

BEREC Draft Guidelines on Article 76 of the EECC—Oxera response to consultation

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Final

1 Introduction

Oxera welcomes the opportunity to provide comments on the Draft Guidelines from BEREC on how national regulatory authorities (NRAs) should apply the criteria for assessing co-investments in new very high capacity network (VHCN) elements, in line with Article 76 of the European Electronic Communications Code (EECC).¹

Simply put, Article 76 allows NRAs to grant operators with significant market power (SMP), a form of regulatory relief from conditions laid out in Article 68 of the code (including strict access obligations)² if they enter into ‘qualifying’ VHCN co-investment schemes.

Guidance to NRAs on what conditions are required for an SMP operator’s co-investment scheme to ‘qualify’ for reduced regulatory intervention is necessary. If the intention of Article 76 is to encourage investment in VHCN through co-investment agreements, and if these co-investments would bring material benefits to consumers and unlock investments that would otherwise not be possible through a standalone investment, then such schemes should be encouraged and rewarded.³ Therefore, SMP operators engaging in co-

¹ Body of European Regulators for Electronic Communications (BEREC) (2020), ‘Draft BEREC Guidelines to foster the consistent application of the criteria for assessing co-investments in new very high capacity network elements (Article 76 EECC)’, BoR, 20:113, 12 June. This is referred to hereafter as ‘the Draft Guidelines’.

² Article 68 of the EECC sets out the rules around the imposition of regulatory obligations on SMP operators. For a compliant co-investment, the NRA shall not impose any additional obligations pursuant to Article 68 as regards the elements of the new VHCN that are subject to the commitments.

³ Recital 198 of the EECC acknowledges, ‘Due to current uncertainty regarding the rate of materialisation of demand for very high capacity broadband services as well as general economies of scale and density, co-investment agreements offer significant benefits in terms of pooling of costs and risks, enabling smaller-scale

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investment schemes that bring such benefits should have confidence that by complying with the conditions of Article 76, the regulatory implications will be no worse than (and may even be preferable to) any regulatory obligations they would be subject to under a standalone investment. Guidance on what tools regulators can use to provide the right incentives to investors and encourage investment, whilst also protecting consumers from the risk of excessive prices, is also needed.

In this regard, we consider there to be two key conditions commented upon in the Guidelines that are worth emphasising.

- First, the co-investment offer must be open to any undertaking over the lifetime of the network build on a non-discriminatory basis (Article 76, paragraph 1, points (a) and (b)).
- Access seekers not participating in the co-investment can benefit from the outset from the same quality, speed, conditions and end-user reach as were available before the deployment, accompanied by a mechanism of adaptation over time (Article 76, paragraph 1, point (d)).

Accordingly, in determining whether the costs of entering into a co-investment agreement structured in compliance with Article 76 would be beneficial, SMP operators will need to consider two questions.

- Will it be able to reflect the greater risk it took by investing early through a higher price of participation for those who want to join the co-investment later?
- Will it be able to create a sufficiently large difference in the quality and price of the access products available to co-investors compared with those available to non co-investors, so as to secure the greater pricing flexibility granted relative to alternative price controls that might otherwise have been applied under Article 68?

In principle, under the wording of the EECC, the answer to both questions is yes. However, exactly how the relevant commitments will be assessed by NRAs to determine the extent to which such practices will be allowed should be made very clear in supporting guidance, and we consider that the Draft Guidelines from BEREC could provide further clarity in some areas.

For example, as a general comment, while BEREC recognises the idea of prices needing to differ between co-investors depending on the time at which they join, and therefore the risk that they take,⁴ the guidance is quite limited on the tools NRAs might use to quantify risk, how to incorporate such tools into the regulatory toolkit, and whether any risk premium should apply to the price paid per line, or some other fee paid to join the co-investment agreement.⁵

Therefore, in this response, we provide some specific comments on where further guidance should be provided, focusing on how risk should be accounted for within the regulatory regime and how this could be incorporated

undertakings to invest on economically rational terms and thus promoting sustainable, long-term competition, including in areas where infrastructure-based competition might not be efficient’.

⁴ For example, see paras 61, 62 and 63 of the Draft Guidelines.

⁵ For the avoidance of doubt, when discussing the ‘risk premium’, we mean a cost-based differential where the costs are influenced by risk (as opposed to a price premium driven by value-based pricing).

into the assessment of the terms of the co-investment at different points of the investment programme.

Further, we consider that further clarity is needed on the extent to which the price of any ‘anchor product’ (the service with the same quality, speed, conditions and end-user reach as were available before the deployment)⁶ will be constrained, and the degree of ‘adaptation’ over time. These factors will be critical to determining the attractiveness of the investment opportunity for any potential investor. At the very least, the terms and conditions of any anchor product regulation need to be consistent with allowing investors to earn a fair return on their investment, which would be afforded under a stand-alone investment.

In this context, our response focuses on two main parts of Article 76 (and BEREC’s Guidance)—namely:

- the need for co-investments to be open on fair and discriminatory terms;⁷
- the mechanism for adaptation.⁸

⁶ Article 76, para. 1, point (d) of the EECC.

⁷ Article 76, para. 1, point (a) and point (b) (i) of the EECC.

⁸ Article 76, para. 1, point (d) of the EECC.

2 Offer to be open on fair and non-discriminatory terms

Article 76, paragraph 1 of the EECC states that when assessing the commitments of the co-investors, NRAs shall determine whether the offer to co-invest complies with a number of conditions including whether:

- it is ‘open at any moment during the lifetime of the network to any provider of electronic communications networks or services’⁹—interpreted by BEREC as referring to the terms offered to potential co-investors to enter the agreement with the possibility for potential and different types of electronic communications providers to join the co-investment at any moment during the lifetime of the network.¹⁰ This includes: (1) access by entering the co-investment agreement at the beginning of the offer; and (2) access by entering the co-investment agreement at a later stage;¹¹
- it does so on ‘fair, reasonable and non-discriminatory terms allowing access to the full capacity of the network to the extent that it is subject to co-investment’.¹²

These requirements makes sense in order to avoid a situation in which only a small number of operators participate in the co-investment scheme, with the rest being unable to access the full range of wholesale access products.

However, there is a risk that this requirement could give rise to arbitrage or ‘free-riding’ opportunities. For example, depending on the terms of access, the requirement could allow access seekers to gain access to the facilities after the network has been built on terms that do not reflect the lower risk that they are bearing, relative to the risk borne by the original investors. Therefore, an important question is about what the rules and terms should be for co-investors who join at a later date and the extent to which ‘fair’ terms include adjustments for the different degree of risk facing later co-investors.

In the Draft Guidelines, BEREC has clarified that the conditions of the EECC do allow for differentiating the terms of the co-investment offer depending on the level of risk or the share of the total risk carried by different potential co-investors—in other words, that co-investors committing for different levels of participation or deciding to co-invest at different points in time could justifiably be offered different terms.¹³ In particular, In the Draft Guidelines, BEREC acknowledges:

As a general rule, potential pricing differences between co-investors should be based on the level of risk that is linked to the investment, in a way that there are no incentives for an efficient provider of electronic communications networks and/or services to postpone the decision to enter into the co-investment agreement to a later stage for the sole reason of better terms and conditions.¹⁴

Consequently, any latecomer to the co-investment should join on terms that are ‘fair, reasonable and non-discriminatory’, relative to the original co-investors, and a key aspect of this is pricing that fairly reflects risks faced at the

⁹ Article 76, para. 1, point (a) of the EECC.

¹⁰ Paras 39–40 of the Draft Guidelines.

¹¹ Para. 44 of the Draft Guidelines.

¹² Article 76, para. 1, point (b) (i) of the EECC.

¹³ Para. 62 of the Draft Guidelines.

¹⁴ Para. 63 of the Draft Guidelines.

time of joining. This will necessarily mean that there is a price premium changing over time, to reflect changing risks.

Regulators and operators will therefore need to think carefully about how to price to reflect changing risk and what an allowable price differential might be for those that join the agreement later on, when risks might be lower relative to those present at the time of the initial investment. The cost reflective price (i.e. a price that is consistent with the making of normal returns) for a share of the project should be expected to change over time, and in particular to rise if the specific risks of the project fall over time as uncertainties become resolved. Therefore, the price paid by any latecomer should accurately reflect the risk profile of the project **at that particular point in time, relative to the risk faced by the original co-investors at the time the investment is first made.**

BEREC has provided little guidance on how such price differentials might be calculated and applied consistently in practice. The main guidance on this is provided at paragraphs 86 and 87:

(86) For the assessment of the financial terms, NRAs could make use in particular of information that forms the basis for the network deployment's business case. For example, information about anticipated costs, expected evolution of demand and revenues, as well as the resulting economic risk associated with the deployment might be of interest to the NRAs and could be evaluated.

(87) If possible, NRAs could also use information gathered from benchmarks of comparable co-investment agreements that are already in place or other agreements between market participants. However, the amount of agreements already in place as well as the comparability between different existing agreements and thus different deployment projects might be very limited. This especially seems relevant for the comparison of projects across different countries.

While the key data points outlined in paragraph 86 may be relevant for some assessment of the risks to different parties at different times, there should be further guidance on how to assess these factors in a clear framework that can be applied consistently across cases and across NRAs.

Oxera considers there to be a clear framework that can be applied in practice or quantifying necessary 'risk premiums' based on the concept of a 'fair bet'. As described below, in our view, the fair bet framework described holds the key to consistent assessment of fair and justifiable price differentials, reflecting different risks for co-investors at different times of joining the co-investment agreement.

2.1 The 'fair bet' framework

Below, we explore how regulators can take appropriate account of the opportunities and risks faced by investors over the lifetime of investments through an approach known as the 'fair bet framework'. We then consider how this approach could be used in assessing compliance with Article 76, and how the terms of joining the co-investment may vary over time to reflect the differing risks facing the investors at the time of investment.

2.1.1 Understanding risk

It is important to distinguish between two concepts of risk that need to be taken into account when assessing the extent to which any (regulated) pricing should allow for a risk premium.

In a regulatory setting, **systematic risk**—risk inherent to the entire market, not just a particular stock or industry—is captured in the asset beta parameter of the capital asset pricing model (CAPM) framework, and feeds into the calculation of the weighted average cost of capital (WACC). Services whose cashflows are more sensitive to macro-economic shocks will have a higher asset beta, leading to a higher WACC. Arguments have been made to suggest that the main sources of systematic risk for VHCN relative to legacy network (higher demand volatility, increased operating leverage and long-term cash flows) would support a higher asset beta and a higher WACC for such services relative to the WACC for legacy services such as copper networks.¹⁵

However, VHCNs are exposed to a number of risks that are not fully reflected in the asset beta, which, if not properly accounted for in the regulatory framework, could sufficiently impede investment and/or result in a regulatory failure to allow investors the opportunity to earn a normal return.

These other risks can be understood to be **non-systematic or idiosyncratic risks** (also sometimes referred to as ‘specific risks’), such as volume take-up, pricing levels, costs, and the like, which create uncertainty on cash flows. Indeed, this second type of risk can be significant for a new network investment. These non-systematic risks faced at the time of the investment should also be compensated for over the investment’s lifetime. This is a further premium over and above the WACC, which is needed to compensate for risks that are not accounted for under the standard CAPM model.

The 2010 NGA Recommendation listed a range of factors that must be taken into account in risk premium analysis including:¹⁶

NRAs should estimate investment risk, inter alia, by taking into account the following factors of uncertainty: (i) uncertainty relating to retail and wholesale demand; (ii) uncertainty relating to the costs of deployment, civil engineering works and managerial execution; (iii) uncertainty relating to technological progress; (iv) uncertainty relating to market dynamics and the evolving competitive situation, such as the degree of infrastructure-based and/or cable competition; and (v) macroeconomic uncertainty.

The first four of the five factors can be considered as non-systematic, highlighting the importance of taking into account these risk factors that are not captured within the asset beta in the WACC calculation.

Of course, these risks are likely to change over time, such that a later investment may be subject to lower risk (if, for example, volume take up and costs are more certain).¹⁷

However it is very important to note that any future changes in the pricing flexibility (e.g. through later price controls or anchor product controls) are likely to aggravate the impact of these idiosyncratic risks by introducing an asymmetry in the distribution of returns and, if not carefully calibrated, prevent investors from earning a fair level of return. This idea is captured by the concept of the fair bet, and can be illustrated with a coin toss game in Box 2.1 below.

¹⁵ For example, see the Brattle Group (2016), ‘Review of approaches to estimate a reasonable rate of return for investments in telecoms networks in regulatory proceedings and options for EU harmonization: A study prepared for the European Commission’.

¹⁶ European Commission (2020), ‘Commission Recommendation of 20 September 2010 on regulated access to Next Generation Access Networks (NGA)’, Annex 1.

¹⁷ This is acknowledged in Article 76 of the EECC and the Draft Guidelines, and price flexibility (in the form of higher prices for later co-investors) may be allowed.

Box 2.1 Coin toss game

Let us play a simple coin toss game:

- you give us €100 (think of this as the cost of investment);
- we then toss a coin. If it lands on heads, we give you €200. If it lands on tails, we give you nothing;
- provided we are using an unbiased coin with a 50:50 chance of landing heads or tails, the expected return from your investment equals €100 ($(€200 \times 0.5) + (€0 \times 0.5)$), which is the same as your initial investment;
- this is therefore a 'fair bet', and provided you were risk neutral, you would take on this game.



Let us play again, only this time if it lands on heads, we determine that €200 is a bit too much of a windfall for you given that you only 'invested' €100, and instead we will limit your gains to €150:

- the expected return from your investment is now €75 ($(€150 \times 0.5) + (€0 \times 0.5)$), which is less than your initial investment;
- this is no longer a 'fair bet' and, if you are risk neutral, you would be well advised not to play this game.



2.1.2 Applying the fair bet principle in to investments in VHCNs

The key insight to be gained from the coin toss example is that, in order to achieve cost recovery on an expected basis, the investor has to be able to retain the upside in the event of a successful outcome (i.e. to keep the £200 rather than be limited to £150 in the example). While the WACC estimated through the CAPM contains an allowance for systematic risk, it does not include any allowance for the specific risks of the type illustrated in the coin toss example. These risks are assumed to be diversified and so investors do not need to be rewarded for bearing them. However, implicit in the CAPM's methodology is an assumption that investors keep the upside and bear the downside of outcomes affected by specific risks. The diversification assumption means that investors are not rewarded for bearing these risks, but for diversification to lead to cost recovery it is vital that upsides are retained as

well as downsides. This means that the fair bet allowance has to be considered separately from, and in addition to, the WACC estimated by the CAPM.

In the context of telecommunications regulation, Ofcom, the UK communications regulator, has defined the fair bet principle as follows: 'An investment is a "fair bet" if, at the time of investment, expected return is equal to the cost of capital.'¹⁸ Hence, 'ensuring that the fair bet is satisfied may entail [...] earning returns above the cost of capital to compensate for the additional downside risks that were faced when the investment was made'.¹⁹

When applying this framework to regulating investments in VHCNs, just like in our simple coin toss game example, the regulator would need to estimate three pieces of information.

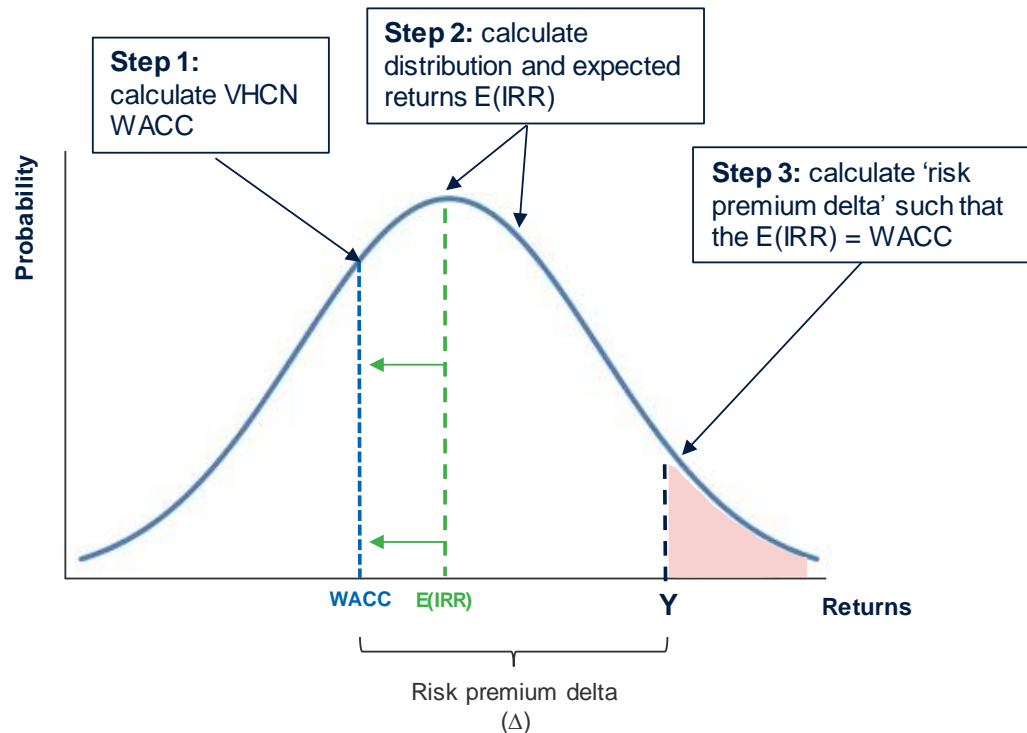
- **The cost of the investment.** In our coin toss game this was €100, whereas in the case of a VHCN investment, this would be the project-specific cost of capital, taking account of the systematic risks of the project.
- **The expected returns of the investment.** In our coin toss game, this was given by the 50% probability for each scenario that resulted in an expected return of €100. In the case of a VHCN investment, this will need to capture the probabilities for the full range of scenarios identified and be based on a robust project-specific financial model covering the life of the project.
- **The distribution of returns of the investment.** In our coin toss game, this was given by the two scenarios, with a return of €0 and €200, respectively. In the case of a VHCN investment, this will need to capture the full range of possible scenarios, and the returns associated with each of these, based on the underlying sources of cash-flow risk (e.g. volumes, prices, costs).

Having estimated these three parameters, it would then be possible to calculate the level of upside return above the WACC (we call this a 'risk premium delta') that would be needed in good scenarios in order to ensure the investment was a fair bet. This is illustrated in Figure 2.1, which summarises the approach in three steps.

¹⁸ Ofcom (2011), 'Proposals for WBA charge control', 20 January, p. 181.

¹⁹ Ofcom (2017), 'Wholesale local access market review', vol. 1, para. 8.31.

Figure 2.1 Approach to estimating the risk premium for investments in risky VHCN assets



Source: Oxera.

A price control that caps returns at 'Y' would equate the expected return after the cap and the WACC. Returns above 'Y' would be consistent with the fair bet, but may also be considered excessive. Capping returns anywhere in the area between WACC and 'Y' would be inconsistent with the fair bet.

2.2 Relevance to Article 76

In the context of Article 76, there are two main places in which an assessment of risk is relevant.

- On the one hand, there is the level of risk that co-investors face at the time of making the investment. Understanding this is essential to be able to estimate the 'risk premium' for investments in next generation networks.
- The other concept relevant for co-investment is relative risk, in particular, between original co-investors and any potential latecomers who want to join the co-investment at a later date.

The fair bet framework outlined above applies directly to the first of these points, by providing a practical framework for assessing the risk premium.

When assessing how risks differ over time (in particular how the risks facing a late co-investor may differ from an early co-investor), the fair bet framework could also be applied.

For example, the regulator would need to be able to model two risk scenarios: one where the investors take all the risk upfront compared to another scenario where some of the co-investment partners enter the project at a later time, when some of the uncertainties giving rise to specific risk may have been resolved.

The two scenarios will result in different risk premium deltas (see Figure 2.1 above), which could then be expressed as a fair price premium delta.

The three key parameters necessary to calculate the risk premium as set out above (the project-specific cost of capital, distribution of returns on investment and the expected returns of the investment) could explicitly be referred to in paragraph 86 of the BEREC Guidelines to expand on what information and why NRAs might need to collect data on the co-investor's business case including: 'anticipated costs, expected evolution of demand and revenues, as well as the resulting economic risk'.

2.2.1 Application to the terms of the co-investment offer

While the fair bet framework provides a clear (and proven) framework for estimated risk premia, there remains a question about how this can practically be built into the terms of the co-investment to ensure that despite different risk premiums, 'other co-investors can compete effectively and sustainably in the long term, especially with the SMP operator'.²⁰

Interested parties have made a number of suggestions as to how, in general, different approaches could be taken to including an uplift on the 'price' to be paid for joining the co-investment late.

For example, some of the options put forward include: (a) payment of a 'risk premium' in the access price of access; (b) the purchase of a 'co-investment option' giving the right to join the scheme later; and (c) the commitment to buy a minimum capacity later.²¹

However, there are a number of pros and cons to each of these options that should be considered in more detail. For example, it is clear that any inclusion of the risk premium in the access price per line, the latecomers' operating costs would be higher than original investors, putting them at a significant disadvantage (akin to a margin squeeze). To the extent that this would mean an efficient undertaking cannot compete effectively and sustainably when accepting the proposed terms of the co-investment offer, these terms are unlikely to be considered being fair, reasonable and non-discriminatory and would not comply with the conditions of Article 76 (1)(b)(i).

The other options may be better suited to particular forms of co-investment agreement, and 'co-investment options' might be preferable where this can be implemented effectively. This would allow for the access price per line to remain constant for all parties part of the co-investment (whether they are one of the original investors or joined later) to ensure effective competition on non-discriminatory terms. However, any price differential to reflect differing risk could be reflected in a fixed lump sum that any late co-investor will pay (in order to access the full range of services). In other words, the risk premium can be implemented separately from the access price, with the lump sum component calibrated to take account of how risk changes over time (as well as any other commitments such as a minimum capacity commitment that the latecomer is willing to make).

²⁰ Para. 61 of the Draft Guidelines.

²¹ For example, see Centre on Regulation in Europe (CERRE) (2020), 'Implementing co-investment and network sharing', May.

Box 2.2 below provides a worked example of how this could work in practice. The example builds on the same principles of risk analysis that underpin the fair bet framework outlined above.

Box 2.2 How to reflect diminishing risk over time for new co-investors

Take the case of a model in which the co-investors hold shares in a joint venture (JV), and the JV builds and owns the new infrastructure and offers wholesale access services on an exclusive basis to co-investors on the same terms as each other (i.e. a set access price per line).

Assume the following.

- The investment project costs €1bn, which is financed by the original co-investors.
- At the outset, the projected NPV of positive cash flows is €2bn if successful and zero in the case of failure. The risk of the project success or failure is 50%; hence, the expected NPV of positive cashflows is €1bn, covering investment costs.
- If the project were certain to be successful, an access price per line of €100 would be needed to generate an NPV of positive cash flows of €1bn; however, due to the risk of failure, the access price must be €200 over the lifetime of the project.¹
- By the time a new co-investor wishes to participate in the project, the risk of the project failing has reduced from 50% to 25%, and they wish to access 10% of the project's capacity.

How should the price of participation be set for this new co-investor?

In principle, if shares in the project were traded, the fair price to be paid by future co-investors would be the market price of the shares. This would capture the changes in risk over time, in a similar way to how the prices of traded equities move to reflect changes in risks. The market price of a share is equal to the (discounted) expected values of future cash flows, and is therefore affected by changes in the probabilities of future outcomes, as these affect the expected value of the cash flows.

At the outset of the project, a 10% share in the JV would be worth €100m (10% of the expected NPV of cashflows of €1bn). As assumed above, by the time the new co-investor wishes to join the risk of project failure has reduced from 50% to 25%, meaning that future expected cash flows are now €1.5bn. A 10% share would now be worth €150m, and this would be the contribution that the new co-investor would need to make in order to join the JV.

An access price of €200 per line must then be paid by the new co-investor for each broadband line that it sells in the downstream market. This is the same price paid by the original co-investors. In other words, in this example, the risk premium is entirely reflected in the price of the 10% share, rather than in the access price.

Therefore, as an investor, the late co-investor has a 10% share of the project-including 10% of all revenues from customers in the downstream market, no matter who the supplier is. Once invested, it can also participate

in the downstream market-and to do so it has to purchase inputs from the JV at £200 per line. The benefit that it gets from being an investor is that it can have access to the full range of services (whereas non co-investors may not get any access, or only access to an entry level product).²

Note: ¹ This is to ensure that the project generates an NVP of €2bn if successful, which equates to an expected NPV of €1bn, given the 50% chance of success. ² As would be the case under the conditions of Article 76, para. 1, point (d) of the EECC.

Source: Oxera.

While we recognise that this example is for a specific JV model, we consider the principle provides for a flexible approach and we envisage that it could be adapted and used to further develop the idea of ‘co-investment options’ possible under the EECC.

The example builds on the same principles of risk analysis that underpin the fair bet framework described above, which has been shown to work in practice.²²

²² Oxera has applied the fair bet framework in the United Kingdom (for BT/Openreach) and in New Zealand (for Chorus). See Oxera (2017), Does Ofcom’s approach in the WLA market review honour the fair bet principle?, June available [here](#); Oxera (2017), Assessing the anticipated shape and distribution of BT’s FTTC returns, October, available [here](#); Oxera (2019), Compensation for asymmetric type 2 risks: Applying the fair bet principle in the new regulatory framework for fibre in New Zealand, available [here](#); and Oxera (2019), Compensation for systematic risks, available [here](#).

3 Availability of access for access seekers not participating in the co-investment

Article 76, paragraph 1, point (d) states:

[A]ccess seekers not participating in the co-investment can benefit from the outset from the same quality, speed, conditions and end-user reach as were available before the deployment, accompanied by a mechanism of adaptation over time confirmed by the national regulatory authority in light of developments on the related retail markets, that maintains the incentives to participate in the co-investment; such mechanism shall ensure that access seekers have access to the very high capacity elements of the network at a time, and on the basis of transparent and non-discriminatory terms, which reflect appropriately the degrees of risk incurred by the respective co-investors at different stages of the deployment and take into account the competitive situation in retail markets [...].

We interpret this condition as intending to ensure that the ‘new’ network can be used to provide services that emulate those provided over the old network. This could be regarded as an application of the Pareto principle, by which no consumer is made worse off as a result of the introduction of the new network and services.

However, we also consider that the implication of this requirement is to introduce a form of ‘anchor product regulation’ on the new network for an entry-level access service. As with all forms of anchor product regulation, the exact terms (including price) will act as a constraint on the degree of pricing freedom for services provided over the new network (and therefore have an effect on investment incentives).

A particularly important issue in this regard is the interpretation of the need for the emulated service to adapt over time through the ‘mechanism of adaptation’.

If the anchor product evolves such that, over time, it becomes a better service for the same or similar price, the constraint on the network owners’ margins on higher-value services on the new network could be significant. However, if the price of the anchor product is allowed to rise while the functionality falls behind that of the higher-value services, the constraint will be weaker, affording greater pricing flexibility for higher bandwidth services and potential for a greater expected return on investment.

Clarity on the extent to which the price of the anchor product will be constrained, and the degree of ‘adaptation’, are therefore critical in determining the attractiveness of the investment opportunity.

In the Draft Guidelines, BEREC notes that:

[...] [T]he adaptation mechanism has to maintain the incentives to participate in the co-investment, i.e. it has to give the co-investors advantages compared to access seekers (with respect to the access to the new very high capacity network or to elements of the network).²³

And BEREC also sets out that:

[A]ccess to the very high capacity network elements has to be provided to access seekers at a time which appropriately reflects the degree of risk incurred by the co-investors at different stages of the deployment, taking into account the

²³ Para. 131 of the Draft Guidelines.

competitive situation at the retail level. Therefore, different types of adaptation mechanisms are possible depending on the risk incurred and the retail market developments, in particular the competitive situation in retail markets.²⁴

BEREC's Draft Guidelines also confirm that it would be for the co-investment offer to describe the adaptation mechanism that will be applied (with reference to timing and nature of adaptations), subject to scrutiny by the NRA—i.e. this will not be dictated by the NRA, but must be approved by it.²⁵

While BEREC has set out some further guidance on how the terms of access may change over time, particularly in relation to timing, pricing and quality and why some of these elements may be permitted to vary to take into account the degree of risk incurred by the co-investors,²⁶ it is not clear how NRA's should determine whether the exact terms of adaptation would result in a 'fair return' for the co-investors (while also assessing whether it allows efficient access seekers to enter the market and/or remain a relevant competitive force).

For example, while recognising that: 'effective wholesale price levels for access seekers could be higher than for co-investors to reflect the risk that co-investors incur, and to maintain the incentives to participate in the co-investment',²⁷ it also notes how the price differential would effectively be limited by the condition that efficient access seekers should be able to enter the market and/or remain a relevant competitive force.²⁸

We consider that the Guidelines would benefit from providing further clarity that when interpreting the commitments on the 'adaptation', at the very least, the terms need to be consistent with allowing investors to earn a fair return on their investment that should be the standard for SMP regulation of standalone networks. That is, if the anchor is set in such a way that would provide additional or changing constraints on pricing flexibility, this may aggravate the impact of the idiosyncratic risks associated with the investment by introducing an asymmetry in the distribution of returns and, if not carefully calibrated, prevent investors from earning a fair level of return (against the principles of fair bet framework described above).

Furthermore, if a regulator wished to encourage co-investment models, it would need to specify up front the conditions under which anchor product regulation could be applied in a more relaxed way to a co-investment project than to a stand-alone investment. For example, this could be linked to demonstrating that there would be superior outcomes for consumers under a co-investment model, if that model were effective in accelerating or expanding the reach of a VHCN investment. This would be similar to an efficiency argument to support the case for cooperative agreements under Article 101 TFEU.

In summary, if the aim of Article 76 is to unlock additional investment by allowing or even favouring co-investment, at the very minimum the regulatory requirements on access and anchor products should not reduce the prospective returns from a co-investment project compared with a stand-alone project. In any case, it is imperative that the principles of the fair bet are not undermined by regulatory requirements.

²⁴ Para. 136 of the Draft Guidelines.

²⁵ Para. 145 of the Draft Guidelines.

²⁶ Paras 138–40 of the Draft Guidelines.

²⁷ Para. 139 of the Draft Guidelines.

²⁸ Para. 139 of the Draft Guidelines.

4 Conclusions

In order to encourage co-investment projects in VHCNs, we recommended that BEREC's guidelines should provide further clarity on the following issues:

- that it is permissible to adjust pricing over time in a way that has the effect of closing off arbitrage opportunities by allowing original co-investors to reflect the higher risk they are bearing compared with late joiners, and that such pricing should be in line with the principles of the fair bet;
- that the required adaptation over time of the emulated/anchor service would be based on a consideration of impacts on prospective returns, with a clear intention that the adaptation should not undermine the fair bet;
- whether regulation of the anchor product would be 'lighter touch' in the case of a co-investment model, and if so, in what way;
- how to design a long-term regulatory framework that is committed to allowing fair returns over the lifetime of the asset, and possibly higher returns relative to a stand-alone investment, where this can be justified on the basis of superior outcomes for consumers.

In reviewing each of these points, a key recommendation is that risk analysis needs to become a much more central tool in the regulatory armoury. It is very important to investment decisions and it will also be key to implement many of the regulatory provisions in the EECC. The fair bet framework set out in our response provides a relevant tool for assessing and quantifying risk and may be helpful for NRAs when assessing the terms of any co-investment and compliance with Article 76.

Furthermore, we note that the concept of the fair bet is also very relevant when considering how projects might be regulated beyond any initial exemption date. In particular, the EECC provides for a co-investment commitment to be in place for a minimum of seven years.²⁹ However, there is no clarity on the maximum duration of the exemption from regulatory obligations. For example, if regulatory exemptions automatically expire after seven years, this can have a significantly negative effect on the returns of the investment. It is therefore important for the regulator to give a clear indication of how the project might be regulated beyond the exemption date to allow investors to assess the expected returns of their investment with confidence.³⁰

A fair bet should be available to all investors of risky projects—regardless of whether the investment is made as part of a co-investment or a stand-alone investment. Therefore, if the intention of Article 76 is to make the terms for co-investment projects more favourable than for stand-alone investment, one way of achieving this would be to commit to less restrictive future price controls under a co-investment model. This might include a 'no margin squeeze' approach (rather than reverting to formal ex ante cost-based regulation). Since such an approach would have the potential to allow returns above those

²⁹ This is specified in Article 79, which is the Commitments procedure under which a co-investment scheme compliant with Article 76 can be accepted by an NRA.

³⁰ It is important for the fair bet framework that the assessment of returns is conducted over the lifetime of a project. For very high-capacity networks, this will require time horizons of 20+ years. While it may not be possible for NRAs to make detailed regulatory decisions that last this long, it will be crucial for investor confidence that BEREC provides a framework that NRAs can adopt that explains how the fair bet principle can be honoured over this timeframe. This should include a full risk analysis of the business case, to be undertaken upfront (before the investment takes place).

necessary to satisfy the fair bet, it would make the co-investment model more attractive relative to the stand-alone investment model.

Oxera would welcome further discussions with BEREC on any of the comments made in this response, to help facilitate the finalisation of the Guidelines.
