Telecom Italia's response to the BEREC public consultations on "Draft BEREC Strategy 2015 – 2017" [Bor(14) 119] and "Draft Work Programme 2015 - BEREC Board of Regulators" [Bor(14) 120]

(24 October 2014)

Executive summary

Telecom Italia (TI) welcomes the opportunity to provide its contribution to the BEREC Strategy 2015 – 2017 and Work Programme 2015.

BEREC has a fundamental role in harmonizing the regulation in Europe since the creation of a true European Telecom Single Market can be achieved only if the rules do not significant diverge among the Member States.

BEREC’s guidance for the next years is of the utmost importance to address the challenges the telecommunication sector is facing. We are in a period of technological revolution which requires all the operators to make high investments for the deployment of next generation fixed and mobile networks, whilst the revenues are declining due to the increased competition and to the economic negative trends.

In this new scenario, operators need bigger scale to become more competitive on a global level and to rely on sufficient resources to make the required investments. Consolidation, in-country and across borders, is needed to make this happen and can be perfectly consistent with the maintenance of an adequate level of competition. In this regard, TI does see any need for BEREC to investigating into oligopoly and consolidation which are typical matters of the competition Authority.

Promoting investment and competition is the first pillar of BEREC 2015 -2017 Strategy. In order to foster the investments in this period of economic recession, the electronic communication sector requires a rethinking of the European regulation policies. A gradual lightening of the regulatory constraints, as envisaged in the objectives of the European Framework is now necessary. Instead, we are witnessing an exacerbation of the rules at national level, which severely undermines investments profitability and therefore the roll-out of high-speed access networks in Europe.

The recent revision of the list of the relevant markets and the forthcoming review of the Regulatory Framework represent an opportunity to reduce the services subject to ex-ante regulation and give positive signals to the investors.

Where the regulation is still necessary, an adequate return on investments should be guaranteed. The main parameter to calculate the fair return on investment is the cost of capital. In this respect, TI calls for more harmonization of the rules to set the cost of capital and NGAN risk premium.

The Recommendation[1] on termination rate does not allow any recovery of the common costs establishing the principle that the traffic related component must be attributed to all the services which use the transport network (e.g. call origination, SMS, MMS, broadband, leased lines, etc.)[2]. However, the Commission did not explicitly indicate if the common costs could be recovered through the increase of the price of other services. A BEREC's guidance is necessary to clarify to NRAs how to recover the common costs no longer recovered through the pure LRIC-based termination tariff.

The majority of NRAs have until now mainly focused their intervention on SMP obligations whilst too little consideration has been given to **symmetric regulation** which is envisaged in the Regulatory framework. BEREC should better investigate and give guidance on the effective implementation of a more symmetric approach in regulating access to NGAN bottlenecks (e.g. entries to building and in-house wiring).

The 2013 EC Recommendation on non-discrimination and cost methodologies[3] requires the NRA to impose EoI or EoO as non-discrimination remedies. TI believes that BEREC should investigate on the positive impacts deriving from EoI but also from EoO.

TI fully supports the concept of the Open Internet and its central role as a platform for economic growth, innovation and social inclusion. The success of the Internet has, so far, been achieved with negligible regulatory oversight or intervention. Europe needs an Open Internet policy framework that focuses on general principles and provides appropriate freedom and flexibility for the development and delivery of specialised services alongside general internet access. Detailed rules established at European level risk jeopardizing the innovation and development of the new services.

It is necessary to ensure a real level playing field amongst all subjects of the value chain to preserve the competition and to give adequate incentives for network operators to continue

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[1] Commission Recommendation of 7 May 2009 on the regulatory treatment of fixed and mobile termination rates in the EU (2009/396/EC)

[2] Commission Recommendation on termination, Recital 14 – "*Then, it may be appropriate to attribute traffic-related costs firstly to other services (e.g. call origination, SMS, MMS, broadband, leased lines, etc.) with wholesale voice call termination being the final service to be taken into account*."

[3] Commission Recommendation of 11.9.2013 on consistent non-discrimination obligations and costing methodologies to promote competition and enhance the broadband investment environment - C(2013) 5761 final

investing. The subjects who currently compete in the TLC service markets are the traditional telecom operators (Telcos) but also the "Over the Top" (OTT). OTTs benefit from fewer constraints in developing new business models and services in respect to Telcos so having a considerable competitive advantage. TI welcomes that BEREC is going to analyse OTT activities and business models and their impact on the electronic communications sector.

TI welcomes that BEREC is engaging in improving its working methods and the quality of its output. Many of the BEREC's deliverables are benchmarks, best practice and reports where European NRA's practices are compared (i.e. Regulatory Accounting in Practice). TI notes that in many instances BEREC's documents do not show the name of the State or National Authority which follows a certain practice. On this matter, BEREC should provide more detailed information for transparency porpoise.

TI believes that BEREC's 2015 Work Programme should include the following topics:

1) **Symmetric Regulation**: BEREC should give guidance to NRAs on how best implementing the provisions of Art. 12 of the Framework Directive for addressing bottlenecks in the access network (e.g. entries to buildings and in-house wiring) in a proportionate and effective manner, taking into account that the facility owner has a SMP in the market of the final access segment.

2) **Cost of capital and Risk Premium:** the Cost of Capital and the Risk Premium for NGA are of paramount relevance in determining the economic perspectives for the deployment of fibre networks and the ability of operators to invest. WACC/CAPM is the methodology universally used by the European NRAs to calculate the cost of Capital[4]. BEREC should give clear guidance on how to treat the single components of the WACC formula.

3) **Equivalence of output and separation models**: assessment of advantages and disadvantages of EoI vs EoO.

4) **Recovery of the common costs no longer recovered through the pure LRIC-based termination tariff:** BEREC should issue a report on the Best Practice or guidelines to ensure harmonisation in Europe of the method for recovery of the common costs of the termination service no longer recovered with the pure LRIC-based model.

[4] Report on Regulatory Accounting in Practice 2013, September 2013

1) Symmetric Regulation

The roll-out of fibre access networks across various local areas by players other than those identified as SMP-operator is creating, in many instances, non-duplicable infrastructure bottlenecks, with particular reference to entries to buildings and in-house wiring.

Therefore, in the new scenario, a key challenge for NRAs is the application of symmetric obligations to regulate new NGA bottlenecks and to ensure competition for end-users, avoiding the creation of "vertical access monopolies" in the buildings cabled by alternative operators. It is essential that the obligations imposed on the alternative operators are exactly the same as the obligations imposed on the incumbent operator for the same bottlenecks resources. In particular the symmetry should be guaranteed not only for the access obligation but also for the other remedies such as price control and transparency. TI does not consider it justified and proportionate to impose only on the SMP operator the cost orientation obligation whilst the other TLC operators benefit from a lighter form of price control. Indeed, both incumbent and alternative operators have SMP in this section of the network and differences in the regulation are not justified.

Consistency of national approaches in this area is needed to avoid distortions in the internal EU market, but relevant differences are currently observed in the different member States.

BEREC 2015 Work programme should therefore include activities aimed at providing NRAs guidance on how best implementing the provisions of Art. 12 of the Framework Directive for addressing bottlenecks in the access network in a proportionate and effective manner.

Consistency between SMP regulation and symmetric regulation remains an on-going challenge. In this regard, BEREC should investigate and clarify the procedure for imposing symmetrical obligations.

Art. 12 of the Framework Directive establishes that the access obligations can be imposed only after a period of consultation. Anyhow, it does not specify whether the procedure to impose these symmetric obligations should be carried out along with the market analyses for the imposition of ex-ante remedies on the operator who has SMP in the access network or can be carried out with a separate proceeding. There is the risk that different proceedings carried out in different timeframes lead to a non-consistent regulation especially if the SMP obligations are imposed before the symmetric ones.

2) Cost of Capital

Promoting investment and competition is the first pillar of BEREC 2015-2017 Strategy.

Investments of regulated operators are promoted if an adequate return on investments is guaranteed for the regulated wholesale prices, along with other regulatory conditions, such as certainty.

In a general context characterised by financial uncertainty and a lack of potential demand, the cost of capital assumes a role of paramount relevance in determining the success of the investment in New Generation Access Networks.

In 2013 BEREC published a report on specific aspects of the calculation of the cost of capital[5], such as the methodology used by the NRAs to evaluate each parameter of the WACC (which is the methodology universal used in EU for the cost of capital), the frequency of calculation and the regulatory period which the cost of capital parameters are applied over. This analysis was not repeated in 2014.

For an operator, the cost of capital represents one of the elements to take into consideration for an investment evaluation. Its evaluation should not be used to "adjust" the wholesale charges. To a certain extent, the role of the WACC in the communications industry is as independent as the interest rate in the economy. The single elements forming the WACC/CAPM formula leave in the hand of the Regulator too many degrees of freedom able to significantly influence the level of the wholesale charges. As an example, the Risk free rate can be calculated using the Treasury Bonds return rates over different periods (5 or 10 years), the value of the Beta can be the result of a benchmark or of a multi-year analysis. BEREC should give guidance on these methodological aspects in order to give the operators the certainty on the ability of the markets to give an adequate return of the investment.

BEREC's guidelines should also analyse whether the cost of capital is to be calculated in the framework of the market analysis review or in a separate proceeding and if a unique value should be used to regulate all the wholesale access and interconnection services.

[5] Annex of the Report on Regulatory Accounting in Practice 2013, September 2013

Regarding the frequency of calculation, TI believes that once the parameters of the WACC formula have been defined by the NRA according to common guidelines, the update is an exercise that can be made any time the conditions require it.

3) Equivalence of output and separation model

In 2014 Work program, BEREC had planned to analyse the issues and challenges related to the implementation of the Equivalence of Input (EoI) model and its potential advantages and disadvantages. In 2015 Work program this important topic has been dropped.

TI believes that BEREC should continue with this analysis extended to the Equivalence of Output (EoO) model. Actually, the EC Recommendation on non-discrimination obligations and costing methodologies envisages that, where the application of EoI is disproportionate, the SMP operator should provide the wholesale inputs on an Equivalence of Output basis. In this regard, BEREC should compare the advantages and disadvantages of EoI and EoO to help NRAs in the choice of the non-discrimination model to apply on the basis of the national circumstances.

4) Recovery of the common costs no longer recovered through the pure LRIC-based termination tariff

In the Recommendation[6] on termination rates, the Commission states that it may be appropriate to attribute traffic-related costs to all the services which use the transport network (e.g. call origination, SMS, MMS, broadband, leased lines, etc.)[7]. However, the Commission did not explicitly indicate if the common costs (not covered by the termination price) could be recovered through the increase of the price of other services.

In order to properly decide which approach to adopt regarding this issue, Ofcom commissioned the consultant Analysys Mason a study on the charge controls applied to fixed call origination and

[6] Commission Recommendation of 7 May 2009 on the regulatory treatment of fixed and mobile termination rates in the EU (2009/396/EC)

[7] Commission Recommendation on termination, Recital 14 – "*Then, it may be appropriate to attribute traffic-related costs firstly to other services (e.g. call origination, SMS, MMS, broadband, leased lines, etc.) with wholesale voice call termination being the final service to be taken into account*."

termination services[8]. Analysys' report shows that the approach adopted by the European NRAs is not uniform. Some NRAs allowed the recovery of the common costs through other wholesale services such as origination or WLR whilst others did not allow any cost recovery, or did not treat the issue at all.

Therefore, on this topic, BEREC should issue a report and individuate the best practice to grant a real harmonization across Europe.

[8] See "Study of approaches to fixed call origination and termination charge control", 15 May 2012, ref. 34541 - 193