BEREC consultation on the competitive effects of NGA co-investments
- Telefónica response -

Executive Summary

Telefónica welcomes this consultation on the competitive effects of NGA co-investment. Co-investment, in its many different flavours, may play a positive role in the deployment of NGAs provided that it is market driven and in the economic interest of the parties involved.

For co-investment to play a meaningful role, the regulatory framework should support investments of the various market parties. We note that the access regulation may undermine the incentives and the rationale for operators to co-invest, holding back the benefits for investment and competition that co-investment may bring about. Rather than approaching co-investment as a threat to competition regulators should take a neutral stance.

In the same way co-investment should not be pushed by regulation. It is critically important at this stage of market development that regulators resist attempts to impose the market structure. We are concerned that the competition standard against which regulators may judge that competition is effective and SMP designation not warranted might not be compatible with a sustainable market outcome for NGAs, thus leading to the perpetuation of market regulation and to the slowing down of investment in Europe.

We suggest that market players willing to invest and develop the market should seek an industry model that ensures a self-sustainable competitive scenario and regulators provide the room necessary for this to happen. It is important that regulators do not try to force the number of market players, and the arrangements among them, as they should be compatible with investment incentives.

For this reason, we call upon BEREC and policy makers to ensure that the regulatory framework for NGAs restores investment incentives for all players, incumbents or not, as a first step. For example, co-investment will be less likely if operators know that incumbent investments will be regulated sooner or later or if operators believe that by co-investing with the incumbent their investment will become regulated.

We believe that at this stage of development, market-driven co-investment projects would more likely materialise in specific local projects where the interest of a number of operators overlap rather than in complex organisations designed beforehand. In order to capture the local dynamics and specificities and make a proper analysis, regulators should accomplish a geographic segmentation of markets with sufficient granularity. Otherwise the competitive effects of co-investment would be diluted into the broader market, making the whole exercise of identification of relevant criteria made in this consultation document completely futile.

I. General comments

Telefónica welcomes this consultation on the competitive effects of NGA[1] co-investment. We believe that this debate is particularly timely specifically in the light of the objectives that

[1]Although NGA can be interpreted in a broader manner, across this response by the term investment in NGA we mean in general to new investment or investment in new (non-legacy) network elements. Therefore it is generally applicable to FTTH deployments as well as to the fibre part of FTTC. This is because when it comes to the

Europe has set out for superfast broadband availability and take-up, the well-known Digital Agenda objectives of 30/100 Mbps.

Generally speaking we believe that co-investment may play a positive role in the deployment of NGAs provided that it is market driven and in the economic interest of all parties involved, and supported by a regulatory framework that restores the investment incentives for all market players.

However, we note and will argue across this document that access regulation may undermine the incentives and the rationale for operators to co-invest. Indeed, we note that only very few co-investment projects have materialised in Europe so far, covering a very small proportion of total FTTH deployments and concentrated in a very small number of countries. The fact that alternative players in Europe are generally not joining their efforts to challenge incumbents on NGAs should be evidence that something in the existing regulatory framework is inhibiting these types of arrangements.

For this reason, we would like to encourage BEREC and policy makers to discuss co-investment in the framework of the broader issue of investment incentives in NGA in Europe, including some reflection on what may be hindering it.

In this regard, Telefónica believes that part of the problem with the investments in fibre NGAs in Europe is related to structural issues. In addition to the current weakness of demand, which is clear and has been widely discussed, there is also an issue with the expected impacts of regulation on investment returns. And this is equally applicable both for new entrants and incumbents. This is important to consider because equity investors provide 60% of capital used in European telecoms sector and debt provides the remaining 40%[2]. Hence fibre deployments are absolutely dependent upon equity investors' approval.

To illustrate the case, it should be enough having a quick look into the trends in prices and EBITDA in Europe in the last few years. It should be obvious at this stage that declining EBITDA together with increasing CAPEX needs is an equation that is difficult to resolve. The question here is whether regulation has driven these prices and EBITDA below levels that can support investment and sustainable competition, leading to the whole business process to be slowed in Europe.

The answer to this question may be different in different places. Some countries have a long tradition of focusing regulation on market entry. These countries aim for creating the regulatory conditions that support service competition (as opposed to network competition) for the highest possible number of competitors, irrespective of their scale, and at the same time of expecting them to climb the ladder of investment in order to ultimately the objective of infrastructure competition.

Experience is that in general operators have not climbed the investment ladder into the last mile to any great extent and this is because the very conditions that support service competition produce **incentives to delay** these kinds of investments by alternative operators, making

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promotion of investments the differential characteristics of legacy and new investment or new network elements require a different regulatory discussion.

[2]HSBC Global Banking & Markets - How to boost investment in next generation access networks: the impact of regulated prices on investments, 8 February 2012

competition focused on prices and finally leading to a structural problem of declining ARPU and EBITDA.

As a result incumbents in general do not face the kind of competition for which the framework was theoretically designed (cable competition being almost the only exception), and this has led to today's sluggish NGA investment in Europe, declining prices, declining ARPU, declining EBITDA, etc. To conclude, competition that feeds a virtuous investment cycle has unfortunately not developed.

Telefónica is not saying that competition is not important; competition is indeed critically important. What we are saying is that the competition model designed for telecoms in Europe has proved to be inadequate for the attainment of the objectives envisaged in the Digital Agenda so far and has created a structural problem difficult to reverse without policy changes[3].

Suggested way forward

Contrary to legacy networks, which existed at the time of liberalisation, NGAs bring us to a new market scenario in which networks are still to be created in many places, alternative operators do not start from scratch and cable operators, not incumbents, lead NGA coverage in many places within the EU. Therefore, it is necessary to apply the regulatory framework having this reality in mind so that is compatible with and supporting to investment incentives.

For this reason we believe that regulators should not take the hypothesis that the market structure pursued by regulation up to now is optimal and should be preferred going forward. The opportunity exists and the incentives to invest have to be protected. The market structure and number of players that is compatible with investment incentives may be different in different places. Prices and market size strongly influence this number, so flexibility is needed here for the market to operate and find the new equilibrium in terms of structure, prices, number of players, levels of investment and any other competitive outcomes[4]. As said before, seeking low prices/margins and a high number of competitors, as the ones traditionally pursued by the regulatory framework, has proved not to be the kind of market outcomes compatible with the need to make extensive CAPEX investment in NGAs.

For this reason, providing the right incentives for operators to invest or co-invest competitively if they so wish, become crucially important, in particular by:

- Avoiding distortion of make or buy decisions
- Ensuring that all operators have flexibility when setting non-discriminatory wholesale prices.

[3] Reinforcing the view of the need to shift policies in order to promote network investments, latest available data on broadband suggest a direct correlation between broadband household penetration and development of infrastructure based competition: four out of the top-five European countries with highest broadband household penetration are also among the top-five countries with highest cable market share (Analysys Mason's Fixed broadband quarterly metrics January 2012 - data for September 2011)

[4] Which does not necessarily lead to an homogeneous picture across the EU territory reinforcing the importance of recognising a geographically segmented market approach.

It should be noted that this is not a discussion on remedies, which unfortunately has been left outside the scope of the consultation document. This is a discussion on ways to enable investment in all forms including co-investment and make them an attractive option for operators.

In order to spark the investment cycle and put the sector onto a growth track again, we suggest that market players willing to invest and develop the market should seek an industry model that ensures a self-sustainable competitive scenario and regulators provide the room necessary for this to happen. Co-investment as well as commercial wholesale access agreements may play significant roles in this regard.

Role for co-investment

Telefónica believes that co-investment, understood as a voluntary and business-driven agreement among a number of players, may be a sensible way to address network roll-out if and when the interests of a number of competitors overlap. For co-investment to deliver its full potential it has to be accompanied by the right regulatory policy, as described above.

Telefónica believes that market-driven co-investment arrangements may bring about a reduction of entry barriers and therefore enhance the prospects for effective and sustainable facilities-based competition. A good example of how co-investment enhances competition is when a number of network competitors co-invest in shared vertical cabling infrastructures within the buildings. Although this case is in many places subject to symmetrical regulation we believe this is a useful example of benefits for competition brought about by co-investment. Another example may be when operators develop networks in different places and then mutually exchange access to their networks in order to expand both parties coverage to the whole area covered.

Of course co-investment can take many forms, for example the grouping of a number of alternative players to create a shared network (or shared parts of their networks) in order to compete with the incumbent; or the grouping of a number of players including the incumbent to invest in and share some network elements (i.e. passive elements such as dark fibre) over which a number of independent networks can be built; or yet another form could be the exchange of access rights between networks covering different geographic areas, etc.

All of these forms have different implications in terms of market models and can be discussed extensively in the light of local market conditions. The important thing is that the market should be given room to organise in the most efficient way and that co-investment as it is just another form of investment it should not be:

- Hindered by regulation. For example, if operators know that incumbent investments will be regulated, their incentive to co-invest will decrease or if operators believe that by co-investing with the incumbent their investment will become regulated, nor
- Pushed by regulation in any particular way, e.g. as a form of structuring the market.

To make network competition happen, regulation should be careful not to destroy or distort the incentives for network operators to find innovative ways to expand the market. For example, (i) agreements on wholesale solutions in commercial terms with any market player present in the market, irrespectively of whether those players are part of a co-investment or not, including for example mutual exchange of rights to access the networks, (ii) invest alone or jointly with other players, be it the incumbent or not, on the network elements needed to build an alternative platform, etc.

Regulations in this framework should only ensure that this can happen by granting access to legacy network elements needed to the extent that it is technically and economically possible[5]to enable new investments, namely the necessary parts of the civil infrastructure, i.e. pole and ducts, and in case of FTTC deployments, access to legacy parts of the networks, e.g. cabinets, etc.

II. Specific comments regarding the list of criteria suggested in the consultation document

We broadly agree that most of the criteria suggested in the consultation document might have relevance when it comes to an assessment of the competitive effects of NGA co-investment, depending on the local circumstances. In order to capture these local specificities and make a proper analysis, regulators should accomplish a geographic segmentation of markets with sufficient granularity. Otherwise the competitive effects of co-investment would be diluted into the broader market, making this whole exercise of identification of relevant criteria completely futile. We would encourage BEREC to emphasise the need for a strong geographically segmented view as one key element for regulators to consider when it comes to analyse competition in the relevant markets.

Telefónica believes that market-driven co-investment may enhance the prospects for facilities-based competition in Europe. For this reason, rather than approaching co-investment as a threat to competition – as it is apparent across the consultation document - regulators should take a more neutral stance to avoid the unfortunate outcome of co-investment being hindered by regulation. In particular, we are concerned by regulators taking unrealistic views of what competition should look like to be considered effective and setting the standard against which judge the level of competition required to remove SMP assessment.

As we have argued across this document, NGAs bring us to a different scenario that requires regulators to step back and resist attempts to engineer what competition should look like. It is important that regulation does not destroy the incentives for operators to cooperate competitively when their interest overlap.

We also note that the document focuses on the impact of NGA co-investment on SMP determination in market 4. It is presumed that the incumbent takes part in the co-investment vehicle in one way or another. Nothing is said, however about the SMP assessment of the incumbent if a number of alternative players were to co-invest in an alternative network without the participation of the incumbent, resulting in one or more additional competing networks. We are concerned of this type of unidirectional analysis and hope that this crucial missing part will be included in the new version of the Report, if only for the sake of completeness and balance.

We agree that the independence of networks is one of the key characteristics to be preserved in order to achieve a competitive environment, co-invested or not, fully or in part. When it comes to the concerns expressed in the consultation document about potential collusive behaviour raised in a co-investment scenario, specifically in a market with a small number of network

[5] We note that deployment of certain techniques to enhance network capabilities over existing legacy networks (for example vectoring) may impose some technical limitations to the broad concept of access that might need to be taken into consideration.

players, we believe that regulators have sufficient means to deal with these situations should they materialise.

Regulators should avoid adding ex-ante barriers to co-investment. An example of such a barrier is related to the compensation mechanism. We agree this may be an important element to be considered in an ex-post case of collusive behaviour by network owners but regulators should not take a position on this point beforehand because it that would damage the options for market players to reach agreements.

We also agree, and indeed welcome the conclusion made in the document that both multifibre or monofibre deployments may be compatible with competitive outcomes recognising that both options have pros and cons and that in practice the selection of one or the other depends on local conditions . This is a useful counterpoint to the unjustified importance assigned to multifibre by the European Commission in its Recommendation on Access to NGAs. This said, we remain concerned again of statements referring to multifibre as "more favourable to competition" since taking together capex, opex and churn in the long run it is not obvious that multifibre would be the most efficient solution.

We are concerned, also, with the suggestion in the consultation document (e.g. page 56) that *"…in case that the NGA deployment is not sufficient to ensure effective competition, asymmetric forms of regulation of access to infrastructures will continue to be necessary…"* in connection with the suggestion that two independent networks would not be enough to be considered effective competition. We have argued extensively in this document that by placing asymmetric forms of regulation (whatever it would mean) the regulator would give the wrong signals to potential co-investors that they should better wait and see, or that their investments will become regulated if and when they associate with an incumbent. This should be avoided at all costs.

This is a fundamental and structural problem of the current regulatory framework and efforts by policy makers should be aimed at solving this particular issue. Telefónica expects that some of the ideas contributed in this paper may help to address the fundamental issues at stake, encourage regulators to put co-investment in the right policy context related to investment in addition to competition and remain, as cannot be other way, willing to contribute with further thoughts on specific solutions going forward.