

The Commission's NGA Recommendation: a critique

EETT's 5th International Conference

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17 June 2010

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I. Supporting NGA (1)

- Next Generation Access (NGA):
 - new fibre networks (FTTH, FTTN)
 - upgraded copper networks (VDSL 1/2)
 - upgraded coaxial networks
- Commission: NGA networks have the potential to drive economic growth and to bring benefits to EU citizens
- Regulatory certainty and properly-tailored regulation crucial to fostering competition and investment in NGA
- After several notifications under Article 7 of the *Framework Directive* there are wide divergences of regulatory approaches in the EU single market. Guidance is therefore necessary to provide a framework for competition, investment and consumer benefits

Supporting NGA (2)

- Three scenarios for NGA considered by the Commission:
 - forbearance and *a priori* exclusion of remedies;
 - resisting any adjustment of the specific rules governing the present regime of *ex ante* regulation; and
 - **a response favouring the imposition of access obligations duly adjusted for investment risk (adopted in the *NGA Recommendation*)**

II. *NGA Recommendation*: Timeline

- First draft (18 September 2008)
- First public consultation (ended November 2008)
- Second draft (12 June 2009)
- Second public consultation (ended July 2009)
- ‘Third’ draft (not released publicly)
 - BEREC published comments on the draft
- Cocom meeting on 17 June 2010
- Final version (to be adopted in August-September 2010)

III. First draft (1)

- Sets out general principles to apply in regulating NGAs
- Infrastructure competition is the preferred regulatory option
- Given that civil works represent a very high proportion of the costs of roll-out of NGAs, the Commission considers that an efficient remedy would be to ensure cost-orientated, non-discriminatory sharing of legacy physical infrastructure or, where this is not viable, access to other passive (dark fibre) or active (bitstream) elements.
- In undertaking market reviews, NRAs should examine the need to define geographic markets taking into account the competitive conditions created at both national and sub-national levels by the progressive roll-out of NGA networks and the status of infrastructure competition

First draft (2)

- Where NRAs find that one or more operators have SMP in the market for wholesale physical access they should mandate access to new and existing ducts, civil engineering works and other elements necessary for the roll-out of competing infrastructure. SMP operators should be required to ensure that when they roll out new ducts and other civil engineering work, sufficient space is allowed as appropriate for other operators to make use of these facilities.
- Where NRAs mandate access to *existing* network infrastructure, price controls on Reference Offers should be based on existing physical capacity, the extent of depreciation of the existing facilities plus the operating costs of an efficient operator.
- When analysing the upstream market for wholesale broadband access (Market 5), NRAs should maintain their current product market definition, including any chain substitutes.

First draft (3)

- Where NRAs mandate access to *new* infrastructure elements, price controls on Reference Offers should incorporate a project-specific risk premium to reflect any investment risk incurred by the operator.
- **Transparency:** SMP operators should be mandated to make Reference Offers within six months of the imposition of the SMP obligations. These should set out the conditions for access to ducts, civil engineering works and other elements necessary for the roll-out of competing infrastructure. They should provide information such as location and capacity. NRAs should specify in the Reference Offer appropriate *ex ante* price controls on all necessary inputs.

First draft (4)

- **Fibre to the Home (FTTH):** NRAs should facilitate co-operation regarding the roll-out and sharing of NGA infrastructure within buildings in order to enable end-users to have competitive choice. Physical access to the fibre sub-loops should be mandated as a remedy to SMP in Market 4.
- **Fibre to the Node (FTTN):** Existing SMP obligations in relation to Market 4 should continue and should not be undone by changes to the existing network structure or topology. NRAs should seek to ensure that agreement is reached between the SMP operator and access seekers in relation to migration from a copper network to a fibre one. NRAs should assess the implications for competition of the decommissioning of the copper network.
- **Wholesale broadband access:** Where SMP is found in Market 5, wholesale access remedies should be maintained for existing services and chain substitutes. Services provided over NGA networks should generally be treated as incremental upgrades and not treated as new markets. Wholesale obligations should not be imposed where an NRA finds that a service provided over NGA networks constitutes a newly emerging retail market.

IV. First consultation (1)

- Flexibility of NRAs in imposing remedies
 - NRAs / ERG: First draft Recommendation too prescriptive
 - more discretion for NRAs to pick and choose remedies most adequate to national circumstances
- Asymmetric vs. symmetric remedies
 - Incumbents: inappropriate to apply the same approach to NGAs that was applied to legacy telecoms infrastructure, thereby advocating symmetric approach (based on the promotion of commercial voluntary agreements)
 - Incumbents: Recommendation should promote symmetric regulation since investment in NGAs was not necessarily always undertaken by the incumbent and remedies should also cover non-telecom infrastructures (ducts, engineering works, *etc.*)
 - Alternative Operators (“AOs”): support asymmetry to avoid re-monopolization by incumbents

First consultation (2)

- Gradation of remedies
 - Incumbents: stress the need to impose only the lightest possible remedies
 - Alternative operators: stress the limited availability of ducts in most Member States and the need to realise the economies of scale for NGA rollout
 - Alternative operators: rolling out parallel networks would only be possible in the long term, whereas fibre unbundling is more realistic in the short term
 - NRAs: need to be able to impose both passive and active remedies in parallel
 - ERG: stressed the need to maintain the “ladder of investment” principle regardless of the evolution of *technology*

First consultation (3)

- Importance of active forms of access
 - Alternative operators: stressed importance of a full optical Bitstream input, such as the "Active Line Access" Ethernet-based product proposed by Ofcom in the UK
- Project-specific premium
 - Alternative operators: stressed the need carefully to assess the real level of risks, taking into account specific national circumstances, insisting that risk was higher for them as compared to incumbents
 - Alternative operators: insisted on the importance of the non-discrimination principle (the retail arm of then SMP operator should thus incur the risk premium)

V. Second draft (1)

- NRAs should ensure that remedies mandated in Markets 4 and 5 are consistent.
- Where fibre is deployed in the access network on greenfield sites, NRAs should not require the SMP operator additionally to deploy a parallel copper network in order to meet its existing obligations, including universal service obligations, but should allow for the provision of any existing regulated products or services by functionally equivalent products or services over fibre.
- Market 4 - access to civil engineering infrastructure of the SMP operator. Where NRAs find that one or more operators have SMP in Market 4, they should assess the availability of civil engineering infrastructure, including ducts owned by the SMP operator, for the purpose of allowing alternative providers to deploy NGA networks.

Second draft (2)

- Market 4 - access to the terminating segment in the case of fibre-to-the-home (FTTH). NRAs should mandate access to the terminating segment of the access network of the SMP operator, including wiring inside buildings. Access to the terminating segment of the NGA network and access to the distribution points should be granted in accordance with the principle of equivalence.
- Market 4 - unbundled access to the fibre loop in the case of FTTH. Regardless of the network architecture and technology implemented by the SMP operator, NRAs should also mandate unbundled access to the fibre loop, including appropriate measures to ensure co-location and backhaul. Access should be provided at the most appropriate point in the network.

Second draft (3)

- **Cost orientation:** the *draft Recommendation* sets out the minimum list of conditions that must be part of the Reference Offer for local loop unbundling (LLU). The price of access should be cost-orientated (taking into account any additional and quantifiable investment risk incurred by the SMP operator when setting the price of access).
- However, the access price need not be cost-orientated where:
 - The SMP operator has deployed an FTTH network based on multiple fibre lines and has granted effective and fully equivalent access to at least one independent alternative provider of electronic communications services competing on the downstream market.
 - Where the SMP operator has jointly, with at least one other provider of electronic communications services competing on the downstream market, deployed an FTTH network based on multiple fibre lines in accordance with the conditions set out in Annex III to the draft Recommendation (the co-investment project is not exclusive and co-investors all enjoy equivalent access).

Second draft (4)

- In the absence of an obligation of cost-orientation, NRAs should, at the request of an operator with rights of access, verify the SMP operator's pricing behaviour by applying a properly specified margin-squeeze test.
- **Annex III** of the *draft Recommendation* sets out the conditions under which it could normally be found that there is no SMP: joint deployment of FTTH networks by several co-investors where there are either two or three other operators; the FTTH networks are based on multiple fibre lines, each co-investor has equivalent and cost-oriented access to the infrastructure; the co-investors are competing on the downstream market; there is sufficient duct capacity for third party use; and migration by third parties is allowed.

Second draft (5)

- Market 4 - access obligations in the case of fibre-to-the node (FTTN). NRAs should assess the demand for unbundled access to the copper sub-loop as well as the costs for the SMP operator of providing such access. NRAs should impose an obligation to meet reasonable requires for unbundled access to the copper sub-loop, on a cost-oriented basis.
- Market 5 - Wholesale broadband access. Where SMP is found in Market 5, wholesale access remedies should be maintained for existing services and chain substitutes. New wholesale broadband access products should be made available at least six months before the SMP operator or its retail subsidiary sells its own corresponding retail NGA products.
 - Access should be on a cost-oriented basis. However, cost orientation should not be required where the conditions above for Market 4 relating to FTTH deployment are met.
 - Where NRAs consider that there is effective access to the unbundled fibre loop of the SMP operator's network and that such access is likely to result in effective competition on the downstream market, NRAs normally should not impose an obligation of wholesale bitstream access.

Second draft (6)

- **Migration.** Existing SMP obligations in Market 4 and 5 should continue despite changes to the existing architecture and technology SMP operators reach agreement with those who currently have access on an appropriate migration path. NRAs should ensure that alternative operators are informed at least five years before any de-commissioning of interconnection points.

Second draft (7)

- **Annex I** sets the common approach to pricing and risk:
 - NRAs should consider whether duplication of the relevant NGA access infrastructure is economically feasible and efficient; where it is not, the overriding aim is to create a genuine level playing field between the downstream operations of the SMP operator and alternative network operators. A consistent regulatory approach implies that NRAs can use different cost bases for the calculation of cost-orientation prices for replicable and non-replicable assets.
 - Where investment into NGAs depends for its profitability on uncertain factors, NRAs should assess whether the cost of capital should reflect the higher risk of investment relative to investment into current networks based on copper. The *draft Recommendation* explains how such a risk premium should be estimated. Where a higher risk premium is justified, additional mechanisms serving to allocate the investment risk between investors and access seekers could also be used, such as long-term access pricing or volume discounts.

Second draft (8)

- The price of access to physical network infrastructure should not be a geographical average in the presence of substantial cost differences between various areas.
- NRAs should impose accounting separation in a way which allows the NRAs to identify the cost of all relevant assets for the determination of access prices and to monitor effectively whether the SMP operator grants access under the same conditions and prices to other market participants as to its own downstream arm.
- NRAs should estimate the incremental costs required to provide access to the facilities concerned. Such incremental costs include the ordering and provisioning of access to civil engineering infrastructure or fibre, operating and maintenance costs for IT systems, and operating costs associated with wholesale product management. These costs should be allocated on a proportionate basis between all undertakings enjoying access, including the downstream arm of the SMP operator.

Second draft (9)

- **Annex II**

- Principle of equivalence for access to the civil engineering infrastructure of the SMP operator
- The SMP operator should provide third party access seekers with the same level of information on its civil engineering infrastructure and distribution points as is available internally.

Second draft (10)

- **Annex III**

- **Co-investment into FTTH:** obligation of LLU unbundling with regard to the fiber loop but no obligation of cost-orientation, under the following conditions:
 - at least three operators (including the SMP operator) jointly deploy and control FTTH networks
 - FTTH networks are based on multiple fibre lines
 - each co-investor enjoys equivalent and cost-oriented access to the joint infrastructure
 - co-investors effectively competing on the downstream market
 - co-investors install sufficient duct capacity for third parties
 - co-investors enable third parties using copper LLU to migrate to NGA wholesale products in the case of de-commissioning

VI. Second consultation

- Investment vs. competition
 - ERG: *draft Recommendation* does not fully recognise the role of effective competition in driving efficient investment and innovation, implying that there is a trade-off to be made between investment and competition
- Impact on the Market Analysis Process
 - ERG|: directs the outcome of the market analysis and limits the choice and form of remedies available to the NRA in an inflexible and deterministic manner (*i.e.*, certain remedies are either excluded or included, depending on mechanistic criteria).
- New Pricing Models
 - ERG: assessing pricing schemes and possible discriminatory or exclusionary effects is part of the NRAs' supervisory activities and should not be decided upon in detail at the European level

Second consultation (2)

- Mandatory provision of access to all rungs of the "ladder of investment"
 - the move from reliance on ducts access to a "ladder of investment" approach involving parallel access to different passive and active access products:
 - Alternative operators: in favor
 - Incumbents, ERG: against
 - ERG: leave broad margin of discretion to the NRA to choose the appropriate mix of access remedies following a market review
 - Incumbents: minimum regulation should be promoted and commercial agreements preferred to access regulation (If this were not the case, incumbents saw a high risk of having their business case "cannibalised" by access seekers owing to arbitrary distribution of the investment return by NRAs)

Second consultation (3)

- Symmetric remedies not covered by the *Recommendation*
 - ERG / incumbents: in the case of access to true infrastructure bottlenecks, such as terminating segments and ducts, symmetric remedies were often more appropriate
- General application of cost orientation
 - Alternative operators: supported the systematic application of cost orientation for the pricing of all access products mandated by NRAs, warned against the systematic inclusion of inflated risk premia in the cost of capital
 - ERG: cost-orientation should only be mandated in specific competitive conditions to be assessed and decided by NRAs themselves
 - Incumbents: strongly opposed to the systematic application of cost-orientation, with risk sharing arrangements allowing for faster penetration than mandated cost-based pricing (including a risk premium)

Second consultation (4)

- Exemptions to cost-oriented access:
 - Incumbents: the scenarios proposed were too restrictive. In their opinion and contrary to the approach of the *Recommendation*, the baseline scenario should be to impose minimum regulation (in particular symmetric obligations) and to let stakeholders negotiate freely any risk-sharing agreements.
 - ERG / alternative operators: strongly opposed the exemption scenarios on the basis that they provided opportunities for strategic behaviour from the SMP operators aimed at avoiding regulation, insisted that SMP-finding and access remedies should not be decided on the basis of the existence of deals between stakeholders. In their view, there could not be any *a priori* exemptions.

Second consultation (5)

- Multiple fibre deployment:
 - Incumbents: strongly opposed the promotion of multiple fibre deployments as creating high additional costs to be incurred by the SMP operators
 - ERG: agreed that it is difficult to forecast the potential increase in competition via multiple fibre deployments
 - Alternative operators: in principle, multiple fibre networks can clearly have a positive effect in the development of effective competition in the market

Second consultation (6)

Elements and Principles of Regulation	ERG	Alternative Operators	Incumbents
Technological neutrality	X	X	X
Co-investment	X		X
Ladder of investment	X	X	
Symmetric regulation	X		X
Differentiation of remedies	X		X
Definition of geographic sub-markets	X		X
Cost orientation	X	X	
Margin squeeze		X	
Price flexibility			X
Risk premium	X		X
Transparency	X	X	
Migration		X	

Second consultation (7)

- **Summary:**

- The comments display a clear dividing line between all-investment stakeholders (mainly incumbents and their network suppliers, equipment and fibre manufacturers) and potential access seekers and independent service providers, which insist on preserving competition and open access.
- NRAs were essentially concerned that the *Recommendation* could limit their margin of manoeuvre at the national level.
- The Commission states that given continued criticism from both incumbents and alternative operators, its current proposal strikes a fair balance.

VII. Third draft

- The regime for co-investment scenarios (**Annex III**) deleted. In particular, exemption of the obligation of cost orientation foreseen for the “duopoly co-investment scenario” has been deleted
- Less prescriptive language used with regard to non-SMP scenario
- Recognises explicitly that symmetric measures are an option to complement SMP regulation in specific cases

Third draft (2)

- **BEREC's comments**

- The *draft Recommendation* is still "too prescriptive" with regard to both the outcome of market analysis and the choice and implementation of remedies
- The Commission should better emphasise that, in all circumstances, the imposition of a certain remedy can only be based on a thorough market analysis, a finding of SMP on the relevant market and a decision on remedies that is justified by the competition problems identified, taking into account the specific circumstances of the Member State in question.
- The primacy of the market analysis process should be made clear, and re-working is needed to avoid the current interpretation that the *draft Recommendation* purports to imply an exhaustive set of remedies for certain markets.

Third draft (3)

- **BEREC's comments**

- BEREC suggests some amendments to the Commission's thinking on the criteria for assessing long-term access pricing and volume discounts, on risk assessment and on the geographical de-averaging of prices.
- Pricing flexibility:
 - both up-front commitments and volume discounts can potentially be discriminatory and can have a detrimental impact on competition
 - any discount schemes must be non-discriminatory and should satisfy a margin squeeze, test otherwise the SMP operator will have an unreasonable competitive advantage due to his economies of scale, with competitors being squeezed out and the market will be foreclosed (suggested by ERG but not heeded by the Commission)

Third draft (4)

- **BEREC's comments**

- Risk assessment

- it is important to draw a clear distinction between cash flow (income and costs) and uncertainty. NGA roll-out in less densely populated areas leads to a higher cost per access line, because the average distance between premises is higher and the expected penetration rate potentially will be lower.
 - Because the population density is a known factor and not a factor that influences the uncertainty of investment a higher WACC is not justified simply because the area is less densely populated.

Third draft (5)

- **BEREC's comments**

- Geographical de-averaging of prices:

- While it may be appropriate for the price of access to physical infrastructure to vary by geographic location where cost differences are present, NRAs need to consider a broad range of issues when making such decisions about prices.
 - These issues include the potential impacts on the price of downstream services and how these might affect conditions of competition, the impact on Universal Service operators to meet their obligations where these require retail prices to be nationally averaged and the extent to which it might be appropriate to disaggregate prices geographically.

- Geographic variations:

- deployment of NGA can lead to geographical differences in competition and welcomes the clarification that such differences can justify the definition of separate geographical markets or differentiated remedies in accordance with the Commission Recommendation 2007/879/EC

Third draft (6)

- **BEREC's comments**

- Migration:

- NRAs to ensure that alternative operators are informed no less than five years before any de-commissioning of points of interconnections. A general five year transitional period may be disproportionate in some circumstances (for example, if assets have yet to be depreciated).

- Possible final changes to text of *draft Recommendation* in light of BEREC's comments?