recent speech by Stephen Timms, UK Minister for Competitiveness, who warned that the United Kingdom risks lagging behind other leading industrialised countries that are rolling out "super-fast broadband"[3].

To date, BT has announced in relation to higher speed broadband services that it will start nation-wide deployment of ADSL2+ in 2008 and will complete deployment in 2011. However, ADSL2+ performance diminishes over distance, meaning that only a small number of customers living close to their local exchange will be able to access the headline speeds of 20-25MB/s. In relation to NGA, it was reported in the *Financial Times* in July 2007[4] that Chairman Sir Christopher Bland said BT's thinking had advanced "quite far" on the case for fibre to the kerb. "That is the more likely development going forward," he said, while stressing, though, that no decision had been taken to go ahead with fibre to the kerb. BT Group is, however, deploying FTTH and FTTO in its access network in new build areas, such as Ebbsfleet Valley development (near BlueWater in Kent)[5].

It would appear that Ofcom is hesitant to criticise BT Group's NGA deployment – or lack thereof – in this consultation and elsewhere. For example, Ed Richards, Ofcom CEO, gave a 'ringing endorsement' to the Openreach negotiated settlement at recent conference[6]:

> "Two years on, I believe that there is evidence that the model is succeeding. Today we have a new confidence in the telecommunications market in the UK and it has spurred a new wave of investment and infrastructure-based market entry."

He, however, produced no evidence of this "new wave of investment" except to cite increases in the take-up of local loop unbundling (LLU).

As mentioned above, BT's provision of ADSL2+ may be insufficient to meet the requirements of the UK economy. ADSL2+ will lead to a patchwork of availability across the UK, with broadband speeds varying considerably depending on location (between 1-20 Mbps) with only 40 per cent expected to get more than 8 Mbps. it is possible, however, that demand for bandwidth will exceed even the headline capabilities of ADSL2+ in the medium term[7]. A 'market failure' may thus exist and

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[2] Broadband Stakeholder Group, "Pipe dreams? Prospects for next generation broadband deployment in the UK," 16 April 2007.
[3] Rt. Hon Stephen Timms MP, "Broadband Stakeholder Group - Next Generation Access," Commonwealth Club, 18 September 2007.
[4] *Financial Times*, "BT looks at ultra-fast broadband," 18 July 2007
[5] thinkbroadband.com, "Openreach to deploy Fibre to the Home at Ebbsfleet Valley," 7 February 2007.
[6] Ed Richards, Ofcom CEO, "Speech on Review of the European Framework: A regulator's perspective," 8th Annual Telecoms Regulation and Competition Law Conference, 31 October 2007.
[7] See fn 2, p. 33.

require urgent regulatory and policy intervention to regulatory and policy change to incentivise private sector investment including BT, and target government funding to under-served areas.

eircom as a private sector investor in Northern Ireland

Re-entry via NICS "Network N.I." Project

eircom's re-entry into the Northern Ireland market is driven currently by it being awarded the Northern Ireland Civil Service (NISC) "Network N.I." project. As part of the Network NI project, eircom will provide services to all 11 government departments. The contract, which runs for 6-10 years and is valued at up to €100m (£70m), will play a critical role in building a world-class, broadband access-based workplace infrastructure for the NICS, which will enable transformational government in Northern Ireland. eircom has designed a secure managed network, based on proven, open technical standards and services processes which will transform the way the NICS works on a daily basis. eircom's solution will support a wide range of voice, video and data applications with next generation capabilities. Network NI will be serviced from eircom's new state-of-the-art Service Operations Centre in Belfast, consisting of a Network Operating Centre and Service organisation that has been designed specifically to meet the particular requirements of project.

Commenting on the project award on September 19th, Pierre Danon, Chairman of eircom said, "eircom is delighted to provide a world class solution for the Northern Ireland Civil Service. eircom's continued investment in Northern Ireland provides a platform for the future that will deliver flexible high bandwidth to the public service in Northern Ireland."

eircom serving the residential, SME and enterprise business customers

As mentioned in the General Remarks section, eircom's deployment of next-generation technology in its core and access networks will be based on a commercial business case. We are currently in the process of determining the most appropriate technical solutions and assessing the commercial viability (i.e., the net present value (NPV) for different access network build vs. buy scenarios) for providing NGA services to residential, SME and enterprise business customers. These analyses, of course, are informed by our experience in the Irish market where eircom faces high capital costs, the erosion of traditional revenue streams, increased competition for broadband-enabled services and uncertainty about future commercial models (e.g., in relation to average revenue per user (ARPU). They are also informed, though, by uncertainty about the regulatory regime in Northern Ireland – for BT and others, which could potential attract access obligations, and by BT's WACC and its flow-through to competitors.

Case for state intervention

Given the lower socio-economic indicators and the higher percentage of rural population, there is a real concern that the incentives for broadband operators to invest in next generation broadband technologies in Northern Ireland are weak. High costs, unproven business models and intense competition for revenues from value added services would make it extremely difficult for operators to justify large-scale investments in new access networks. Therefore eircom supports the key goal of "improved communications networks, maintaining technological pace with the best in Europe in terms of increased internet connectivity speed, capacity and availability" in the Northern Ireland Executive's *Building a Better Future -- Draft Investment Strategy 2008-2018*.

In eircom's view, government funding to achieve public policy objectives is not creating "artificial incentives" for private sector investors. Given the crucial importance of broadband for economic development and the creation of a knowledge and information-based society, public authorities must provide economic stimuli to prevent a 'digital divide' between urban areas, which attract private sector investment, and rural and scarcely populated areas. Such initiatives are in line with the European Commission's overall policy of making broadband crucial to European growth and quality of life in the years ahead as long as they are can be deemed to be compatible with the EU state aid rules[8].

As the NI Executive's *Building a Better Future -- Draft Investment Strategy 2008-2018*[9] states,

> "Northern Ireland was one of the first regions in Europe to offer 100% broadband availability. The challenge now, working with the private sector and the official regulator (Ofcom), is to increase broadband take-up rates especially outside the Belfast Metropolitan Area, encourage business to leverage fully the opportunities of greater connectivity, and to keep our region at pace with technological developments in speed and capacity (bandwidth) to maintain our economic competitiveness and attract inward investment, with a view to supporting a more balanced development and a consequent reduction in regional disparities."

While ensuring ubiquitous access to first generation ADSL (512kbps) is an achievement, it will not guarantee the ubiquitous rollout of very high-speed digital subscriber line (VDSL) VDSL or other very high-speed technologies, such as FTTH/O. To overcome the historic under-investment in the region, the NI Government outlines an ambitious programme of capital investment:

> "Over the lifetime of this Strategy, we aspire to deliver:
>
> . . .
>
> - improved communications networks, maintaining technological pace with the best in Europe in terms of increased internet connectivity speed, capacity and availability.
>
> . . .
>
> In working towards these goals, key milestones will include:
>
> - by the end of 2011, working with the private sector, the delivery of widespread access for businesses to a next generation broadband network"

eircom see itself as one of the "private sector partners" working with the NI Government in meeting the challenge of delivering its largest ever investment programme "to drive up competitiveness of local businesses and attract internationally mobile investment in the high technology and trade-able services sectors."

Regulation and public policy targeted for geographic markets

eircom is encouraged that this consultation recognises the "geographic markets" identified in Ofcom's on-going Review of the wholesale broadband access markets 2006/07. Ofcom, however, appears to have discounted this factor when making its assessment for the need for state intervention to overcome current and future market failure in the supply of broadband.

As European Commissioner for Information Society and Media Viviane Reding said in a recent press conference:
"Regulation should be adjusted to reflect levels of competition in different geographic zones of Europe. Such an approach should create incentives for sustainable infrastructure competition, where the market permits, whilst continuing to promote service competition where infrastructure competition is not possible, in a form which guarantees choice for Europe's consumers."[10]

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[8] European Commission, Directorate-General for Competition, unit H-3 "Public funding for broadband networks - recent developments," *Competition Policy Newsletter*, Number 3 Autumn 2006, pp. 13-18.
[9] Programme for Government and Budget, 25 October 2007, http://www.pfgbudgetni.gov.uk/investmentstrategy241007-2.pdf
[10] European Commission, MEMO/07/474, "EU Telecoms Commissioner Viviane Reding meets Reinaldo Rodríguez, Chairman of the Spanish Regulatory Authority CMT," 19 November 2007.

Question 2: Do you agree with the principles outlined for regulating next generation access?

While eircom generally accepts the policy principles presented, it has concerns in relation to two of the five.

Policy principle: "equivalence"

Recital 17 of the EU Framework Directive defines "non-discrimination," stating:

> "The principle of non-discrimination ensures that undertakings with market power do not distort competition, in particular where they are vertically integrated undertakings that supply services to undertakings with whom they compete on downstream markets."

Ofcom is defining the principle of "equivalence" almost identically as "the requirement for operators with market power to make the inputs used by their downstream businesses available to their competitors on the same basis. " eircom finds dangerous this confounding of the terms non-discrimination, which applies to a vertically-integrated operator, and equivalence, which should apply only to functionally or structurally separated operators.

Functional separation

eircom believes that functional separation is an unjustified and disproportionate regulatory remedy unless, as per the guidance of the European Commission, "where there has been persistent failure to achieve effective non-discrimination in several of the markets concerned, and where there is little or no prospect of infrastructure competition within a reasonable timeframe after recourse to one or more remedies previously considered to be appropriate."[11] We thus reject Ofcom's conclusion that functional separation is "essential to reduce incentives for anti-competitive behaviour while retaining incentives for efficient investment."

BT's functional separation applied in Northern Ireland

Without prejudice to the above stated position on functional separation, eircom recognises the Undertakings established in a regulatory settlement between BT and Ofcom. We thus note the agreement between Ofcom and BT that:

> "5.58 All the proposed undertakings discussed above would apply in Northern Ireland, except for the operational separation of an ASD in Northern Ireland (and some consequential proposed undertakings around staff incentives). Equivalence of inputs, prices, processes and timescales; the Equality of Access board; the provisions relating to next generation networks; and all the other undertakings would be the same in Northern Ireland as in the rest of the UK.
>
> 5.59 The reason for the exception is that BT Northern Ireland is a comparatively small division of BT, and has historically been structured as a single, vertically integrated operation. Ofcom considers that it would not be practical to draw a boundary line between ASD and non-ASD staff in Northern Ireland. Furthermore, product management and many other functions are run on a national (all UK) basis, operating out of London. Therefore, the only roles potentially separable in Northern Ireland would be local operations and local sales (other functions, such as sales to corporate

[11] European Commission, COM(2007)697 rev1, *Proposal for a Directive amending Directives 2002/21/EC on a common regulatory framework for electronic communications networks and services, 2002/19/EC on access to, and interconnection of, electronic communications networks and services, and 2002/20/EC on the authorisation of electronic communications networks and services*, 13 November 2007.

> customers and call centres, are either carried out on the mainland, or are not specific to Northern Ireland)."[12] [our emphasis]

As Ofcom explains, for example, the Undertakings already require BT in NI (and Openreach elsewhere in the UK) to provide access to any fibre deployed on an equivalence of inputs basis. It also appears that the undertakings would require Openreach to provide active wholesale access products at the MSAN (the Local Access Node in BT's NGN) on an equivalence of input basis. eircom trusts that Ofcom will monitor whether BT is complying with these Undertakings in its NI operations.

Policy principle: "reflecting risk in returns"

eircom agrees with Ofcom's view that that anyone who makes investments in next generation access is likely to face significant commercial risks. Access obligations imposed on an SMP operator making such investments thus should reflect these risks in order to provide appropriate incentives for the investment in the first place.

Please see our response to Question 3 for how we believe the regulatory regime could reflect investment risks.

Anchor product regulation

eircom finds Ofcom's consideration of approaches to reflect high investment risk side-tracked by the introduction of the concept of "anchor product regulation." It appears that Ofcom is revealing a public policy priority for consumer protection and "the promotion of the availability of services to consumers." The suggested anchor product regulation would involve offering one or more wholesale products on the NGA network that replicate existing offerings to end-users in terms of price (to be set by Ofcom) and service for a period of time. eircom maintains that such regulation would effectively creates a retail and wholesale universal service obligation for legacy broadband services (e.g., ADSL). If this indeed is Ofcom's true policy objective, it should seek to achieve this in its policy-making in regard to the definition of universal service and future approaches to funding universal service/ universal access.

Any risk-adjusted price controls or regulatory forbearance, which would result from Ofcom's consideration of new and emerging markets and proportionality in the application of regulatory remedies, should not made conditional on the introduction of anchor product regulation.

Question 3: How should Ofcom reflect risk in regulated access terms?

eircom concurs with the following point made in a March 2007 paper[13] by Brian Williamson, presented at an Ofcom seminar:

> *"There are two reasons why efficient and timely investment might not occur under status quo regulation as applied to legacy copper access networks.*
>
> > *• First, a large up-front investment is required ahead of demand rather than incrementally in response to demand and there is a significant risk attached. In contrast, investment in core network NGN does not involve significant demand risk and investment in DSL broadband was able to proceed incrementally in response to demand on the back of legacy copper networks.*

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[12] Ofcom, Notice under Section 155(1) of the Enterprise Act 2002 - Consultation on undertakings offered by British Telecommunications plc in lieu of a reference under Part 4 of the Enterprise Act 2002, 30 June 2005.

[13] B. Williamson, Risk, reward and efficient investment in access networks - Paper for Ofcom European seminar on regulatory challenges posed by next generation access networks," 27 March 2007.

• Second, investors tend to evaluate telecoms investment assuming that no revenue uplift will be achieved with improved technology, in other words the investment would have to justify itself on cost reduction grounds even though one might expect that there would be greater willingness to pay for enhanced service. Existing rules of thumb reflect experience and a scepticism that regulators would allow higher prices for enhanced service."

On this issue of "enhanced services," eircom would like to bring to Ofcom's attention a study by DIW[14] and a paper presented by Ovum and Indepen[15]. These studies both advocate a regulatory approach that deals with the question of investment risk in the context of the 'emerging markets' concept.

Instead of subjecting new investment to the threat of regulatory intervention wherever alternative entry is not expected in the short-term, no regulation should apply also in cases where it is uncertain whether alternative entry in the medium to long term will occur. This would also increase the incentive of both innovator and entrants to seriously engage in voluntary access arrangements where these are in the interest of both the network operator and potential service providers and give a strong signal to potential investors other than the first-mover that they will find favourable conditions for infrastructure investment, encouraging the emergence of true inter-platform competition.

Question 4: Do you agree with the need for both passive and active access remedies to promote competition?

Yes, eircom agree with the need for both passive and active access remedies to promote competition eircom is concerned that the two options, which Ofcom identifies two options – competition based on passive and active wholesale products -- to promote competition in NGA networks, are considered in the abstract and separate from the 'SMP regime' of the EU Framework.

Definition of relevant markets

eircom notes with concern that Ofcom has not to date defined which market NGA may fit within – whether an existing market(s) or a new one(s).

eircom is encouraged, however, that this consultation makes reference to the "geographic markets" identified in Ofcom's on-going *Review of the wholesale broadband access markets 2006/07*[16], for example, "exchanges where there are 4 or more operators (including BT and ntl:Telewest) where the exchange serves 10,000 or more homes and businesses."

eircom also finds positive the statement: "Ofcom does not presume that any organisation that invests in next generation access services will have market power."

Regulatory obligations vs. BT Undertakings

As indicated by Ofcom, the Undertakings already impose access obligations on BT/Openreach in relation to potential future NGA deployment. Where any of the access obligations (and their terms and conditions) contained within the Undertakings are not

[14] P. Baake, U. Kamecke, C. Wey; Deutsches Instut fur Wirtschaftsforschung (DIW), "Efficient Regulation of Dynamic Telecommunications Markets and the New Regulatory Framework in Europe", April 2005; paper financially supported by Deutsche Telekom.

[15] Ovum (D. Lewin) and Indepen (B. Williamson), "Regulating emerging markets?", Economic Policy Note prepared for OPTA, 5 April 2005

[16] Ofcom, *Review of the wholesale broadband access markets 2006/07 Identification of relevant markets, assessment of market power and proposed remedies*, 21 November 2006.

supported by a market analysis and imposition of justified proportionate remedies on BT as an SMP operator consistent with the EU Framework, Ofcom should make this transparent. All other access (and their terms and conditions) should be identified as being voluntary but subject to Ofcom oversight.

Under the Framework, the Commission's Guidelines on market analysis and the assessment of SMP highlight "the respect for the principle of proportionality" as a "key criterion" to assess measures proposed by NRAs under the procedure of Article 7 of the Framework Directive and as "well-established in Community law". Thus it is a prerequisite for the imposition of remedies that the means used to attain a given end "should be no more than what is appropriate and necessary to attain that end." The means employed to achieve the aim must be the least onerous, i.e., the <u>minimum</u> necessary.

eircom notes with great concern that the principle of justified and proportionate remedies to remedy market failures in the interest of the end-user risks being abandoned by Ofcom in favour of interventionist policies which facilitate market entry and support the business models of access-based competitors, giving priority to the "promotion of competition" objective of the Framework.

For FTTC deployments, for example, Ofcom proposes the following two remedies, which it believes will "complement" each other:

- sub-loop unbundling of the copper line at street cabinet, with appropriate supporting backhaul products (possible options include duct sharing, dark fibre, wholesale backhaul services based on Ethernet); and
- active line access – a high quality, flexible, Ethernet-based, wholesale product available at a number of points in the network (possible options include street cabinet, local exchange, metro node or core node).

Under the EU Access Directive, there is no such concept of "complements, nor is it contained in the Framework or to be derived from it. eircom would maintain that where passive access remedies were imposed, such as sub-loop unbundling **or** duct sharing, this access could represent the proportionate, or least onerous, regulatory remedy necessary.

Symmetric obligations to share passive infrastructure

As regards passive access, eircom believes that is neither adequate, justified not in fact sufficient to impose access obligations regarding ducts, masts or other civil works infrastructures on telecommunications network operators simply on the basis of their dominant position on an electronic communications market.

New electronic communications infrastructure is being built also by other players than the dominant companies on traditional fixed access markets. Recent rollouts of new fibre access networks demonstrate that clearly. In several European cities and regions, well-established alternative operators rollout their own fibre network, laying new ducts. Furthermore, existing ducts and manholes of other utilities or local communities can be used.

eircom calls upon Ofcom to consider the proposed amendment of Article 12 of the Framework Directive to impose a symmetrical obligation to any operator to negotiate sharing of facilities under reasonable requests from another operator, and allow operators to bring any refusal for sharing of facilities before the relevant NRA for settlement of disputes.

Question 5: Do you consider there to be a role of direct regulatory or public policy intervention to create artificial incentives for earlier investment in next generation access?

No. Please see our response to Question 1.