



ERG (08) 38 rev2

**IRG/ERG Response to the Draft Recommendation on the regulated access to Next Generation Access Networks (NGA) of 18<sup>th</sup> September 2008**

*October 2008*

**General remarks**

The question of appropriate regulatory treatment of Next Generation Access Networks is one that is attracting considerable public and political interest at present, and the ERG therefore welcomes the initiation of a debate about the appropriate regulatory treatment of NGAs.

We welcome the Commission's decision to take on board some of our comments that we have provided upon request of the Commission on an earlier version of the draft recommendation. Nevertheless, we would like to express our regret that a significant number of our suggestions have not been taken into account in the final text of the draft recommendation, e.g. we consider that the part on specific pricing principles remains overly prescriptive and oppose the generally excessively prescriptive nature of the recommendation (e.g. when requiring NRAs to impose the development of a reference offer in all cases).

Having said this, the reality is that, across the EU, deployment of NGA is generally at a very early stage. Also, NGA roll-out strategies necessarily show a considerable diversity between countries due to different local conditions as the ERG pointed out in its NGA CP/Opinion in 2007 and no clear view of the business perspectives has yet emerged among market players. With considerable uncertainty as to the technology choices of operators, the speed and geographic extent of roll-out, the pricing and packaging of offers, and the levels of consumer demand for NGA-delivered services, it would be premature – and could in fact be dangerous – to attempt to be too definitive at this stage to try to identify very tightly harmonised regulatory best practice. From our point of view, the current Commission approach particularly with regard to pricing principles and costing methodologies actually goes against best regulatory practice and consequently runs the risk of damaging the sector. The ERG is concerned that such proposals, if implemented, could impede investment, innovation and competition, which may possibly, in the end, penalize consumers, the industry and European competitiveness.

In our view, as a basis for a consistent and coordinated regulatory approach the recommendation should at this stage focus on the harmonisation of the principles of regulation rather than being overly prescriptive regarding the implementation of remedies such as pricing of ducts. This principle-led approach would be valuable to the extent that it:

- Confirms that the current Framework is basically fit for purpose to address issues arising from the deployment of NGAs and does not need radical revision;
- Confirms that the regulation of NGAs should continue to promote effective competition rather than the development of new monopolies;
- Notes the importance of regulatory certainty and transparency in creating the appropriate conditions for efficient NGA investment, and provides necessary guidance on how regulatory certainty can be achieved under the Framework; and

- Encourages NRAs to draw from a balanced list of potential remedies attuned to national market specificities, rather than attempt to pre-define preferred market outcomes and remedies at this stage.

At present, the ERG believes that the draft recommendation as it currently stands is too ambitious in the degree of harmonisation of regulatory approach it attempts to promote. Some of the underlying assumptions of the draft recommendation may not hold in all member states, or even across each member state, risking negative impact on these member states or areas where the situation differs. E.g. the deployment of NGAs in rural areas may be negatively impacted by the remedies proposed if NRAs were to follow the Draft Recommendation as it stands and may have adverse effects, i.e. instead of promoting infrastructure competition it may result in higher market concentration. Harmonization of regulated access to NGA should include a larger set of remedies. Each NRA can then apply the most appropriate remedy for the national circumstances.

Specifically, some of the detailed recommendations regarding remedies (e.g. in Art. 5 and 9) may pre-empt the outcome of the market analysis and limit the discretion of NRAs to choose the most appropriate remedies close to zero. This contradicts the principles of the ECNS Regulatory Framework that allows NRAs sufficient flexibility to tailor remedies to the national circumstances in order to promote competition in the best possible way. For example, Articles 4 and 9 refer to the fact that when SMP is found (in Markets 4 or 5) duct access should be mandated and a Reference Offer put in place within 6 months. The recommendations made by the Commission run the risk of preventing NRAs from applying the most effective remedies for national circumstances thereby potentially conflicting with the principle of proportionality. This may also lead to foregoing the benefits that a competitive market brings to consumers and business customers alike.

As recognized by the draft recommendation NGA deployment is clearly not an area for a “one-size-fits-all” approach, rather the opposite is true. The Commission herself notes in Article 3 of the draft Recommendation that there are a number of different scenarios for the roll-out of Next Generation Access (NGA) networks. Given these possible scenarios, and the widely varying national and even local circumstances that apply (and differ) across member states, it is essential that NRAs have the latitude to apply the most appropriate regulatory solution for such circumstances and impose the most appropriate remedies/obligations for the problems encountered or envisaged. ERG therefore wishes to emphasize the need to maintain the flexibility of NRAs as provided for in the ECNS Regulatory Framework.

The Commission also seems sometimes to second-guess the market. It is up to the operators to assess the business case for investment according to commercial viability and not according to “undesirability” as seen by the NRA. Such implicit steering of the market may end in industry wide policy setting. This fails to meet the principles and objectives of economic regulation which should set the conditions to foster competition and incentivise efficient and economically rational decision-making of market players. There is some danger that we revert to a model which favours specific business models and results in ‘picking winners’.

### **Scope of the recommendation**

The draft Recommendation primarily deals with the need to ensure that on one hand, the roll-out of fibre-based NGA is not disincentivised by the imposition of insufficient and inconsistent regulation, and on the other hand, how such a roll-out is conducted as efficiently as possible.

However, the ERG wishes to point out that the Commission is not consistent with Art. 1 which states that the recommendation concerns SMP remedies concerning access to NGAs. Instead Art. 3, 7 and 23 deal with market definition and market analysis. It is rather confusing to have measures related to market definition and market analysis in this recommendation

rather than the Recommendation on relevant markets (2007/879/EC) and the Guidelines on SMP analysis. This might create inconsistencies due to overlap. In this respect the ERG likes to ask the Commission on how the reviewing of relevant markets is compatible with regulatory certainty and predictability which is particularly important for long term NGA investment. In fact, whereas according to the existing ECNS regulatory framework NRAs are obliged to perform a new market analysis periodically after three years or sooner if competitive conditions have significantly changed, operators ask for “commitments” over several periods, according to the nature of investments in NGA networks by SMP operators. The ERG invites the Commission to provide NRAs with clearer guidance on this issue by providing the tools and flexibility which will allow NRAs to give sufficient regulatory certainty to market players for a sufficiently long period so that investment is not chilled.

The ERG welcomes that generally the Commission distinguishes between SMP remedies and symmetric measures (see in particular Recital 13), but notes that reference is made to symmetric regulation (e.g. Art. 11 and 18) in a number of places. The ERG sticks to its proposal of symmetrical regulation acc. to Art. 12 FD with regard to the sharing of the terminating segment of the access network as establishing SMP at the level of each building is neither feasible nor reasonable. The ERG therefore reiterates its request for a strengthening of Art. 12 FD for facility sharing.<sup>1</sup>

### **Ladder of Investment and access to ducts**

ERG shares the Commission’s belief that infrastructure competition is preferable to service-based competition and should be encouraged where economically efficient and practical. However the ERG continues to believe that regulation of NGA networks must stimulate efficient investment in infrastructure by the incumbent as well as competitors and that there should be a prioritisation of remedies based on the ladder of investment.

Whilst it may not be the Commission’s intention, the current text could be interpreted as implying that duct access seems to be “the” regulatory panacea. ERG considers that depending on national circumstances duct sharing could be an efficient remedy to stimulate infrastructure competition, as is the case in France and Portugal. However this might not be sufficient in itself and may have to be complemented by other remedies. Again, in other countries it may not be applicable at all. For example, in The Netherlands and Belgium the existing copper access network does not use ducts since cables are buried directly in the ground. Also the investment risk of build-and-share projects between SMP-operators and competitors at the time of new investments to replace or establish cables, ducts and other facilities is high for competitors if the expected market share of the incumbent compared with competitors is large. Especially in the case where cable operators hold a strong position and capture a large part of the potential market share, this risk will be even greater. ERG therefore considers that too much emphasis is placed on passive remedies and would like to see more emphasis on active remedies such as enhanced bitstream products (e.g. Active Line Access) and/or backhaul products. In any case neither should be privileged as the balanced combination of active and passive remedies should be left to the discretion of the NRA according to national circumstances.

The ERG also wishes to draw the Commission’s attention to the nature of the obligation to provide access to ducts. Looking at Art. 5 in particular, it seems that the Commission sees the access to ducts as an access obligation in its own right only<sup>2</sup>. However, an obligation to provide access to ducts can also be imposed as an ancillary service in order to realize the access to the unbundled local loop.<sup>3</sup>

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<sup>1</sup> Cf. ERG CP/Opinion on NGA (ERG (08) 16rev2), p. 45.

<sup>2</sup> E.g. in France the decision of 25 July 2008 imposed duct sharing as a remedy on Market 4.

<sup>3</sup> E.g. in Germany duct sharing was imposed as an ancillary service on Market 11/4 on 27 June 2007.

If access to ducts is technically or physically impossible, economically not viable or if there are operational barriers, NRAs will have to be able to continue to impose other forms of passive access (like unbundled access) instead without further justification. Equally their use should not be compelled when they do not make economic sense. In the draft recommendation the Commission proposes alternative remedies such as dark fibre and access to the ODF if duct access is not viable. Consistent with our comments above, we urge the Commission to explicitly support the need for NRAs to maintain their flexibility in applying the most suitable remedies to national or local circumstances, whilst factoring in the need to promote competition as well as to incentivise investment.

As stated in the ERG CP/Opinion on NGA, it is important that infrastructure and service competition are not seen as opposed to each other, but are linked through the ladder of investment allowing competitors through a sequence of regulated access products that are consistently priced to invest in a step by step manner in own infrastructure.<sup>4</sup> However a reliance solely on passive remedies will create rungs on the ladder of investment that are so high as to possibly deter market entry or prevent market entry based on active remedies to be sustained. The ERG therefore calls on the Commission to amend the draft recommendation to state clearly that NRAs must implement the most appropriate remedies following a careful market definition and analysis. Specifically, it is important to have a menu of remedies which would allow competition to develop across the board and include the possibility to have active remedies available in parallel to passive ones. This is particularly important given the fact that NGA deployment is likely to reinforce economies of scale and density<sup>5</sup> thereby rendering the business case more difficult which would let us to expect more demand for enhanced active wholesale products.

### **Pricing principles mainly on duct usage**

ERG considers that the pricing principles for access to ducts proposed by the Commission in its draft recommendation, and more specifically in its Annex 1, are neither reasonable nor feasible and are generally too prescriptive.

The ERG asks the Commission to redefine its position regarding the pricing principles for ducts.

#### **a/ General pricing principles**

First of all, ERG notes that Commission's proposals for volume-based pricing is not in line with the way that wholesale prices are set up for the other broadband wholesale services. The lack of justification regarding these new pricing prescriptions could lead to legal risks in the event of any appeal before national courts, even if they are recommended by the Commission.<sup>6</sup> If the Commission has tested out the practicalities of their proposals, the ERG would be interested to see the analysis. If a detailed data-base of all ducts including information on asset lives and depreciation is required then the Commission should justify this, possibly by carrying out a cost benefit analysis. The ERG does not see the need for detailed pricing rules for access to ducts. LRIC is an established, well understood and widely adopted methodology that allows for fair cost-based pricing.<sup>7</sup> Based on the relevant increment required to offer infrastructure, this methodology can overcome both geographical differences and differences in old and newly constructed infrastructure e.g. ducts. Focusing on these two

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<sup>4</sup> Cf. ERG CP/Opinion on NGA, p. XIII and 48.

<sup>5</sup> Cf. ERG CP/Opinion on NGA, p. VI and 19.

<sup>6</sup> The BIPT decision on MTR have been cancelled by the national Courts, even if the method used was the one recommended by the Commission in a previous comment letter.

<sup>7</sup> In this context ERG is confused by reference to a mark-up for common costs in Annex I. This is a LRIC concept but LRIC is not mentioned anywhere else in the recommendation.

types of differences seems to be a step back in regulatory consistency and will, in addition, require detailed costing data instead of currently used costing models.

The Commission's proposal raises issues of feasibility, from an operational and regulatory point of view. Indeed, the draft recommendation may be interpreted in a way where ducts would have to be considered one by one (duct by duct), taking into account the actual age and physical condition, utilisation and economic viability of each duct individually, which is unrealistic. It is all the more entirely unrealistic considering that regulatory accounting put in place by incumbents, on which NRAs base their cost analysis, is generally nation-wide, at any case always based on a wider scope (e.g. in case of geographical markets).

Eventually, considering ducts are at the basis of many fixed products, the definition of such principles for ducts pricing may have an impact on the whole chain of products. At least, ERG considers that the Commission should clearly specify that the principles in question only apply to the amount of civil works costs that have to be specifically recovered by the Fttx networks rolled out in the ducts. However, such a clarification would not solve another problem: the use of a different methodology makes it difficult to implement the last recommendation of these general principals that state: *"If applicable, the usage price of a duct should be corrected for the relevant amount already paid by the access seeker for renting the local loop (which includes the same duct)."*

Therefore, following such an approach would cause problems of consistency regarding prices of other wholesale access products. Furthermore if not taken into account properly in the downstream markets, i.e. with a differentiated price structure reflecting upstream differentiation, a margin squeeze situation will be created.

#### b/ Existing ducts vs. new ducts

The ERG considers that in the context of an SMP remedy the distinction proposed by the Commission between existing and new ducts risks severely distorting investment decisions. Considering the case of the incumbent, existing ducts will have been inherited by the former monopoly. However, a network lives, evolves, and needs constant investment. New civil works are constantly undertaken in order to maintain legacy ducts, to facilitate future development with reserve ducts put in place at marginal cost during other civil works and to create new ducts in greenfield areas. In all of these cases, no peculiar risk is taken by the incumbent considering that ducts have to be built whatever the situation is.

Thus, with respect to the cost of duct access, the ERG considers that any general deployment is liable to include a combination of existing (fully depreciated) ducts, existing (non-fully depreciated) ducts and new ducts. The Commission's rationale for pricing ducts dependent on its financing status (as stated in Recital 5 of the draft recommendation) is unclear. For example, if fully depreciated ducts are priced lower than other ducts (implied by the Commission's remarks) then it is unclear what would happen when this is replaced soon after a sharing arrangement is put in place? Also, the commercial and economic incentive on an operator is to minimise the overall cost of its duct costs and depreciation is clearly only one element of this assessment.

Besides, the Commission seems to confuse in its statements regarding existing or new ducts on one hand and their localisation on the other hand. In particular, the Commission identifies new ducts as those normally built from the concentration point to the home. This assumption should be seriously revised: although in some member states, the incumbent may not have rolled out ducts on every part of its copper local loop (but rather preferred to bury the loop), in some other member states, such as France or Portugal, ducts have been rolled out on all parts of the local loop, and are equally available for fibre deployments.

#### c/ Historical costs vs. current costs.

The Commission's proposal seems to fully invert historical costs and current costs. Indeed, in all member states, regulatory accounts do not necessarily reflect historical costs. The Commission recommendation of the use of historic costs is contradictory to previous guidance and there is no explanation why this should be the appropriate cost base. There is also an assumption that the regulatory accounts of the SMP operator will provide all the required cost data but it is not explained how this can be achieved.

The current wording of the draft recommendation implies a duct by duct approach (see Annex I). The ERG believes that this is unrealistic given the level of detail required, and in addition such an approach would not be consistent with regulatory cost accounting systems, which rely on asset classes. Furthermore, paying the exact price of a particular route would require this particular route to be taken out of the scope of local loop costs, to avoid double counting. Such implications show a clear need for further elaboration by the Commission to avoid unwanted cost shifts in the local loop or discrimination issues (average approach for LLU, route by route approach for fibre). We also question whether the practicalities of the proposals have been tested. If a detailed database of all ducts including information on asset lives and depreciation is required then the Commission should explain why and carry out a cost-benefit analysis.

The ERG considers that these statements are incoherent and contradictory to established regulatory best practice and the earlier guidance of the Commission on cost accounting and accounting separation.<sup>8</sup> Therefore the ERG reiterates its request that NRAs should be allowed to follow established principles of regulatory accounting that do not risk to distort investment decisions. The necessary flexibility with regard to the application of regulatory accounting principles need to be maintained.

#### d/ Risk premium

ERG wishes to point out that in order to incentivise efficient investment it is important to calculate a reasonable rate of return that adequately reflects the risks as this is done now when regulating access prices ex-ante. However the ERG does not agree with the presumption that a higher risk premium applies only because new infrastructure is rolled-out. The risks must be carefully assessed using state-of-the art analytical tools before any definite statement should be made which may pre-empt the result of such a careful analysis. Moreover the results will differ across Europe depending on, among other things, the competitive situation in the member states. Also, it must be stressed that in the case of an access obligation, there is no "risk sharing" involved. The risk is born solely by the SMP operator and is already adequately reflected in the reasonable rate of return included in the regulated access price.

From this case one has to distinguish the so-called "build-and-share projects" (infrastructure sharing) where the incumbent and alternative operators agree to share e.g. civil engineering works for a "joint roll-out". This includes a cost and risk sharing, which will be agreed commercially as otherwise the parties would not agree on such a scheme. Such "cost and risk sharing arrangements" might be encouraged by the regulator or imposed as a symmetric measure acc. to Art. 12 FD. However there does not seem to be any convincing argument that this should include the fixing of a risk premium for one of the parties. The risk is shared and it is not clear why one of the parties should be entitled to a risk premium above the other party.

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<sup>8</sup> Recommendation on accounting separation and cost accounting systems under the regulatory framework for electronic communications of 2005, 2005/698/EC.

Finally a third scenario can be envisaged if the SMP operator requires a commitment from alternative operators before rolling-out new infrastructure. In this case the overall risk is lowered as all parties would have less capacity utilisation risk for their networks.

The ERG is concerned by the level of prescription proposed by the Commission regarding the evaluation of risk premium. In addition, the Commission (in Annex II) recommends that this risk premium be evaluated using examples taken from other sectors, such as media services. It is also unclear why media services are singled out. Such an example appears particularly awkward for products like civil engineering and ducts that are not relevant in the media sector. Intentions seem perfectly clear but demonstration does not seem relevant. These statements do not seem to provide for additional certainty. Furthermore, the requirement for this premium to be "project-specific" may, in particular, cause an unnecessary burden on regulators and bring about endless litigation, notwithstanding the question whether it is economically sensible.

The proposal in Annex I (No. 5) implies that the price depends on the usage. As previously stated, it should in any case be up to the NRA to assess the risk of investment as now and set a reasonable rate of return according to Art. 13.1 Access Directive based on the assessment of the current and potential competitive situation in the national market as well as sufficient evidence rather than general statements which are not reasoned any further and do not seem to be based on an in-depth study on factors influencing the risk of NGA investment. These risks will likely vary considerably across Europe and even within member states.<sup>9</sup> NRAs are best placed to set the correct economic incentives for efficient investments and promotion of competition depending on national circumstances.

Taken together the pricing measures distinguishing between different categories

- existing/new ducts,
- historic/current costs,
- risk premium on a project basis yes/no

applied on possibly regionally differentiated markets will increase the level of complexity of regulation thereby increasing the risk of inconsistent prices distorting investment decisions and generating margin squeezes with a consequently negative impact on competition.

## Transparency and process

The ERG welcomes the recommendations regarding transparency and information requirements on future roll-out plans regarding NGA deployment. However, ERG wonders about the relation with the proposed amendments of the Framework Directive. Further guidance on how NRAs could enforce the information requirements under the current regime is welcome. Again some of the recommendations are too prescriptive, e.g. to require a reference offer in all cases to be in place, and within six months after the imposition of SMP obligations is too rigid and goes beyond what is possible under the current Framework. The statement in Art. 9 "*NRAs should specify in the reference offer appropriate ex ante price controls on all necessary inputs referred to above in this article*" is unclear as the obligation of "ex ante price control" will have been imposed in the general remedies decision. The reference offer should detail and prescribe transparently the prices for the different services and necessary inputs.

The ERG also agrees with the necessity to influence the process of practical implementation of street cabinet collocation and other concentration points in order to prevent first-movers foreclosing the market to competitors by creating technical limitations that cannot be undone afterwards thereby. However, it needs to be kept in mind that often NRAs may not be the competent authority to intervene. E.g. in some member states, it may be the municipal authority that provides (or declines) building permits etc. for the size of the street cabinet. The

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<sup>9</sup> Cf. ERG NGA CP/Opinion, p. VI and pp. 14.

same holds true for the recommendation regarding sharing of civil engineering works as such for which the Commission calls in several places. It is unclear that NRAs have the necessary powers to do so and presumably the Commission is referring to the civil works solely of public electronic communications providers. Likewise, regarding in-building wiring, the NRA will have to assess at national level the competence to intervene.

An important subject in the context of NGA that deserves more attention in the Recommendation is the migration path for competitors from legacy networks to NGA networks. The ERG supports the view of the Commission that NRAs should ensure that competitors can continue to provide services by means of a proper migration path. These transition issues play an important role independent on the type of NGA (FttH or FttN) network. The Commission acknowledges the possibility that NRAs seek possibilities that an (commercial) agreement can be reached between the SMP operator and access seekers on a migration path from the prevailing access to access under the new network structure. The ERG invites the Commission to give further guidance on the principles to ensure that appropriate transitional arrangements will be in place. What can be the role of commercial or negotiated agreements? What kind of role should NRAs take and which incentives can NRAs give to ensure that operators have an incentive to reach an agreement?

## **FTTH**

In line with the principle of technology neutrality it is important to impose remedies which do not depend on how FTTH is implemented (PON<sup>10</sup> vs. P2P) in order to prevent inviting operators to gaming by choosing PON architecture to avoid unbundling obligations rather than for efficiency reasons.

As a matter of fact, access to an unlit fibre dedicated to one single user may not be technically simple or even feasible in case of PON, due to the presence of the splitter. However, other forms of passive access are possible for PON, based on extra fibre between the splitters and the access point.

## **FTTN**

The ERG agrees that co-location at the street cabinet is an important remedy in the FTTN case. The Commission mentions practical difficulties regarding the access to street cabinets, e.g. collocation requires additional space in the street cabinet which are currently designed to house only the incumbent's equipment. However, in the ERG's view the proposed solutions do not tackle these difficulties and do not contain a cost-benefit analysis. The ERG draws the Commission's attention to Section 4.3.1.1 of the ERG Common Position/Opinion on NGA<sup>11</sup> for a detailed analysis of the problems involved.

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<sup>10</sup> PON is comparable to SLU. One way to upgrade from FTTC to PON is to install passive splitters in the street cabinet and put P2P fibre to end users from street cabinets. In case of a Greenfield installation this last section can be shorter.

<sup>11</sup> Cf. ERG NGA CP/Opinion, p. 35.



## **Conclusions**

In summary the ERG considers that an NGA recommendation should at this stage focus on the harmonisation of the principles of regulation rather than being over-prescriptive on the implementation of remedies such as pricing of ducts. A number of suggestions are impractical and their implementation would cause difficulties for NRAs, if they were to take account of them.

NGA deployment is clearly not an area for a “one-size-fits-all” approach, rather the opposite is true. The ERG therefore emphasizes the need to maintain the flexibility of NRAs as otherwise they cannot impose remedies that are proportional and solve competition problems in the best possible way.

ERG is ready to work closely with the Commission on the further drafting, and refers again to the ERG CP/Opinion on NGA which sets out a number of general principles based on a thorough economic analysis of the different scenarios and competences under the current Framework including the areas identified above.