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Tele2 AB Comments on IRG-WG RA (06) WACC

Having been invited to comment on the IRG WG Regulatory Accounting document “Principles of Implementation and Best Practice for WACC calculation”, September 2006, Tele2 AB offers the following input.

The document elaborates partly on the issue of trying to calculate a beta value for companies whose equity shares are not quoted on a stock exchange. However, the same arguments as for non listed companies could be used in order to try to calculate the divisional, or project beta also for companies whose stocks are publicly traded. This issue is important, since most SMP operators of any considerable size, are public companies whose stocks are publicly traded. Specifically, regarding incumbents which offer both fixed interconnection, mobile termination and ULL access, using one and the same WACC to calculate the cost of capital for wholesale services in such different markets will inevitably lead to the wrong relative pricing of those services and thus to the wrong investment signals.

There is a growing consent among operators and NRAs that large scale replication of the access network will not take place. However, the demand for fixed access will remain high for the foreseeable future due to the growth of broadband services. Looking then at the ULL market, the business risk of renting access facilities in a monopoly like market would appear to be extremely low since there will always be a demand for close to 100% of the available facilities, either from the incumbents retail branch or from wholesale customers. This risk is most likely much lower than the combined risk of an incumbent whose business include fixed and mobile services in several geographical markets both within and outside of the EU.

The business risk will on the other hand increase dramatically should the NRAs encourage investments in parallel access facilities. Such investments would represent “sunk cost” and would theoretically at best generate revenue just above operational cost.

Tele2 would find it appropriate that the IRG mentions the growing consent that a large scale replication of the access network is not going to happen and emphasises the importance of applying the correct *divisional* WACC under these circumstances. Tele2

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would welcome a deeper discussion favouring the divisional approach in the paper, providing firmer guidelines for how such “project betas” could be calculated. One approach that is mentioned in the paper but that could be further stressed, is to look at other natural monopolies, such as electrical distribution networks or water utilities in order to assess the correct risk (i.e. beta value) in a natural monopoly market. The main rationale for the divisional approach is to be found in the LRIC methodology, where the “increment” is the whole service, i.e. ULL or no ULL, voice or no voice, etc. Therefore the correct WACC would be the one considering the risk for the specific Increment. The increment is *not* Incumbent or no Incumbent, which is implied in a corporate beta value.

Sincerely Yours

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