Body of European Regulators for Electronic Communications

BEREC

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BEREC views on Article 74 of the draft Code
Co-investment and "very high-capacity (VHC) networks"

The Commission's proposals

The Commission is seeking to encourage co-investment as a means of mitigating high risks and high costs of network rollout, by offering a potential route to unregulated network expansions where co-investment offers meet certain broad criteria. Article 74 prevents NRAs from imposing SMP remedies in relation to the new network elements in such circumstances.

BEREC agrees that co-investment could play an important role in the pursuit of high-speed connectivity. Different forms of co-investment have been successfully used in three EU Member States (France, Spain and Portugal) as well as in Switzerland. So we are sceptical of the need to include a specific provision enabling co-investment (given the absence of obstacles to this business model), and indeed of the Commission's apparent preference for one business model over others.

Moreover, the proposed criteria for what would qualify as co-investment for regulatory forbearance are too weak to ensure a competitive environment, and offer a wide scope for tactical gaming by any operator investing in NGA or VHC network rollout, including the incumbent (e.g. co-investment offers issued only to avoid regulation, and not taken up). This is particularly concerning given that there is no contingency planning (i.e. clarity on NRAs' ability to regulate) where the co-investment results in a continued or new monopoly.

The risk is that co-investment does not ensure sufficient competition in the provision of services to consumers in the geography covered by the new network, reinforcing or extending the market power of SMP operators, potentially allowing the co-investors to foreclose the market. This, in turn, would impact on the virtuous cycle of competition- and demand-driven investment, undermining the Commission's ultimate goal of increasing high-speed connectivity.

The draft ITRE Report

The draft ITRE Report introduces additional areas of concern – it introduces substantial regulatory uncertainty by anchoring legal provisions to a vague and aspirational definition of "VHC" networks, and seeks to carve out an exceptional regulatory framework for such networks:

- The draft ITRE report proposes to limit the application of Article 74 to "VHC" networks, and proposes to move Article 74 into a separate chapter dedicated to such networks, ostensibly separate to the SMP framework (AM135, 139). BEREC does not see any merit in distinguishing between regulatory approaches based on the speed of the network in question, which would seriously undermine the principle of technology neutrality.

- This concern is exacerbated by the draft ITRE report's proposal for a new and vague definition of VHC networks (defined as providing "sufficient capacity to allow

unconstrained use of the network in terms of bandwidth, resilience, error-related parameters, and latency and its variation") (AM136). This vagueness is not mitigated by the proposal that BEREC should issue guidelines on how a network might "meet demand for unconstrained use by all categories of users". There is no such thing as unconstrained capacity, and while networks can be over-engineered to exceed any expected demand, the ITRE proposals would incentivise inefficient investment through the promise of regulatory forbearance.

Option 1

Article 74 is not necessary in order to enable co-investments to take place. Indeed, there is nothing in the current Framework which prevents co-investments from taking place – and there have been successful commercial co-investments in several European countries, as noted above. Where it makes commercial sense, they will happen (assuming there are no other, non-sectoral regulatory obstacles).[1] BEREC would be concerned about the introduction of provisions intended to "incentivise" co-investment, If the incentives are at the expense of competition.

NRAs already take into account co-investments and are required to take a prospective view of market developments, when carrying out their market analysis. NRAs are also already required to reflect the risk of investments when setting any access or price regulation.[2] Furthermore, NRAs are required under Article 3 of the draft Code to impose only such SMP remedies as are necessary and proportionate for achieving the objectives set out in this Article, including the promotion of very high capacity data connectivity, as well as the promotion of efficient investment in new and enhanced infrastructures that takes account of the risk of investors under cooperative arrangements. **As NRAs must already take into account the existence of sustainable co-investment schemes in their market analysis and in assessing the proportionality of remedies, Article 74 serves no practical purpose in positively encouraging co-investment as a means of mitigating the high risks and high costs of network rollout.**

It is also worth bearing in mind that co-investment schemes will not necessarily reduce the complexity and regulatory burden for NRAs or the undertakings concerned. The implementation of Article 74 would require highly detailed specifications for a large number of aspects of the co-investment agreement between the contracting parties, together with clear and precise rules for co-investors who might potentially join the scheme at a later date. These rules, in turn, would need to allow for differentiating between co-investors, depending on a variety of factors such as the value and timing of their commitment.

[1] In some Member States, co-investment schemes have even developed as result of a regulatory obligation, demonstrating that regulation can be an enabler for, rather than an obstacle to, co-investment.

[2] Indeed, this is described in Recital 173 of the draft Code: "NRAs should, when imposing obligations for access to new and enhanced infrastructures, ensure that access conditions reflect the circumstances underlying the investment decision, taking into account, *inter alia*, the roll-out costs, the expected rate of take up of the new products and services and the expected retail price levels… " as well as Recital 174: "Mandating access to network infrastructure can be justified as a means of increasing competition, but NRAs need to balance the rights of an infrastructure owner to exploit its infrastructure for its own benefit, and the rights of other service providers to access facilities that are essential for the provision of competing services." Regarding access obligations, cf. Article 71(2)(c) and (d).

BEREC suggested amendments under Option 1

Given the risks of "automatic" and broad regulatory forbearance, as explained above, together with the risks posed to regulatory certainty, **we would therefore recommend that Article 74 be deleted. This would have no impact on the existing permissibility of co-investment schemes under the Framework, or on the development of this business model going forward.**

Option 2

While there is no regulatory obstacle to co-investment, we recognise that there might nonetheless be a legitimate desire to explicitly signal "openness" to this particular business model. If Article 74 is to be retained, then it would be necessary to ensure that the Code contains appropriate guarantees to enable NRAs to prevent the creation of new monopolies, and to continue to promote effective competition (which the Commission agrees is the key driver for investment). We would therefore seek amendments to address the following issues:

- NRAs should be *empowered* to forbear, rather than being *required* to forbear ("may" vs "shall"). This is consistent with Recitals 173 and 174 (see footnote), and indeed with the SMP framework more broadly. To prohibit NRAs from regulating new network elements where it would be reasonable and proportionate to do so in light of competition problems identified and the objectives of the Code, would represent and unwarranted limitation of NRAs' ability to fulfil their functions. This is not to say NRAs should have a "carte blanche" to regulate. Indeed, their exercise of regulatory discretion in the case of co-investment (and the deployment of new network elements) would remain subject to the regulatory principles and disciplines/processes of the Framework (and retained in the draft Code).

- Greater clarity would be needed on what is intended to be covered by the term "new network elements" (in respect of which the regulatory forbearance would apply). As things stand, this could be interpreted as anything from new ducts to network upgrades (including fibre). Is "new" the same as "future" as in "not yet built"? Or does it refer to network elements that are existing but, e.g., less than five years old (as would undoubtedly be argued by operators)? And for how long would they remain "new"?

- It should not be enough for there to be a qualifying offer – regulatory treatment should depend on whether the offer is taken up.

- "Co-investment" in the context of this article could mean anything from opening up ducts and offering co-location to actually co-owning active equipment, and these different scenarios can generate very different competitive outcomes. The outcomes could depend on a number of factors including the number of co-investors (where a low number could make the scheme more vulnerable to collusive behaviour), population density, parallel versus complementary roll-out, and whether access restrictions are included in the contract. Co-investment could mean that two operators co-own equipment and compete with each other, or it could also mean that the SMP operator offers anyone the ability to install their own equipment on transparent and reasonable terms. If there is no economic case for more than one operator, the incumbent (or those involved in/planning the co-

investment) could claim that any new network elements which they themselves installed should nonetheless be exempt from regulation, which would only cement the bottleneck problems in that area.

- Regulatory treatment should also depend on who takes the offer up. For instance, in order to prevent the investors from "gaming" (abusing) the system (e.g. by the lead investor bringing on board a financial investor who "co-invests" but otherwise leaves the lead investor to run the new network as a monopoly), the criteria for qualifying co-investments should be strengthened to include reference to the following (proxies to an SMP assessment):

    - the relative control of the investing parties in the new network (so that they effectively constrain each other). For instance, preferential access would not necessarily constrain the lead investor in the same way as an indefeasible right of use (IRU) might.

    - whether there is a reasonably likely prospect that the co-investor would compete (or, if intending to be a wholesale-only company, successfully promote competition) with the incumbent investor in the same retail market (to mitigate the risk of competition concerns such as cartel behaviour or insufficient competitive constraint).

- By making the forbearance discretionary, it should be made explicit that NRAs may intervene after an initial (transitional) period of no regulation. In the longer term, it would be problematic if competition problems were allowed to remain unchecked, resulting in practices detrimental to end-users such as over-pricing, lack of innovation and investment.

- Finally, while the Commission's proposal focuses on operators with the capacity/incentive to co-invest, there will be other operators who will legitimately choose not to engage in co-investment, for example because they operate in niche markets (such as a business market), or because they are new entrants. The Commission's proposals could have the effect of foreclosing the market to those who cannot climb the last rung of the ladder, as the only guarantee they would have would be to "benefit from the same quality, speed, conditions and end-user reach as was available before the deployment…" (Article 74(1)(c)), rather than access to the new network (even at prices reflecting the fact that they had not taken on the costs or risks of the investment). This would amount to a diluted form of wholesale access as compared to what would be available to the co-investors, thus further reducing the competitive constraints from these operators on the retail market. In the longer run, this could significantly restrict competition on the market, either when the legacy network ceased to provide a competitive constraint, or if the SMP operator were to decide to shut down the legacy network (at which point the safeguards set out in Article 78(2) (*Migration from legacy infrastructure*) would not apply since the SMP operator would not have been subject to any form of obligation).

For these reasons, the NRA should be able to ensure that third-party operators can obtain access to the infrastructure under fair, reasonable and non-discriminatory terms (taking appropriate account of the risks incurred by the co-investors).

BEREC suggested amendments under Option 2

Article 74

1. ***When*** ~~A~~ ***a*** national regulatory authority ***is considering the appropriateness of imposing*** ~~shall not impose~~ obligations ~~as regards~~ ***in respect of*** new network elements that ~~are~~ ***form*** part of the relevant market on which it intends to impose or maintain obligations in accordance with Articles 66 and Articles 67 to 72 and ~~that~~ ***where*** the operator designated as ***having*** significant market power on that relevant market has deployed or is planning to deploy ***new network elements***, ***it shall take into account, inter alia,*** ~~if~~ the following ~~cumulative conditions are met~~ ***factors***:

   (a) ***the extent to which the deployment of the new network elements is to be funded through an existing co-investment agreement the terms of which were negotiated through*** ~~… the deployment of the new network elements is open to co-investment offers according to~~ a transparent process and on terms which favour sustainable competition in the long term including inter alia fair, reasonable and non-discriminatory terms offered to potential co-investors; flexibility in terms of the value and timing of the commitment provided by each co-investor; possibility to increase such commitment in the future; reciprocal rights awarded by the co-investors after the deployment of the co-invested infrastructure;

   (ab) the extent to which the co-investors to the SMP operator are or intend to be service providers in the relevant retail market, and have a reasonable prospect of competing effectively with the SMP operator or, where the co-investors to the SMP operator intend to be wholesale-only providers, whether they are reasonably likely to host service providers that have a reasonable prospect of competing effectively with the SMP operator.

   (b) ***the extent to which*** the deployment of the new network elements contributes significantly to the deployment of very high capacity networks;

   (c) ***the extent to which*** access seekers not participating in the co-investment can benefit from ***fair, reasonable and non-discriminatory access conditions, taking appropriate account of the risk incurred by the co-investors*** ~~the same quality, speed, conditions and end-user reach as was available before the deployment~~, either through commercial agreements based on fair and reasonable terms or by means of regulated access maintained or adapted by the national regulatory authority;

   If an NRA determines that one or more such factors sufficiently addresses the nature of the competition problems analysed in relation to such network elements, it shall not be required to impose any of the abovementioned obligations on the SMP operator.

BEREC shall, after consulting stakeholders and in close cooperation with the Commission, issue guidelines on the criteria for considering co-investment agreements for the purposes of this Article. When assessing co-investment ***agreements*** ~~offers and processes~~ referred to in point (a) of the first subparagraph, national regulatory authorities shall ***take utmost account of BEREC guidelines and shall*** ensure that ***such co-investment agreements are open to any undertaking over the lifetime of the network built under a co-investment agreement on a non-discriminatory basis*** ~~that those offers and processes comply with the criteria set out in Annex IV~~.

For the purposes of this Article, references to new network elements are references only to such elements of an electronic communications network, or of its associated facilities, where the physical transmission medium of the broadband service is newly provided at least up to the building and its deployment is linked to significant specific investment risks. This shall not include network elements deployed before the entry into force of an NRA's most recent decisions under Article 66, or upgrades to such elements by raising them to higher standards or by adding or replacing components.

Justification

The proposed amendments provide that NRAs should have the discretion, not the obligation, to forbear from regulation, and, by implication, that they are able to intervene ex ante (following a market review) where justified. In exercising their discretion, they should take into account factors whose satisfaction should mean that NRAs would not have a competition concern. As noted above, in exercising their discretion, NRAs would remain subject to the regulatory principles and disciplines/processes of the Framework, retained in the draft Code.

The proposed amendments include the introduction of a new paragraph (ab) which is intended to ensure there is a real co-investment (not just an offer) and that the co-investment partners will have a realistic prospect of ensuring competition, addressing the risk of foreclosure by the co-investors. BEREC is also proposing the deletion of Annex IV (while incorporating some of its relevant components into the operative provision) and its replacement by a reference to BEREC guidelines. The amendments also include new language clarifying the meaning of "new network elements".