

BT Response to Second European Commission Consultation on Proposed NGA Recommendation

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INTRODUCTION / SUMMARY

BT welcomes the fact that the Commission is producing a Recommendation on NGA. The Recommendation will play an important role in guiding NRA decisions over coming years and ensuring appropriate regulatory frameworks are in place. The scale of investments being made, the long-term nature of any pay-back, and the uncertainty over demand, require a policy response which rewards investment, recognises risk, provides certainty, and does not jeopardise competition or innovation at the service level.

We fully support the commitment from Commissioner Reding that “It is not the role of the Commission to take sides between incumbents or new entrants; but to make sure that there is effective competition in a Single Market that triggers investment, innovation and consumer benefits.¹”

The existing legal Framework, which this Recommendation will interpret, makes very clear (FD Art 8) that NRAs shall have a duty to promote competition in networks *and* services by inter alia *ensuring no distortion or restriction of competition*, and by *encouraging efficient investment in infrastructure and promoting innovation*. This balance is not questioned by either the European Council conclusions of March 2009 or the proposed changes to the Framework Directive, and the Recommendation should not depart from it.

The Commission’s second draft goes some way towards recognising these principles, and BT welcomes the Commission’s publicly stated commitment to ensuring competition and a consistent approach. However, instead of focusing on the general principles, the draft goes into a level of detail which becomes too prescriptive in terms of which remedies to apply, and which technology choices to reward with deregulation.

In particular the draft still gives an unjustified weight to infrastructure competition which conflicts with the carefully balanced objectives of the existing legal framework by down-playing the NRA’s duty to promote competition in services.

BT considers that the underlying assumptions about the prospects for, and benefits from, infrastructure competition via multiple duplicate access networks are still too optimistic, and the Recommendation could jeopardise the substantial economic and consumer benefits from service-based competition which arise from supplying businesses with high quality services based on active remedies across all infrastructures of copper, fibre and wireless technologies.

The Commission also seriously underestimates the costs of providing access to civil engineering infrastructure and the levels of demand that would justify the investment

¹ How to Reward the Risk of Investment into Fibre in a Competitive Environment – ECTA Conference Brussels 25 June 2009.

needed to offer such access to third parties. In general the draft Recommendation gives undue weight to costly measures intended to promote infrastructure competition and risks frustrating the deployment of new networks whenever the business case is marginal – particularly during times of recession.

While BT welcomes such recognition that the second draft gives to the role of active wholesale access remedies, we do not support the Commission's apparent view that, as far as NGA is concerned, competition in Market 4 is in some sense 'superior' to competition in Market 5. Specifically, BT is concerned by the suggestion that NGA remedies in Market 5 may be dropped if there is just the likelihood of effective competition based on remedies in Market 4, rather than proof of effective competition as required by the Framework and Access Directives. This issue is especially critical for the suppliers of Business-to-Business (B2B) services (who will have widely dispersed customers with sites in many locations and insufficient volumes in any one area to make Market 4 fibre access remedies a feasible or economic option).

This raises a broader issue which BT wishes to discuss concerning market definition. Thus far the Commission is treating Markets 4 and 5 as distinct even though it is apparent that remedies in one may have a strong bearing on SMP and the appropriateness of remedies in the other. BT suggests that it would be appropriate for the Commission to permit NRAs full flexibility to assess the efficacy of remedies across Markets 4 and 5 on a joint basis for NGA. This would have the added advantage of ensuring that pricing could form a coherent design rather than a fragmented or compartmentalised approach.

Summary of Key Points

Applying the Appropriate Remedies

- Evidence suggests the economic/geographic scope for duplicate physical access networks is extremely limited – even for mass market consumer services². This strongly suggests the need for bitstream type services on NGA networks.
- Conversely, the costs of providing access to civil engineering infrastructure are so high that a) there must be substantial real demand before NRAs mandate this, and b) set-up costs will have to be recovered through initial charges to access seekers. These together indicate that the scope for passive remedies is likely to be highly localised.
- Given the intrinsic uncertainty over the outcome of different access technologies including in particular where there are overlay networks, it makes sense to consider NGA remedies for Markets 4 and 5 on a joint basis which will allow proper geographic and customer-based segmentations.

² BT distinguishes NGA from competition based on LLU in this regard. B2B suppliers are likely to require appropriate regulated non-discriminatory NGA active products in Market 5 even if there is competitive supply of consumer services via multiple networks in Market 4. It has been estimated that the value of fully competitive B2B service supply to the European economy could entail an increase of 1.6-2% of GDP [BT Report - Productivity, Growth and Jobs: How Telecoms Regulation Can Support European Businesses]

- NRAs must be free to conduct market analyses and impose remedies in accordance with their own findings, without being obliged to adopt the precise solutions pre-determined by the Recommendation; NRAs should be free to rule that Market 5 remedies may be both necessary and fully sufficient in some circumstances.

Ensuring Open Competition

- Regulatory holidays should not be conceded *per se* as a reward for risky investment – particularly through “joint investment” arrangements that are structured in a way which precludes competition, or on the unproven basis that market entry via infrastructure competition is a viable option and hence no further regulatory measures are required;
- ‘Joint investment’ arrangements do not alter this position especially if they are structured in a way which precludes subsequent competition;

Reasonable Transition Periods

- Transitional periods must not be excessive both in terms of delaying SMP operators’ retail offerings and requiring the parallel operation of copper and fibre networks. BT believes that fixed periods of 6 months and 5 years respectively, as proposed in the draft recommendation, would be excessive.

Consistency on Pricing, Risk and Reward

- BT considers that the Commission needs to re-examine the coherence of its argumentation on pricing, risk and reward. The draft Recommendation appears at some points to propose that all forms of risk are rewarded but at others only certain aspects of risk. More generally, there is not a clear explanation of how the different forms of pricing being proposed could work in practice.

CONSULTATION ON NGA RECOMMENDATION - DETAILED POINTS

2.1 Access to Civil Engineering Infrastructure (CEI)

(i) Appropriateness of SMP at the level of basic infrastructure

It is not clear to BT that Market 4 should be taken to include CEI. A finding of SMP relating to fibre or copper cable access does not mean that SMP exists in relation to duct access if there are other ducts in the area (e.g. utilities, cable) that could be used for fibre or copper. Furthermore, the SMP communications provider may be leasing duct-space from a real-estate developer – in which case the SMP obligations relating to CEI (if there are to be any) should fall on the real-estate company.

If there are to be obligations on access to CEI, they should be based on an assessment of all suitable or comparable infrastructures regardless of their ownership or purpose.

(ii) Cost recovery

The Commission requires NRAs to assess the demand for duct access but gives no guidance on how much demand would be needed to justify the huge expenditure associated with making duct access available³. Nor does the Commission address the issues of enforceable commitment by other operators, or their financial ability/strength underpinning the commitment to pay for access. It would not be appropriate to force the SMP operator to absorb the overwhelming majority of costs if these were apportioned on the basis of the share of CEI actually used when demand from third parties proved to be negligible or transitory.

As we stated in response to the earlier consultation, the initial set-up costs for the detailed duct-sharing RIO required by the Commission will be substantial and much too large to be borne on the basis of a risk premium to be contributed by any eventual wholesale customers. In the event of a substantial set-up cost there must be a matching, guaranteed, up-front, cost recovery mechanism based on payments from alternative operators with a serious commitment to using shared duct.

(iii) Problems of extending Functional Separation (FS)

BT is a strong advocate of FS and considers that with Equivalence of Input (EOI) this forms a highly suitable model for the provision of NGA services. However, there are limitations to the practicality of extending this framework which the Recommendation does not appear to appreciate.

Critically, the requirement to provide “equivalent” CEI access in accordance with Annex 2 of the Recommendation could also result in a further additional level of Functional Separation to be applied on top of any existing Functional Separation at copper/fibre/service level. This complication would potentially undermine Functional Separation at the service level where it exists or is being contemplated – and this is where the major benefits of FS will lie. BT would be particularly concerned if NRAs decided to impose FS at the CEI level instead of at the service level.

There is also the issue of whether margin squeeze tests might be required in order to confirm the pricing of CEI access and, separately, the pricing of copper/fibre access. NRAs must have much more flexibility here and Annex 2 of the draft Recommendation could be usefully refocused on providing guidance to NRAs to ensure equivalence at service level rather than infrastructure level.

(iv) Level of detail

BT believes the entire section containing paragraphs 9-14 is too prescriptive.

2.2 Costs of Multi-Fibre Deployment and Viability of Multiple Operators

The draft Recommendation contains numerous provisions to encourage or mandate the provision of multiple fibres, including the requirement for NRAs to waive cost-orientation or reject an SMP finding such as in conditions of multiple fibre deployment. BT believes that such deployment is likely often to result in higher

³ Paras 11-14 are also inconsistent as to whether the NRA’s actions should be “in accordance with market demand”.

investment costs and higher end-user prices, or abandoned investment plans. The Commission's Recommendation thus risks being counterproductive.

There are various estimates of the additional cost of multi-fibre deployment. Swisscom⁴ have indicated a figure of 10%-20% based in part on the capacity of their ducts to take thicker cables; other networks may have higher cost penalties. Whatever the precise figure, this additional cost represents a very significant burden on the investing operator and one which could restrict NGA deployment to the most densely populated and profitable areas. Furthermore, it is hard to understand how a prescription of multi-fibre deployment can be technology neutral as the Commission argues in Recital 19 – not least because it rules out FTTC/FTTN or wireless solutions (and here the Commission's definition of NGA may need to be revisited). Indeed it is entirely possible that, for example, terminating segments could be deployed using a mix of technologies (dependent on terrain and demographics for instance) which may include wireless.

The incremental additional fibre deployment cost is one problem associated with multiple fibre deployment but there is at least one more; competing networks on the extra fibres will have to pay a non-discriminatory equal share of the NGA costs, build their own backhaul and switching capability (unless mandated on the incumbent), and duplicate other costs. Since few customers will subscribe to multiple networks and some will subscribe to none, the total revenue is limited. In a multi-fibre situation, on average, n operators will share $1/n$ of the market at more than $1/n$ of the total costs. And to make matters worse, the additional operators may have a smaller range of services and thus not be able to come close to the ARPU of the larger triple-play providers. This does not augur well for sustainable competition on this business model.

In an earlier response BT drew the Commission's attention to work by WIK and Analysys-Mason on the limited replicability of NGA networks⁵. We believe that their findings remain valid and constitute a major objection to the Commission's approach.

Further evidence has since emerged⁶ and we understand that Swiss operator Sunrise is sceptical about the value of Swisscom's multi-fibre deployment.

2.3 Risk Profiles

BT does not believe that the Commission can demonstrate that FTTC/FTTN is in itself lower risk than FTTP and although the deployment costs are clearly different, they are still significant. Uncertainty about the level of demand and about consumers' willingness to pay a premium for higher speeds is common to both. BT also suggests that the Commission is not being consistent in this regard by indicating that in this comparison the relevant benchmark is total project risk while on the other hand NRAs are invited to assess risk using the CAPM model which only embraces systematic risk.

⁴ In response to the Commission's first NGA consultation.

⁵ WIK Study for ECTA "The Economics of Next Generation Access". Analysys-Mason report for the UK Broadband Stakeholders Group "The Costs of Deploying Fibre Based Next Generation Broadband".

⁶ Presentations by WIK and Sunrise at ECTA Conference – June 2009

It may well be the case that FTTC/FTTN and FTTP would have different penetration levels and the demand for such services is more cyclical in one outcome than another but it is surely speculative at this stage to say which will experience the greater systematic uncertainty. The general risk principles discussed in the Recommendation should guide NRAs to their own judgments on this matter.

The Recommendation includes a range of pricing options at the different layers of potential competition. Taken individually these may be feasible approaches but it is far from clear that they can be combined in a manner which will give any operator the confidence to market services.

Where new civil engineering infrastructure is created for an NGA (FTTP or FTTC/FTTN) network then its risk factor is clearly equal to the risk of the NGA network as there would be no demand for it in the absence of the NGA system. Arguably the CEI component is economically as well as physically 'sunk' and absent demand for more fibres in the ducts will be invariant to the level of final demand at the retail level. It probably represents the greatest component of unsystematic risk of all investments.

2.4 Co-investment, Risk Sharing, and Non-Discrimination

The Recommendation does not seem to be clear about the impact on, or safeguards required for, sustainable retail competition in the face of co-investment and risk sharing schemes. BT believes that the requirement to reward risk should be met by the prices charged for access on a non-discriminatory basis to all retail operators including those vertically integrated with the wholesale investors. BT supports appropriate discounts for volume or duration as long as these are available on a non-discriminatory basis (not just to the original investors) and are compliant with competition law. The reward for risk should not take the form of a higher retail market share for the vertically integrated investor and the original investors should not be allowed to form a quasi-cartel.

Where operators have universal service obligations they should have guaranteed, regulated, rights of access to any infrastructure needed to deliver those obligations. It would be unacceptable to expose universal service providers to commercial negotiations for wholesale products that they need in order to deliver their legal obligations.

2.5 Significance of Functional Separation

BT welcomes the Commission's acknowledgement that Functional Separation may remove the need for cost orientation but believes that the Commission has underplayed the desirability of this approach and been too cautious in suggesting that NRAs should routinely use a margin squeeze test to monitor the SMP operator's behaviour. This seems too prescriptive and ignores the potential for NRAs to rely on other pricing constraints from direct and chain substitutes.

As discussed above, the requirement for equivalent access to civil engineering infrastructure raises the prospect of multiple layers of Functional Separation –

potentially with multiple margin squeeze tests – and threatens the viability of the concept.

2.6 Triggers for Absence of Cost Orientation and SMP

BT is concerned about the general principles expressed in Annex 3 which appear to both limit an NRA's ability to conduct proper market analyses and threaten to introduce "regulatory holidays" in cases where competition is in practice far from effective. In particular, BT is concerned about the threat to the ongoing availability of regulated active products for B2B suppliers. Such suppliers will have too low a customer density in any one area for physical access to be a workable solution.

It is not clear how the various triggers for absence of FTTH cost orientation and SMP that are mentioned in Annex 3 will function if operators only compete in part of a relevant zone. The current draft of Annex 3 actually suggests that as long as there is co-investment and availability of multiple fibre lines then, even if there is actually no competition at all, cost orientation will not be required. Presumably a very substantial part of the relevant area will need to be actually served by two operators before cost orientation can be relaxed (in the absence of other indicators).

BT believes that the availability of broadband services via copper or wireless, as substitutes or chain substitutes, may also constrain excessive pricing. Coupled with a transparent, non-discriminatory, functional separation regime a fairly extensive relaxation of regulation can be contemplated as a result of competition; subject to the principle that regulation should only be lifted where rigorous analysis conducted in line with competition law principles has identified the existence of effective competition.

2.7 Margin Squeeze Tests

BT wishes to stress the importance of competition law being properly enforced at all times. However the recognition that this may not address potential competition issues in a sufficiently timely manner is, rightly, one of the drivers for the framework of telecommunications regulation. The ability for competition to flourish is at the heart of this framework and that requires NRAs to have sufficient and appropriate remedies at their disposal to fulfil their obligations to support competition and to further the interests of consumers. An important element of this is that the NRA should be able to set remedies relevant to the market conditions within a country, and the Commission should not be too prescriptive in the mandating of any particular remedy. To this end, cost orientation and margin squeeze tests form important parts of the toolkit available to NRAs.

It is also important to recognise that margin squeeze tests assist in the demonstration of non discrimination as well as providing a level of pricing transparency, helping to assess the ability for entrants to compete in downstream markets, therefore these tests should not be linked as closely with cost orientation obligations as the Commission suggests.

2.8 Primacy of Active Wholesale Access (Market 5)

A well designed active wholesale access product (such as Generic Ethernet Access) allows third party operators the same scope for innovation that they would have had with their own networks. Indeed this allows potentially more scope for innovation if software upgrades are more affordable when the underlying network cost is split between many wholesale customers. Active products also avoid the enormous set-up costs of inventory systems to list and manage duct and other passive component availability and are useable by large and small scale operators alike – thus increasing the size of the pool of potential innovators.

BT does not agree with the suggestion that Market 5 can be automatically deregulated consequent on a finding of effective competition in Market 4. A proper analysis of Market 5 should be carried out (including both business and consumer services) and NRAs may decide that effective competition over appropriate products in Market 5 means there is insufficient demand to mandate access to Market 4.

2.9 Pricing of CEI

BT believes that if access to civil engineering infrastructure is deemed proportionate and becomes mandated, then it should be priced at current/replacement cost rather than net book value. Historical depreciation should not be a driving factor in price setting and section 2 of Annex 1 needs to be modified.

The Commission could usefully clarify that cost-oriented access to duct means a proportionate share of the total cost of the duct based on space actually used by each party including a charge for spare capacity. This is particularly important if additional speculative capacity has been created as the costs must be recovered from those operators who do use the duct.

2.10 Terminology

It is unclear what is meant by the terms “virtual co-location” (in section 5 of Annex 1) or “fully equivalent active access” (in Para 43).

2.11 Undertakings that are not Communications Providers

There is a potential access and enforcement issue in the case of new green field sites and campus networks where the property developer or management company owns the civil engineering infrastructure and possibly also the access network. NRAs need to be able to impose appropriate remedies on such undertakings even if they do not obviously have SMP (since market analysis on a site by site basis may be infeasible). Undertakings with universal service obligations will need regulated access in order to deliver those obligations.

2.12 Transitional Issues

The requirement in Para 33 for the SMP operator to wait six months after introducing new wholesale products before introducing its own retail products is completely unreasonable. A level non-discriminatory playing field is needed for all retail operators, rather than one tilted against the investor.

A rigid 5 year notice period before decommissioning a local loop is excessive. The cost of parallel running of two networks will damage the business case for NGA deployment. Appropriate consultation periods and alternative arrangements for other operators are important – but the detail must be left for NRAs to determine.

2.13 The Market 4 / 5 Continuum

Although the Commission has based its work on the Recommendation on Markets Susceptible to Ex-Ante Regulation – and in particular Markets 4 and 5 – BT is not convinced that this is a useful framework in the NGA context. Seen from the viewpoint of users consuming services and the need for competitive supply it may be more helpful to consider the two markets as one, with a continuum of possible remedies.

2.14 Terminating Segments

There is scope for considerable confusion around the issue of terminating segments and “in-building” wiring. The meaning of the expression “terminating segment” should ideally be consistent with other circumstances such as partial private circuits. In BT’s view the terminating segment goes from the local exchange (or equivalent point) to the customer (not necessarily or always the end-user as suggested in the Definitions section. However, the “in-building wiring” may or may not be the responsibility of the NGA provider. This will have ramifications for the service characteristics and quality which can be supported to the end-user. It is therefore worth noting that there may be significant standards issues associated with the edge of the network and the way in which services break-out or connect.

Issues of “in-building” wiring are linked to the question of whether a site is a single building, a campus, or multiple campuses, whether it is in multiple or single ownership, and whether wireless access systems should be included in the scope of “wiring”.

The above factors suggest that this is another area for NRA flexibility, since commercial and demographic models vary considerably between member states. NRAs should have the freedom to determine the most appropriate remedies and response to fit the prevailing circumstances and to deal with significant differences.

3. Conclusions

The Commission should amend the Recommendation:

- to allow NRAs greater flexibility when deciding:
 - whether to impose access to ducts/fibre,
 - whether to make a finding of SMP, and,
 - whether to impose cost-orientation or other forms of price control / or remedies.
- to stress the importance of service competition and recognise the enhanced scope for innovation from fit for purpose active access products - on the basis that such products will support a larger pool of service providers than passive access and offer a wide range of features (e.g. via Ethernet);

- to stress that regulation should only be lifted where there is effective competition (for business as well as consumer services) and not simply where a limited set of co-investment conditions is met;
- to recognise the marginal viability of duplicate infrastructure competition and the need both to avoid increasing costs and to allow investors the widest range of technology and architecture choices.