

Compecon - Competition & Regulatory Economics E-Zine.

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Editorial.

Welcome to the first issue of Compecon’s Competition and Regulatory Economics E-Zine. The e-Zine will provide a regular updates on economic aspects of competition and regulation. The emphasis in our first issue is very much focused on regulation. In our first article we review the new Public Transport Regulator Act, 2009, which was enacted just before Christmas and, which disappointingly fails to provide for much needed competitive reform of the bus industry. In contrast a Consultation Paper by the CER has proposed an easing of regulation in respect of the supply of electricity to SMEs and household customers on the grounds that those markets are sufficiently competitive to justify the removal of price controls. The CER’s proposals are discussed in our second article. Our final article considers the implications of an agreement between Eircom and ComReg regarding Eircom’s call bundle packages.

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Missing the Bus on Reform – The Public Transport Regulation Act, 2009.

Introduction.

The Public Transport Regulation Act, 2009, which was passed by the Oireachtas in December, affords the two State bus companies, Dublin Bus and Bus Eireann continued protection against competition. Launching the then Bill, last autumn, the Minister claimed:

“The primary focus of this new Bill is to place the bus passenger at the centre of a new, transformed national bus licencing regime and to replace the current outmoded and inadequate regime that has applied to the authorisation of bus routes for some 77 years.”

Despite the lofty statements, bus passengers are unlikely to benefit from the proposed legislation which excludes any competition on existing Dublin Bus and Bus Eireann urban and local routes. Private operators will only be permitted to tender for new routes. This is despite significant reductions in service levels on many routes by both State companies within the past year because of financial difficulties.

The Department of Transport’s Regulatory Impact Assessment (RIA) of the legislation rather gives the game away by stating that there will be no significant increase in enforcement costs under the new regime “as the number of new service providers is expected to be limited”.

Key Aspects of the Legislation

The Act renames the Dublin Transport Authority as the National Transport Authority. (NTA). The NTA

will be responsible for awarding licences to operate bus passenger services throughout the State. It also provides for the Commission for Taxi Regulation to be subsumed into the new Authority.

Section 6 of the Act provides that a public bus passenger service may only be operated under licence and makes it an offence to operate an unlicensed service. This does not apply to services operated under a Public Service Contract entered into under Section 48 of the Dublin Transport Authority Act, 2008, or to international services. This in conjunction with Section 52 of the 2008 Act provided that Dublin Bus and Bus Eireann had the exclusive right to provide services on all of their existing routes within the Greater Dublin Area and required the DTA to award them public service contracts in respect of all such routes for a period of five years. In other words these provisions protected the incumbent State companies against entry on all of their routes in the Dublin Area for a period of five years and the new Act continues this protection.

Section 20 provides that any services operated by Dublin Bus and Bus Eireann not covered by Section 48 of the 2008 Act may be continued for up to two years after the new legislation comes into force and provides that the Authority shall grant the companies one year licences for such services.

The Act provides that the new Authority may award licences for the operation of public bus passenger services (Section 7). Such a licence shall specify:

1. The route to be followed;
2. The commencement and completion points of the service;
3. Any stopping points along the route;
4. Scheduling and frequency of the service “where appropriate”.

Under Section 13 the Authority may attach conditions to licenses in relation to each of the above but also specifying the ticketing equipment to be used and the number of vehicles that must be deployed in the provision of the service. The Authority can also require a licensed operator to produce a timetable for the licensed service and to display it at such places and in such a manner as the Authority may determine. Section 14 provides that where a licence holder wishes to alter a service it must apply for an amendment to its licence.

Section 8 provides that the Authority may specify different categories of licences.

Section 10 provides that, in considering a licence application, the Authority “shall take account of the demand or potential demand that exists” for the service “having regard to the needs of consumers and any existing public bus passenger services on or in the vicinity of the route to be served by the proposed public bus passenger services”. Section 10(b) sets out 11 other criteria which the Authority shall take into account unless it considers it inappropriate to do so. These include a requirement to take account of the impact of any proposed service on existing Dublin Bus routes awarded public service contracts by virtue of the 2008 Act, on or in the vicinity of the proposed route. The Authority is required to conduct a review of the operation of the licensing regime every five years and to report the findings of such a review to the Minister.

Apart from protecting incumbent State operators from competition on their existing routes several other aspects of the Act pose problems. The requirement that any variation of a licensed service requires an amendment to the licence is bureaucratic and will stymie the ability of operators to respond quickly to changes in consumer demand. For example, a bus operator who finds that most of its passengers would prefer a service leaving ten minutes earlier must apply for and await the approval of the Authority before it can introduce such an alteration. Giving the regulator power to specify the number of vehicles that must be deployed on a service creates the potential for the regulator to engage in micro management of the business. This should be a matter for the bus operator. The requirement for periodic reviews of the licensing regime is welcome but it is unfortunate that the Act does not provide for such reviews to be carried out independently of the regulator.

Evidence on Bus Liberalisation

Opponents of bus liberalisation assert that it has failed, usually citing alleged UK experience to support such claims. It is claimed that deregulation in the UK led to unreliability, service fragmentation, poor integration and poor information resulting in a vicious circle of declining passenger numbers leading to reductions in services leading to further declines in passenger numbers. In contrast competitive tendering which operates in London is regarded as successful because passenger numbers there have increased.

The claim that deregulation led to a decline in bus passengers is not supported by the evidence. Bus passenger numbers in Britain had been

falling at an annual rate of 3-3.5% since 1950. Following deregulation in the mid 1980s the rate of decline in passenger numbers initially slowed.

Since the mid 1990s, however, bus passenger numbers in Britain have risen as Table 1 illustrates reversing the trends of the previous 40 years.

Table 1: Annual Average % Change in Bus Passengers						
	England			Scotland	Wales	Total
	London	Metropolitan Areas	Non-Metropolitan Areas			
1985/6-1990/1	+0.4	-5.6	-2.6	-2.7	-2.3	-3.0
1990/1-1995/6	+0.2	-3.5	-1.9	-3.3	-2.6	-2.1
1995/6-2000/1	+2.5	-1.4	0.5	-1.5	-1.3	+0.2
2000/1-2005/6	+6.9	-1.6	-1.4	+0.8	-0.2	+1.6
2005/6-2007/8	+5.4	+0.4	+4.7	+3.7	+1.7	+3.8

Source: *Transport Statistics for Great Britain*.

While initially such increases were confined to London, in recent years all parts of Britain have seen an increase in bus passenger numbers. In Scotland bus passenger numbers have risen steadily for most of the past decade and by 2007/8 they were back to their mid 1990s levels. In Wales bus passenger numbers in 2007/8 had returned to their 1997/8 levels. In rural areas of England passenger numbers are back to the levels of the early 1990s. The poorest performance in terms of passenger numbers has occurred in the large English cities although passenger numbers in these areas in 2007/8 were 10m higher than two years previously.

In all areas except the English Metropolitan Areas total bus kilometres have increased over the past ten years indicating an expansion in the level of services. Thus in most parts of Britain both service frequencies and passenger numbers have been rising not falling for most of the past ten years.

There are a number of reasons why bus usage is higher in London than in other UK regions. London has lower levels of car ownership, higher parking

costs and a congestion charge. The table shows that the rate of increase in bus patronage in London picked up considerably following the introduction of the congestion charge in February 2002. It is therefore somewhat simplistic to conclude that the better performance of London in terms of passenger numbers is due to the competitive tendering model.

The House of Commons Transport Select Committee reported that cities such as Oxford, Cambridge, York and Brighton all recorded increases in bus passenger numbers under deregulation. The Committee was told that other areas could achieve similar results by adopting similar measures.¹

Uni-Link, a novel joint venture between Southampton University and a bus operator, in its submission to the Select Committee expressed the view that without deregulation it was highly unlikely that its highly successful service would have been created "...and the steady growth in patronage would not have existed and we would still be served by a poor performing local bus service in decline".² TAS a specialist transport consulting firm reported that,

in terms of passenger journeys, “the deregulated regime has performed rather better than the previous systems”³

Another criticism that is sometimes raised of deregulation in Britain is that, over time, competition has declined with individual operators dominating markets in particular areas. Such arguments hardly justify preventing competition in the first place.

It is true that direct competition between the major bus groups in Britain has tended to be rare, although smaller operators do compete with the larger groups. The Office of Fair Trading has recently requested the Competition Commission to conduct an investigation of local bus services.

Regulatory Failure.

There was widespread evidence of predatory behaviour in the bus industry in Britain following deregulation. It was claimed that, such was the reputation of the Stagecoach group for predatory behaviour, the mere indication that it intended to enter a particular market was sufficient to cause incumbents to withdraw.

The competition agencies failed to respond quickly and effectively to prevent predation driving out rival firms. Both the Office of Fair Trading and the former Monopolies and Mergers Commission produced numerous reports which found that various bus operators had engaged in predatory behaviour but in almost all cases the target firm had disappeared long before such investigations had been completed.⁴

More recently, in November 2008, the OFT found that Cardiff Bus had engaged in predatory behaviour to eliminate a new entrant but decided that the volume of commerce involved did not justify imposing any fine on the

predator.⁵ Again the target firm had exited before the report was concluded. Firms are unlikely to enter the market when they see successful predation go unpunished.

The creation of local monopolies in the bus industry thus would appear, in part at least, to be the result of regulatory failure.

Cost of Restricting Competition.

Details of the financial performance of Dublin Bus in respect of its scheduled services are given in Table 2, i.e. excluding commercial hire and tour services.

	Revenue	Costs	Deficit	Subsidy
2001	144.2	197.8	53.5	52.4
2002	149.1	204.7	55.6	56.1
2003	162.4	212.0	49.6	53.9
2004	165.3	228.5	63.2	61.8
2005	168.4	235.8	67.4	64.9
2006	174.4	246.7	72.3	69.8
2007	184.2	266.2	82.0	80.1
2008	188.6	292.2	103.6	85.6

Source: *Dublin Bus Annual Reports*

Dublin Bus scheduled passenger services had revenues of €189m in 2007 but operating costs amounted to €292m resulting in an operating deficit of €104m which was significantly offset by a Government subvention of €86m. Since 2001 Dublin Bus’ operating deficit virtually doubled from €54m to €104m. The Government subvention has increased from €52m to €86m over the same period.

An efficiency review of Dublin Bus published in January 2009 identified significant inefficiencies.

- A detailed review of one route corridor (Finglas to City Centre) found that a more efficient service

could be provided while reducing costs by 17% (€2.1m). If such a level of cost reduction could be replicated across the entire network it would yield savings of €45m.

- Out of service mileage accounted for 20% of total mileage operated on the number 40 routes. The comparable UK figure was 3-10%,
- Drivers on Monday-Friday duties on the number 40 routes were in passenger service only 76% of the time.
- On 153 driver duties operated from Harristown and Donnybrook depots, drivers/buses were in passenger service for just 4.25 hours out of an average 7.5 hour daily shift.⁶

A Missed Opportunity.

The RIA advances a number of questionable arguments against deregulation. Much of these appear to have been taken verbatim from a 2002 report.⁷ The RIA suggests that deregulation could lead to “unsustainable competition” on “certain key route” and “cherry-picking”. It claims that deregulation resulted in the establishment of monopoly operators in other jurisdictions without citing specific examples and fails to consider whether such outcomes could be avoided. It argues that deregulation could lead to the need for increased subventions but adduces no evidence to support this claim. This also ignores the dramatic increase in the subvention paid to Dublin Bus in recent years. It is legitimate to ask whether the level of subvention would have increased as rapidly in a more liberalised market.

Little attention appears to have been paid to how a tendering system for new routes might operate. Private operators would appear to be at a distinct

disadvantage to the incumbent State companies which operate virtually all of the existing routes and have the benefit of State subsidies. It is unclear how the tender process will ensure that Dublin Bus does not cross subsidise any proposed new routes in order to win the tender. A bus operator can utilise buses more efficiently when it operates on contiguous routes. This again would indicate that incumbent operators will have an in-built advantage in any tender. In London tenders normally involve a package of a number of contiguous routes are normally packaged together in any tender in recognition of this. The scope for tendering a package of routes in this fashion would seem limited by the decision to allow the State firms to retain all of their existing routes.

According to the RIA:

“The ultimate objective is to provide a legal framework for the delivery of accessible, integrated and competitive public transport services that represent value for money, meet the requirements of users in a growing and complex market, as well as providing a level playing field for all service providers.”

It is difficult to see how these objectives can be achieved by prohibiting entry on the existing route network of the incumbent State operators. Both Dublin Bus and Bus Eireann have reduced services on a wide range of their existing routes within the past year due to financial constraints, despite evidence that significant cost reductions could be achieved without adversely affecting services. Further reductions would appear inevitable as the need for the Government to restore budgetary stability means that the level of subvention paid to Dublin Bus may be reduced further. The new legislation will

not, however, allow private operators to offer alternative services even where services have been reduced by Dublin Bus. The rationale for such an approach is difficult to understand.

Inviting tenders for those routes on which Dublin Bus and Bus Eireann have cut services has the potential for reducing costs while maintaining or possibly improving service levels. Such an approach would appear to represent a far better option than simply allowing Dublin Bus to retain its monopoly of existing routes even when it reduces service levels on those routes.

¹ House of Commons Transport Committee, *Bus Services Across the UK*, London: HMSO, 2006

² *Ibid.* Ev 103, Submission by Uni-Link.

³ TAS, *Bus Industry Monitor 2005 Volume I*, 2006, p.8.

⁴ Monopolies and Mergers Commission, *Highland Scottish Omnibuses Limited: A Report on the Conduct of Highland Scottish Omnibuses in Respect of its Operation of Local Bus Services in the Inverness Area*, 1993; *Sussex Coastline Buses*, 1993; *The Supply of Bus Services in Mid-and West Kent*, 1993; *The Supply of Bus Services in the North East of England*, 1995.

⁵ Decision of the Office of Fair Trading No. CA98/01/2008 Abuse of a dominant position by Cardiff Bus 18 November 2008.

⁶ Deloitte, *Cost and Efficiency Review of Dublin Bus and Bus Eireann*, January 2009.

⁷ Steer Davies Gleave *Regulation of Bus Services Outside the Greater Dublin Area*, 2002.

CER Seeks Views on Removing Electricity Price Controls.

Introduction.

In a consultation paper issued on 2nd December, the CER has sought views on the possible removal of price controls for household and SME electricity customers.¹ Price controls were removed in the case of large business users in 2007. As well as seeking views on the possible lifting of price controls the consultation paper has also asked for submissions on what other measures might be required to ensure a fully competitive deregulated electricity market. It should be noted, however, that the removal of price controls would require changes to secondary

legislation.² Thus while the CER may recommend that price controls should be removed, the final decision will rest with the Minister. The deadline for submissions is 1st February 2010.

Background.

The production and supply of electricity to individual users – both households and businesses – can be broken down into four distinct activities:

- Generation;
- Transmission;
- Distribution; and
- Supply.

Transmission and distribution constitute natural monopolies whereas generation and supply are (potentially) competitive activities, although historically in many countries legislation limited those activities to State owned monopolies. EU Member States were obliged to open up their generation and supply markets to competition as a result of a series of EU measures. These required that the supply business be opened in a series of stages starting with the market for large business customers. The supply business in Ireland was fully liberalised in February 2002, Ireland having been granted a two year derogation.

All electricity suppliers must be licensed by the CER. The ESB's customer supply division is designated as the Public Electricity Supplier (PES) and it is subject to a number of specific obligations. In addition ESB Independent Energy (ESBIE) is also active in the supply business but its supply licence precludes it from supplying customers who consume less than 225 GWh per annum. This is to prevent market foreclosure given the very large market share already held by ESB PES.

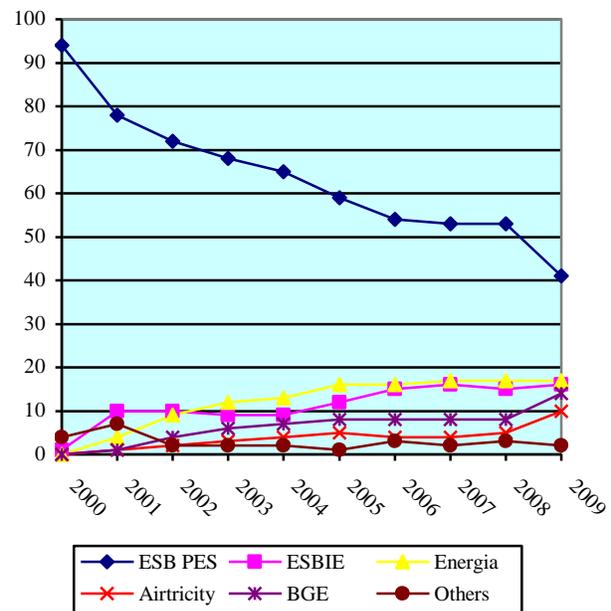
ESB PES' prices are regulated by the CER which sets the price at which the PES must sell electricity. ESB PES cannot sell electricity for less than the regulated price even when rivals suppliers offer lower prices. Such restrictions reflect concerns that it might use its market power to weaken or damage entrants by means of practices such as predatory pricing or margin squeezing. Of course such restrictions also restrict the incumbent's ability to compete with new entrants and may give rise to "umbrella pricing", a situation where entrants know that they can

undercut the incumbent's prices while being protected against competition from the incumbent. This may create an incentive for entrants not to compete too aggressively but instead to set prices slightly below the incumbent's so as to enable them to secure a sufficient share of the market but one that is not large enough to risk losing the benefit of regulatory protection.

The Relevant Markets.

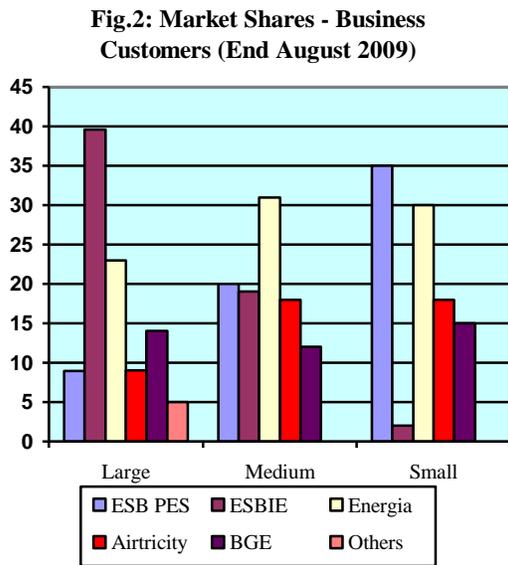
There are five independent firms plus the two ESB companies engaged in the electricity supply business, although two of the independent suppliers account for less than 10% of total electricity supply. There has been a significant shift in shares as illustrated in Fig.1. ESB PES share of the electricity supply business has fallen from 94% in 2000 to just 41% in 2009. ESBIE and Energia have 16% and 17% respectively, BGE 14% and Airtricity 10%.

Fig.1: % Distribution of Electricity Supply Business (GWh)



The Consultation Paper concludes that electricity supply consists of a number of separate markets: large business users; medium sized business users; small business users; households; and public lighting and unmetered supply (streetlights, bus shelters, kiosks etc). This market has been practically uncontested to date.

Suppliers' shares of the different business markets are shown in Fig.2.



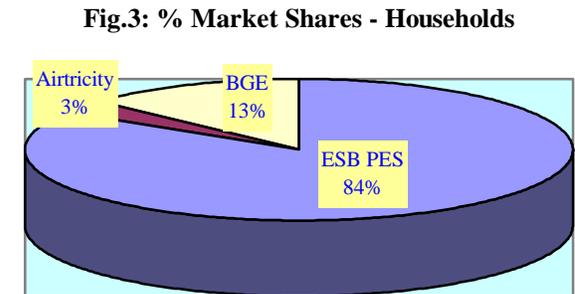
In addition to the two ESB firms, there are three suppliers with significant shares in all three business markets.

There are around 1,600 customers in the large business market which was the first to be opened to competition. This market was deemed sufficiently competitive for price controls to be removed in 2007. In August 2009, ESBIE had almost 40% of this market, while ESB PES had a further 9%, giving the two ESB entities a combined market share of around 49%. Energia with 23%, BGE with around 14% and Airtricity 9% are the other significant players in this market. (Other suppliers not included in the chart have 5%).³

According to the CER there are approximately 13,500 medium sized business customers. Energia is the largest supplier in this market with 31%, ESB PES has 20%, ESBIE 19% (giving the ESB firms a combined market share of around 39%), Airtricity 18% and BGE 12%. The CER estimate that there were approximately 190,000 small business customers. ESB PES is the largest supplier in this market with 35%, while ESBIE has just 2% which probably reflects the fact that its licence precludes it from supplying small users, giving the two ESB businesses a combined market share of 37%. Energia had around 30% of this market, Airtricity 18% and BGE 15%.

Interestingly the ESB firms' combined market share is significantly higher in the large business market than in either the medium or small business markets (49% versus 39% and 37% respectively). There are three significant sized competitors to the ESB companies in all three markets, although Airtricity has a smaller share in the large business market than in the other two.

Fig.3 gives details of market shares in the household electricity market.



According to the CER, average annual household electricity consumption is 4,500 KWh but around 22% of households consume less than

2,000 KWh per annum. There was virtually no entry into this market until early 2009. In the first eight months of 2009, ESB PES lost almost 250,000 customers leaving it with a market share of around 84% at end August 2009. Most of these customers switched to BGE which had 13% of the market at end August 2009, while Airtricity had just 3%. CER estimates indicated that a further 70,000 household customers may have left ESB PES in September/October 2009.

Some indication of the relevant strength of competition in the various markets can be obtained by looking at the degree of market concentration in each case as measured by the HHI.⁴

Market	HHI
Large Businesses	2,504
Medium Businesses	2,190
Small Businesses	2,903
Households	7,234

Source: CER Consultation Paper.

The level of market concentration in all four cases is above the 1,800 threshold at which the Competition Authority defines markets as highly concentrated. The household market is clearly very highly concentrated at 7,234 (a monopoly market would have a HHI of 10,000). The three business markets are far less highly concentrated. It is interesting that the least concentrated market is that for medium sized businesses, followed by the large business market with the small business market the most concentrated of the three business markets.

Key Issues.

The Consultation Paper acknowledges that “effective

competition is likely to be superior to regulation and thus where markets are effectively competitive the replacement of end user retail tariff regulation in electricity and gas markets is a desirable outcome.” The recognition that competitive markets produce superior outcomes for customers is welcome.

The paper proposes using a number of criteria for assessing whether or not individual markets are sufficiently competitive to remove price controls namely:

- the number of suppliers active in a particular market;
- individual market shares of the incumbent (and its affiliates) and of independent suppliers;
- barriers to entry, expansion and exit including: sunk costs, switching systems and processes, branding, non discriminatory network access; and access to wholesale product.

The paper argues that sunk costs do not represent a barrier to entry in the supply business in contrast to generation, supply and distribution. It acknowledges that new entrants “must sign up to a number of market agreements to enable them to participate in the wholesale market, secure network access and interface with the retail market systems but this does not constitute a major financial investment, relative to the generation market.” The fact that sunk costs may be lower than in generation does not mean that they do not constitute a barrier to entry.

Customer switching costs are relatively low according to the paper. While noting that there has been a high level of switching from the incumbent in the small business and household markets, the paper questions whether this would change or even be reversed in the absence of price regulation.

According to the CER, a number of independent suppliers have claimed that the ESB has limited their expansion in business customer markets and is a constraint on their entering the household market. The consultation acknowledges that the ESB brand is one of the “foremost Irish brand names, synonymous with electricity supply since its establishment in 1927.” It goes on to state:

“While there are no structural or regulatory reasons to suggest that a new entrant with significant brand recognition in a different market could not successfully enter and compete with the ESB brand in the domestic market for the supply of electricity, it still may present a challenge to competitors.”

It notes that despite regulatory ring-fencing many customers still perceive the PES and Networks businesses as being one and the same.

“The common brand creates the potential for customer confusion and may cause unjustified consumer concern that switching away from ESB Customer Supply to an independent supplier will result in a lower quality of service in the event of any problems with their electricity supply or connection.”

While acknowledging the difficulty measuring this empirically, it suggests that a proposed consumer survey may provide some evidence on whether or not this constitutes a major concern. Interestingly the paper states:

“In any event the branding issue is key to future decisions on deregulation and the Commission would favour appropriate remedies in order [to] provide clarity to all consumers on the unequivocal business separation between the

supply and distribution businesses within ESB.”

It will be interesting to see how the regulator will address this issue.

The paper sets out a number of conditions which must be met in order for a market to be considered competitive and these are set out in Table 2.

Table 2: Criteria for a Competitive Market.

- 3 independent suppliers in addition to two ESB firms.
- 2 of the independent suppliers must have at least 10% market share (in terms of load - GWh).
- ESB PES and ESBIE combined market shares must not exceed - 40-50% in medium and small business markets, 55-60% in household market.

It is proposed that there should be at least three independent suppliers in addition to the two ESB undertakings and that two of these must have market shares of at least 10%. In addition the combined market shares of the two ESB undertakings could not exceed 40-50% in the markets for small and medium sized business customers and 50-60% in the household market.

Conclusions.

The CER decision to institute a debate on the merits or otherwise of removing price controls and moving towards a greater reliance on competition in various supply markets represents a welcome step.

The regulator proposes that three independent suppliers in addition to the two ESB supply businesses would suffice for a market to be regarded as competitive (subject to certain market

share thresholds). If one regards the two ESB arms as a single undertaking this would mean that a minimum of four suppliers must be present in a market.⁵ Whether four firms is sufficient to ensure effective competition is debatable. The proposed market share thresholds in the small and medium business market appear reasonable. The evidence suggests that competition is working effectively in the large business market, even though that market is more highly concentrated than that for medium sized businesses and the aggregate share of the ESB firms is higher for larger businesses than for small and medium ones. The aggregate market share of the two ESB suppliers in the small and medium business market is currently below 40% so it is unclear why a higher 50% threshold is being proposed. The proposed market shares in the household sector are more problematic. There is a presumption in competition law that a firm with a market share in excess of 50% is dominant. Thus the basis for stating that the household market could be considered competitive even if ESB PES effectively still had a 60% share of the market is difficult to understand. Experience in many other jurisdictions besides Ireland indicates that

competition is slower to develop in the household market for a variety of reasons. That would not appear to represent an adequate reason for applying less stringent requirements for that market to be considered competitive. Finally, it will be interesting to see how the CER proposes to address the issue of the ESB brand having identified it as a possible obstacle to competition particularly in the household market. As previously stated the deadline for submissions on the consultation is 1st February 2010.

¹ Commission for Energy Regulation, *Review of the Regulatory Framework for the Retail Electricity Market Proposals on a Roadmap for Deregulation*, Consultation Paper CER 09/189 2nd December 2009.

² European Communities (Internal Market in Electricity) Regulations 2005: SI 60, 2005.

³ The paper states that ESBIE, Energia and BGE had “emerged as the dominant suppliers in this market”.

⁴ The HHI (Herfindahl-Hirschman Index) is generally recognised as the most useful measure of market concentration. It is calculated by summing the squares of the market shares of all the firms in a market.

⁵ The restriction preventing ESBIE from supplying customers consuming less than 275 GW per annum effectively excludes it from the household and most of the small business market anyway so the CER proposal in those markets is effectively for four competitors.

Eircom Agrees to ComReg Unbundling Order.

Introduction.

In October 2009 Eircom and ComReg reached an out of court settlement whereby Eircom agreed not to

unreasonably bundle its fixed line rental services with other services. The dispute arose from the launch by Eircom of a series of promotional bundles, known as

“TalkTime”, in October 2008 that included free calls to Meteor mobile subscribers. ComReg found that Eircom’s 1MB and 3MB Family TalkTime bundles were being sold below cost with potential adverse effects on competition in the line rental and related markets. ComReg held that this was in breach of an earlier ComReg decision requiring Eircom not to engage in unreasonable bundling of its products.

Economic Analysis of Bundling.

Bundling is the practice of selling two (or more) products together; the products may be available only as a bundle or, if available separately, the bundle is offered at a discount relative to their combined individual prices. If two items are only sold together and are not available separately, this is a case of pure bundling.

Until fairly recently, there was some scepticism regarding the potential for bundling to be used to distort competition. More recent research has shown that while in some instances bundling may be efficiency enhancing, it can also be used as an exclusionary device to prevent entry. Even when it does not exclude entrants, bundling can mitigate the impact of entry and weaken rivals.

One method for identifying exclusionary bundling is to compare incremental prices and costs. In the case of two products A and B, the incremental price of the AB bundle must be compared with the stand alone price of A, i.e. how much more must be paid to obtain the bundle than for A on its own. This then needs to be compared with the incremental cost to the firm of producing B. If the incremental price is less than the incremental cost, this will foreclose equally efficient producers of

B from the B market. Such behaviour constitutes exclusionary bundling.

Facts of the Case.

In a decision dated 24th August 2007, ComReg imposed an obligation on Eircom not to unreasonably bundle line rental services with other services. Paragraph 7.9 of that Decision states that where eircom offers services as a bundle it must ensure that end-users were able to purchase an individual service included in any such bundle without being required to purchase the entire bundle and that tariffs for the individual services comprising the bundle should not require end-users “to pay for services, or facilities which are not necessary for the service requested.” The wording therefore appears to reflect a concern about possible exploitation of customers rather than exclusion of rivals.

In October 2008, Eircom introduced a series of promotional bundles, marketed as “TalkTime” packages. These packages included free calls to Meteor subscribers. ComReg found that the 1MB and 3MB Family TalkTime bundles were being sold below cost with potential adverse effects on competition in the line rental and related markets. It based this conclusion on the results of a Net Revenue Test (NRT). ComReg therefore held that the relevant “TalkTime” packages were in breach of its earlier August 2007 decision, although the concern in this instance was of excluding competitors rather than directly harming consumers. Eircom proposed introducing revised bundles in April 2009 but ComReg also considered that these were in breach of the unreasonable bundling obligation.

The agreement between ComReg and Eircom provides that:

1. Bundles will be assessed by reference to the NRT using average total cost;
2. Eircom will not launch bundles which include retail line rental without ComReg's prior approval;
3. Eircom will either modify its October 2008 bundles in a manner approved by ComReg or withdraw them;
4. Eircom will modify or withdraw any bundles that include retail line rental which had been cleared by ComReg if ComReg subsequently determines they do not pass the NRT;
5. ComReg is to conduct a consultation in relation to a further specification of the existing obligation not to unreasonably bundle.

Comment.

The agreement would appear to bring to an end behaviour regarded by ComReg as uncompetitive. As noted there has been a growing recognition in the economics literature in recent of the potential for practices such as bundling to foreclose markets. It is important to recognise, however, that foreclosure only arises when equally efficient firms are excluded from a market. Competition and regulation are not meant to promote inefficient entry.

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