

BEREC views on Article 77 of the draft Code Vertically separate undertakings

In Article 77 of the draft Code, the European Commission has proposed changes to the regulatory treatment of vertically separate undertakings, exempting them from *ex ante* regulation other than access obligations with a view to increasing investments in and roll-out of very high-capacity (VHC) networks (leaving NRAs able to intervene only on an *ex post* basis).

However, as drafted, the provision would not only affect new investments and roll-out, but also existing high-capacity networks in many Member States.

By preventing NRAs from intervening *ex ante* to regulate the price of access, or impose non-discrimination or transparency obligations, the proposal risks preventing NRAs from safeguarding and promoting competition. This includes the risk of inefficient pricing on wholesale products, which would in turn be transferred onto retail markets, leading to an increase in consumer prices, reducing demand and ultimately slowing down the take-up of digital services.

While the challenges of regulating vertically separate undertakings might not affect all Member States today, the prevalence of networks with a significant local footprint, active on the wholesale level, is likely to increase across Europe over time.

Both the Commission's proposals and the ITRE draft report seems to assume that regulatory forbearance will unleash new investment, and that the curtailing of competition for these purposes is a price worth paying. BEREC disagrees, bearing in mind that evidence shows that competition is a key driver of investment and, ultimately, the benefit of European consumers. The ITRE draft report only hastens the risks of these proposals, as it proposes to expand the definition of vertically separate undertakings qualifying for this regulatory regime to include those which are merely "functionally" separated from their retail arms (AM 28 - to recital 190).

For these reasons, and as further explained below, BEREC would urge the legislators to delete Article 77 altogether.

Article 77 blurs the line between *ex ante* and *ex post* regulation

Traditionally, *ex ante* regulation is built on the concept of a *potential* abuse of market power. If a market player is considered by the NRA to have significant market power (SMP), it is because that market player is *able* to abuse its market power; it is not constrained by customers or competitors. Any *actual* abuse of market power (which is not considered a breach of regulation) falls within the realm of general competition law. It is dealt with *ex post* and falls within the jurisdiction of competition authorities and competition courts. Article 77, as worded, partially turns the regulation tables from *ex ante* to *ex post*. For instance, Article 77(4) requires proof of actual damage to end-users as a precondition for price regulation in accordance with Article 72 (rather than potential damage, which is the essence of *ex ante*

regulation). In this case, *actual* abuse of market power and the consequential end-user harm must be proved, much like under regular competition law.

The Commission's proposal therefore assumes that *ex post* intervention would be sufficient. However, it does not provide any evidence to support this assumption and in fact the main factors which create the risk of abuse of market power and non-competitive market dynamics do not depend on the vertical integration or separation of an undertaking. As is further explained below, while wholesale-only operators do by definition have incentives to grant access to service providers, it is by no means certain that this business model would lead to significantly lower retail prices, consumer choice and/or higher quality of services, since the upstream bottleneck problem would remain unaddressed and since vertical separation brings with it other potential inefficiencies¹.

Regulatory uncertainty and reduced investment incentives

The Commission's proposal would create significant practical problems and significantly increase regulatory uncertainty, ultimately to the detriment of the achievement of the shared connectivity objectives.

In Member States with numerous relevant markets, each with similar potential competition problems (such as monopoly pricing), providing regulatory certainty and securing investment incentives require the possibility of imposing the necessary regulation, especially price regulation where appropriate, in a transparent and predictable manner. A system where the imposition of price regulation under Article 72 requires comprehensive investigation in every single instance, and where the regulatory process is lengthy, will result in differences in the application of price regulation on different national markets that might be similar and actually require similar regulation. Such a system would not create a stable and predictable investment climate.

In some Member States there are potentially hundreds of relevant sub-national geographic markets, most or all of which have SMP operators. It would be a daunting task for any NRA to gather the information needed (actual offers from network owners) and for national service providers operating in many sub-national markets to provide the information, in order to demonstrate actual competition problems and end-user harm. While the information is gathered and analysed, the markets would potentially be under-regulated for a long time. This system of de-regulation (as a result of the implementation of the Article 77 presumption against regulation) and re-regulation (once the NRA is able to demonstrate end-user harm), and the potential for different regulatory responses in seemingly similar markets, would create substantial regulatory uncertainty, which is an impediment to investment and ultimately to the detriment of end-users.

The imposition, from the start, of proportionate remedies which take into account the competitive environment in which wholesale-only players operate, is far more favorable to investment (from all types of market players) than the unstable regulatory environment where

¹ Notably foregone economies of scope and double marginalisation. Double Marginalisation occurs in vertically related markets where upstream and downstream firms have their respective market powers and hence apply markups in their prices. Due to these markups a deadweight loss is induced at each vertical level, and the resulting sum of deadweight losses is larger than the single deadweight loss that would be induced by a vertically integrated firm with a comparable degree of market power. In a sense, double marginalisation is an externality between producers that makes everyone (producers and consumers) worse off.

the NRA might need to intervene in a "heavy-handed" way after collecting evidence of actual consumer harm.

End-users pay for excessive pricing on the wholesale market

Finally, there is the question of how exactly NRAs can "prove" that the conditions in Article 77(4) are met. The suspension of *ex ante* regulation suggests that the Commission believes that general competition law could deal with monopoly pricing, in the absence of regulation. But given that a market, in order to be regulated, must already have passed the third criteria (namely that competition law would not be sufficient to address the competition issue identified), this seems highly unlikely.

Article 77, as it stands, is therefore inconsistent with the current Framework's long-term goal of protecting end-users as it restricts NRAs from imposing remedies other than access to civil engineering and network facilities on "wholesale-only" SMP operators. In practice, the imposition of access to civil engineering and specific network facilities without a definition (through regulation) of a fair and reasonable wholesale price, could lead to reduced demand for such access.

ANNEX – proposed amendments

BEREC would recommend the deletion of Article 77.

Justification

The proposed Article 77 aims to promote the development of undertakings targeting wholesale markets for VHC networks. The potential effects of any such incentivisation must be considered against the potential harm it would cause to competition and consequently to end-users. As competition is a key driver for investment, and given the risks posed by this proposal to competition, the net effect of the proposed Article 77 is likely to be negative, in a number of existing market situations across Europe.