



## **BEREC Opinion to the Draft Recommendation on regulated access to Next Generation Access Networks (NGA) of 28 April 2010**

28 May 2010

### **Introduction**

1. BEREC welcomes the opportunity to respond to the European Commission's Draft Recommendation on regulated access to Next Generation Access Networks (NGA). It hereby submits its Opinion as requested by the Commission on 28 April 2010 in accordance with Article 19 of the amended Framework Directive. It also thanks the Commission for their cooperation and dialogue on the various revisions made to the Draft NGA Recommendation of June 2009.
2. BEREC shares the aim of the Commission to foster the development of the single market by enhancing legal certainty and promoting investment, competition and innovation in the market for broadband services, in particular in the transition to NGA networks. BEREC also recognises and fully supports the important role these networks can play in the further development of the economies of Europe and the benefits that they can they bring to its citizens. The publication of this Recommendation is in our view timely in the light of the challenges facing regulators and industry alike on the roll-out of Next Generation Networks. In the context of its Opinion, BEREC also welcomes the improvements to the text which recognise the important role that effective competition has and will continue to play as the key driver of efficient investment. We do however believe that this message could be still further emphasised in the document.
3. BEREC believes that regulatory certainty and consistency are crucial in order to foster a competitive environment for long-term investment in NGA. Thus BEREC shares the goal of the Commission's Recommendation on NGA to complement and enhance the NRAs ability to follow due process and create a regulatory environment that applies appropriate and considered measures which promote both investment and competition. In this regard the NGA Recommendation is a timely step to ensure the roll-out and deployment of NGA across Europe while recognising that Member States are at different stages of NGA roll-out and deployment.
4. BEREC shares the view of the Commission as expressed in its "Staff Working Document"<sup>1</sup> that the ladder of investment principle should be maintained and should be applied in the remedies imposed. BEREC would therefore welcome the explicit mention in the

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<sup>1</sup> Commission Staff Working Document Accompanying document to the Commission Recommendation on regulated access to Next Generation Access Networks (NGA)

Recommendation of the “*continued validity of a proportionate application of the ladder of investment principle*”.<sup>2</sup>

5. In terms of the detail of the Recommendation, BEREC particularly welcomes the improvements that are contained in this latest version of the Draft Recommendation reflecting many issues raised by the “I/ERG Response to the draft NGA Recommendation” (ERG (09) 16rev3).
6. As regards the co-investment scenarios BEREC strongly welcomes that the Commission has taken up the ERG’s proposal to delete Annex III and the relevant Articles 23-25, 26, 37-39, 42 and to adjust Recitals 29, 30, 32, 46 accordingly.
7. It welcomes that the exemption of the obligation of cost orientation foreseen for the “duopoly co-investment scenario” (originally described in Annex III.1) has been deleted.
8. Also it is welcomed that less prescriptive language is used with regard to the “non-SMP scenario” of Annex III.2 (now included in Art. 28).
9. BEREC welcomes the explicit recognition that symmetric measures are an option to complement SMP regulation in specific cases (new Art. 7).
10. BEREC also welcomes that the Commission has taken on board the ERG’s suggestions of mentioning criteria to assess uncertainties to calculate the appropriate risk premia. BEREC considers that assessing the investment risk by taking account of the various uncertainties<sup>3</sup>, rather than making an a priori classification of risk, is appropriate in order to calculate a risk-reflective premium of NGA roll-out that provides the necessary investment incentives. This approach implicitly generates distinctions in the risk assessment between different roll-out scenarios on a case by case basis by NRAs. Despite the general recognition of this approach Annex I still keeps an *a priori* risk categorisation for different NGA roll-out scenarios. Accordingly we suggest the inclusion of wording from the Staff Working Document in the Recommendation along the lines of the following: “... *investment risk should be rewarded by means of a risk premium incorporated in the cost of capital.*”<sup>4</sup>

### **Areas needing further improvements**

11. In recognizing these improvements made, BEREC wishes to raise some issues with the current Draft Recommendation. BEREC makes these comments in the hope that they will contribute to better achieving the aims envisaged by the NGA Recommendation.
12. In general, BEREC thinks that the Draft Recommendation is still quite detailed and too prescriptive with regard to both the outcome of market analysis and the choice and implementation of remedies. We request the Commission to better emphasise in the Recommendation 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 in the country in question.<sup>5</sup> If this is not the case, the principle of proportionality may be infringed, and there would be a risk of inconsistency

<sup>2</sup> See Staff Working Document, p. 26

<sup>3</sup> See ERG Response (para. 33) to the previous draft Recommendation

<sup>4</sup> See p. 20.

<sup>5</sup> The Commission acknowledges this fact in its “Staff Working Document”, for example on p. 14: “some of these differences [e.g. in the remedies imposed] may be justified in the light of national circumstances and specificities”.

between the Framework and underlying competition law principles<sup>6</sup> on the one hand and the NGA Recommendation on the other. Such inconsistency would lead to legal and regulatory uncertainty, which could damage competition and/or investment in NGA.

13. Furthermore, the Draft Recommendation sometimes gives room for different interpretations or contains some inconsistencies. This has potential to reduce the level of regulatory certainty and predictability, by causing more discussions and legal procedures between the NRAs and market parties, thereby increasing the risk of delays to decisions, and therefore to investment and competition in NGA. It may also entail the risk of inconsistencies between the regulatory approaches taken by NRAs.

***Primacy of the Market Analysis Process enshrined in the Regulatory Framework***

14. BEREC wishes to recall that the NGA Recommendation should not go beyond the fundamental principles of the Regulatory Framework according to the Directives. Considering that the NGA Recommendation calls for a consistent implementation of remedies with regard to NGAs, BEREC calls for this important principle to be recognised by the following slight amendments to Articles 2 and 3:

- i. On Art. 2 (Aim and Scope): *“This Recommendation lays down a common approach for promoting the consistent implementation of remedies, with regard to NGAs, **derived from the completion of a Market Analysis process** pursuant to ...”*
- ii. On Article 3 (Aim and Scope): *“NRAs should design **effective** remedies in accordance **with the requirements of those Directives, based on the common approach set out in this Recommendation. The EU framework furnishes NRAs with a toolbox of remedies, allowing for the flexibility to design appropriate measures to tackle market failures and achieve intended regulatory objectives in each Member State.**”, the last sentence being taken from Staff working document (p. 12).*

15. The Draft Recommendation is too prescriptive in that it purports to imply an exhaustive set of remedies for markets 4 and 5. This is inconsistent with the relevant provisions of the Framework Directive pursuant to which the Commission will issue the Recommendation. In particular, recital 58 of the Better Regulation Directive 2009/140/EC provides that “Any Commission decision under Article 19(1) of Directive 2002/21/EC (Framework Directive) should be limited to regulatory principles, approaches and methodologies. For the avoidance of doubt, it should not prescribe detail which will normally need to reflect national circumstances, and it should not prohibit alternative approaches which can reasonably be expected to have equivalent effect. Such a decision should be proportionate and should not have an effect on decisions taken by national regulatory authorities that do not create a barrier to the internal market.”

***Cost-orientation***

16. The Draft Recommendation foresees to impose cost-orientation in all cases for all wholesale services.<sup>7</sup> Generally prescribing cost-orientation neglecting the specific circumstances without a clear reference to the result of the market analysis may contradict Art. 8 (4) Access Directive requiring obligations “*be based on the nature of the problem identified,*

<sup>6</sup> Commission’s Staff Working Document, p. 36

<sup>7</sup> Civil engineering infrastructure [Art.14]; terminating segment [Art. 20]; access to the fibre loop [Art. 25]; sub-loop unbundling [Art. 30]; wholesale broadband access [Art. 35]). Art. 25 and 35 addressing fibre-loop unbundling and wholesale broadband access differ from Art. 14, Art. 20, and Art. 30 insofar as it foresees cost orientation “in principle”.

*proportionate and justified in the light of the objectives laid down in Article 8 of Directive 2002/21/EC (Framework Directive)*". Without such a reference this may result in an incompatibility between the NGA Recommendation and the Framework and enhances the risk that NRAs' decisions would not withstand judicial review, as the Commission acknowledges in the "Staff Working Document".<sup>8</sup> Furthermore, Recital 20 of the Access Directive notes that the method for cost recovery should be appropriate to the circumstances. Therefore, NRAs need flexibility to decide on appropriate methodologies for price control measures including e.g. retail minus.

### **Pricing flexibility**

17. The Draft Recommendation helpfully seeks to set out the criteria for assessing long-term access pricing and volume discounts. Long-term up-front commitments by buyers of NGA access are intended to reduce the risk of the investor by transferring part of the risk from the investor to other operators ('risk diversification')<sup>9</sup>. In contrast, BEREC considers that the main objective of volume discounts is not to reduce the risk of the investment as in the case of upfront commitments, but to stimulate network penetration rate and lower per end user unit costs. The reduction in unit costs occurs because in network industries there is a negative relationship between market penetration and the cost per connection: the higher the penetration, the lower the cost per connection. This means that, in order to minimise cost per connection, a supplier of NGA access will want to expand the network volume by encouraging buyers to purchase more lines. The introduction of volume discounts schemes is one way of incentivising buyers, whereby part of the achievable benefits of scale of the investor is shared with the operators purchasing access. However, this reasoning does not only apply to FttH as stated in Annex I.
18. In BEREC's view, the level of investment risk is only impacted to a limited extent, if any, by the presence of volume discount schemes to the extent that the investment has already taken place prior to the volumes being purchased. Potentially there could be an indirect impact on investment risk to the extent that an investor has certainty prior to the investment taking place that volume discounts will be allowed in principle, whereby the investor could expect that network penetration rates and total turnover will be higher than in the case when such discounts are ex ante prohibited.
19. BEREC is concerned that both upfront commitments and volume discounts can potentially be discriminatory and have a detrimental impact on competition. This is the case where the retail arm of the SMP operator, which – in many member states will have the highest potential market share – is likely to be able to commit to larger long-term upfront volume contracts and therefore potentially be able to qualify for a higher volume discount. It should be clarified in the Recommendation that this case is excluded. If the Commission implies to allow a single discount only taking into account the estimated minimum efficient scale this should be stated clearly. However, it must be borne in mind that the threshold of the minimum efficient scale may curtail competition and foreclose the market, because in a number of circumstances the minimum efficient scale may not allow more than one additional competitor beside the SMP operator to be eligible for the discount. Further, BEREC does not consider that any volume discount should always be calculated by Metropolitan Point of

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<sup>8</sup> See Sec. 7.5, page 38.

<sup>9</sup> A long term commitment by the retail arm of a vertically integrated investor should however not be considered as a risk reduction of the investor.

Presence (MPoP<sup>10</sup>), although recognising that this may in many circumstances be an appropriate approach. Rather the NRA should have the flexibility to choose the appropriate criteria and appropriately sized reference units taking account of national circumstances and network architecture. Therefore the conditions under which a volume discount is acceptable should be adjusted accordingly. Furthermore they should state that a volume discount shall be applied in a non-discriminatory manner to all access seekers including the SMP operators retail arm and not have an anti-competitive effect.

20. BEREC would like to reiterate the statements made in paragraphs 42-46 of the previous ERG Response (new pricing models), namely that any discount schemes must be non-discriminatory and satisfy a margin squeeze test otherwise the SMP operator will have an unreasonable competitive advantage due to his economies of scale and competitors will get squeezed out and the market will be foreclosed.
21. BEREC is concerned that in the current Draft, the first condition regarding volume discounts has been adjusted in the wrong direction. According to the current Draft *“volume discounts ... apply non-discriminatory manner to all access seekers which, in the area concerned, are willing to pay the volume of lines giving access to the discount”* instead of the reference in the former draft *‘to all access seekers in that area’*. With a volume discount based on market volume as a whole rather than individual volume, smaller operators would profit as well.

### **Risk assessment**

22. Regarding pricing principles and risks (Annex I, No. 6 page 19) BEREC thinks it is important to make a clear distinction between cash flow (income and costs) and uncertainty. Clearly, point *“(ii) ‘the population density of the geographical areas concerned’<sup>11</sup>* is not a factor of uncertainty, but a known factor (to be considered in the assessment). 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. This implies that the business case in less dense populated areas will likely be more difficult than in dense areas. Because the population density is a known factor and not a factor that influences the uncertainty of investment a higher WACC is not justified just because the area is less densely populated. We therefore suggest the deletion of point (ii) in the above mentioned paragraph and the sentence starting with: *“However, the risk attaching to FttN/VDSL deployment in less dense populated areas...<sup>12</sup>*. Recitals 22, 31 should be adapted accordingly.

### **Geographical de-averaging of prices**

23. BEREC is concerned about the potential implications of the third paragraph of Annex I on page 17 of the revised Draft Recommendation. 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. Therefore BEREC suggests that the Commission either deletes the referenced paragraph or amends it in such a way that it continues to identify the issue, but indicates that it is appropriate for

<sup>10</sup> A definition of this term is provided in Art. 11 of the Draft NGA Recommendation.

<sup>11</sup> Annex I.6, 2<sup>nd</sup> para, in ii, Page 19; also in Recitals 22, 31.

<sup>12</sup> Paragraph 4, page 19.

NRAs to continue to have discretion over whether prices should be uniform or not, e.g. “NRAs should consider whether the price of access ... should or should not be a geographical average in the presence of substantial and objective cost differences.”

### ***Geographic variations***

24. BEREC agrees (Art. 9 and Recital 9) that the 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. BEREC therefore suggests keeping Articles 9 and 10, but suggests removing the reference to the possibility of separate markets in Articles 28 and 38 (and Recital 27). BEREC considers that it is not consistent to only re-emphasise this point in the context of the joint deployment of FttH networks based on multi-fibre in an unbundled access to the fibre loop scenario. BEREC further considers that there is no reason to believe that in such a multi-fibre NGA scenario, geographical differentiation is more justified than in another NGA or non-NGA scenario.

### ***Migration***

25. Art. 39 requests NRAs to ensure that alternative operators are informed no less than five years before any de-commissioning of points of interconnections (see also Rec. 39). BEREC reiterates the ERG view (ERG (09) 16rev3, para. 62) that a general five year transitional period may be disproportionate in some circumstance, for example, if assets have yet to be depreciated. Therefore, BEREC suggests that Art. 39 (2<sup>nd</sup> sentence) should be adapted as follows: “...ensure that alternative operators are informed no less than five years **where appropriate taking into account national circumstances** before ...”. Similarly, Recital 39 should be adapted accordingly: “Existing SMP obligations should be maintained for an **appropriate** transitional period.”

## **Annex : Other points of detail**

### ***Access remedies***

26. Art. 13 (“should mandate access to civil engineering”) and Art. 18 (“should ... mandate access to the terminating segment”) are similarly prescriptive. While prescribing these remedies may be appropriate in many cases, the prescriptiveness of the wording may run counter to Art. 8 (4) AD. Therefore, it is suggested to add “where appropriate” in Art. 13 and Art. 18.

### ***Reference offer***

27. BEREC welcomes the fact that the current Draft Recommendation no longer makes remedies dependent on the forecasted market demand, as commented in the ERG response to the second Draft Recommendation (ERG (09) 16rev3, para. 56).
28. The new Draft Recommendation, in addition to mandating access, imposes a reference offer in all cases (duct access, access to the terminating segment, access to the fibre loop, unbundled access to the sub-loop and bitstream). But as already pointed out by the ERG (ERG (09) 16rev3, para. 56), a valid option when market demand is uncertain (as is the case for certain types of access, due to economical viability) is “to *impose access without detailed terms in a reference offer*”. BEREC is of the opinion that this should remain a valid alternative for NRAs, in order to ensure that mandated remedies are proportionate (as full development of an offer from day 1 where demand is unclear could be seen as disproportionate). Therefore, the wording in Article 30 could be revised, for example, to: “...*the SMP operator should be required to develop a full reference offer in case of sufficient and sustained demand from alternative operators for this access form.*”

### ***Specific issues with regard to Market 4***

29. Referring to paragraph 15 of this Opinion, a slight amendment to Art. 12 of the draft Recommendation is suggested as follows: “*Where SMP is found on market 4, NRAs should impose an appropriate set of remedies **taking into account the non exhaustive list of principles set out below.***”

### ***Specific issues with regard to Market 5***

30. According to Art. 32 “*NRAs should oblige the SMP operator to make new wholesale broadband access products available in principle six months before the SMP operator or its retail subsidiary markets its own corresponding NGA retail services*”. BEREC is of the opinion that a strict application of a defined timescale, for such a dynamic and innovative market, may not be appropriate and/or proportionate in all cases (e.g. in case of a simple/minor update on the wholesale offer, like a new access profile or QoS level, which do not require much adjustment of competitors’ offers). Therefore, BEREC calls for a more open and flexible wording.
31. BEREC also considers that it is not considered proportionate to allow the competitors an early market entry and oblige the SMP operator to wait several months before launching a competing product. This has potential to stifle innovation and increase “time to market”. Thus, BEREC suggests that the right approach should be one that enables any competitor to launch its (retail) product in the market at the same time as the retail arm of the SMP operator.

### **Clarifications and suggestions for consistency**

32. BEREC would appreciate clarification on what legal grounds NRAs may determine the location of the distribution point of the terminating segment (Art. 18).
33. Art. 22 and 23 differ as Art. 22 requires “in principle” to mandate unbundled access to the fibre loop whereas Art. 23 is stricter (“should mandate”). We suggest that the wording “*in principle*” should also be used in Art. 23.
34. Also Art. 29 (“should impose”) differs from Recital 29 (and 28), where it is stated that NRAs analyze if “*sub-loop unbundling remedies are needed*”.
35. Similarly, Art. 35 foresees to “*in principle* impose cost-orientation” whereas the “*in principle*” is not applied in Art. 14, 20, 30.
36. BEREC suggests the replacement in Art. 17 of “*all ducts*” with “*civil engineering infrastructure*” (accordingly: Annex II.3., 1st para, end of last sentence), thereby enabling these provisions to apply when infrastructures other than ducts, e.g. man-holes or poles, are deployed in practice. Furthermore, BEREC calls for greater clarity about when a provision relates to civil engineering in general (ducts, poles etc.) and when it relates to ducts only (Article 13 mentions ducts and civil engineering infrastructure).
37. Some of the articles of the Draft Recommendation link together co-investment and multi-fibre. BEREC would like to underline that co-investment may also occur in a mono-fibre architecture.
38. BEREC is not clear what is meant by “virtual co-location” (Art. 29), and asks for a definition for this term.<sup>13</sup>
39. Art. 39 foresees the possibility of a period of less than five years (information on de-commissioning points of interconnection) in case of “fully equivalent active access”. What does ‘fully equivalent’ mean (functional separation, non-discrimination?) And why may this only be less than five years if *active* access is provided and not if equivalent *passive* access is provided?
40. While FttH is defined in Art. 11 there is no such definition for FttN.
41. BEREC would appreciate clarification under which legal powers the obligations in Annex II.7 (2<sup>nd</sup> para) can be imposed.

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<sup>13</sup> E.g. there is already a definition used in Denmark. How does the Commission’s understanding relate to this definition?