



**P&T LUXEMBOURG PAPER POSITION
AS OF JULY 13TH 2009 ON THE
2ND DRAFT RECOMMENDATION ON NGA DATED JUNE 12TH 2009
ISSUED BY THE EUROPEAN COMMISSION.**

Having regards to the substantial investments the NGA roll-out will cost throughout the European Union¹, the NGA roll-out is of one the crucial keys of Europe's economic recovery and for Europe to play a key role worldwide in the future as to electronic communications.

As such, the 2nd draft recommendation issued by the European Commission on June 12th 2009 for public consultation ("NGA Draft Recommendation") will and shall play a determining role in the investors' decision-making process to go or not to go for the NGA roll-out and to make the NGA roll-out a success for Europe or to block it for years.

If the NGA Draft Recommendation seems to have taken somehow into account some of the most important comments that had been raised by market players onto the 1st draft recommendation issued by the European Commission on September 18th 2008, it has left expressly aside the principle of gradation of remedies, while it is one of the basic regulatory norm of the whole telecoms regulation, to favor a rigid, cumulative and extensive set of obligations only targeting SMP operators and largely mirroring access obligations on the current copper-based networks. As such, the NGA Draft Recommendation appears as not suited and then not future-proof for the NGA roll-out on the long term.

In line with the position developed by ETNO that P&T Luxembourg ("EPT") shares, the purpose of this Position Paper is to summarize and to address the main EPT's comments and concerns as to the NGA Draft Recommendation within the frame of the above-mentioned public consultation.

For better understanding and clarity purposes, this Position Paper is divided into 5 main parts.

1. A too prescriptive frame not suitable for long-term NGA development.

In order to enable the national regulatory authorities ("NRAs") to properly address the issues relating to the NGA roll-out and to regulate appropriately their national market to promote competition, NGA investments, innovation and free trade, the NGA Draft Recommendation should provide the NRAs with a relevant minimum set of principles and tools, promoting first of all a proportionate gradation of access remedies based on the principle of technological neutrality and appropriate geographic segmentation, in order to enable, sustain and frame the NGA roll-out in the long term.

To the contrary, in its current version, the regulatory approach of the NGA Draft Recommendation:

- (i) undermines the principle of technological neutrality since it targets essentially on fibre optics solutions and does not consider at all wireless infrastructure;
- (ii) misses the fundamental premise that raising of the horizontal barriers – duct access in this case – is the regulatory axis for operators that wish to develop NGA;
- (iii) prompts the imposition of a single and pre-established regulatory model that set aside the reality of most Member States and leads to Commission's intervention in the operator's

¹ The pan-European NGA roll-out is estimated to cost around EUR 250-300 billions.

- adopted architecture at the fibre access network level, resulting in an unacceptable interference with freedom to manage the network resources;
- (iv) imposes a rigid and extensive set of regulatory obligations on an NGA network investor by creating a pyramid of cumulative regulatory obligations instead of creating diversification and segmentation of obligations by NRAs in compliance with the effective situation (notably as regards existing infrastructure, competition, etc.) in the concerned national markets.

Imposing a “whole range” of access products, i.e. the ‘ladder of investment’ concept, is definitively not appropriate to the NGA roll-out, especially for new-build networks.

To ensure proper and timely roll-out throughout Europe of NGA and provide suitable incentives to foster investment, the NGA Draft Recommendation should not set aside basic principles of the EU regulatory framework and prioritize the preservation of current forms of service-based competition over investment incentives and the potential for sustainable competition based on competing infrastructures.

As a consequence, the following regulatory norms should be conceived as key elements to ensure proportionate gradation of access remedies, which shall remain in any case the basic principle underlying the whole regulatory frame and superstructure²:

- (i) the principle of technology neutrality, as it has been a regulatory norm since the beginning of the liberalization of the telecom sector and should then remain, while the regulatory approach adopted in the NGA Draft Recommendation only considers some scenarios within the fixed network technologies the European Commission considers as valuable, or in other words as “technology winner”. Nevertheless nowadays among the leading companies in FTTx markets worldwide, no such clear “technology winner” is emerging, while it is even too early – having regards notably to the time, the operational constraints and effective reliability of the on-going NGA technologies and topologies evolution and tuning – to define any such “Technology winner”. Indeed, the most common technology within the European Union appears to be G-PON, but point-to-point (P2P) solutions are also deployed at some scale, all this most frequently without multiple fibres to the home, while in the near future the deployment of broadband services through wireless solutions will most probably significantly increase, leading the wireless technologies to have an important impact on the business for NGN/NGAs. Technology neutrality implies that network investors can choose - as a function of the market situation, including the degree of competition from alternative platforms, roll-out costs and demand expectations, both at the retail and wholesale level - the most appropriate high-speed broadband technology and/or topology that, according to its own analyses and business cases (a) suits market needs, be it VDSL, Ethernet – P2P fibre, BPON, EPON, GPON, WDM-PON, cable or, in the field of wireless, LTE and (b) allows it to recover NGA network costs;
- (ii) the principle of geographic segmentation, as its main basic objectives are to withdraw remedies from areas with effective competition and to adjust remedies to effective conditions of competition;
- (iii) the principle of welfare-enhancing commercial agreements between operators and/or actors, as such agreements are usually better suited to market needs in developing NGA market than ex-ante economic regulation.

As a consequence of the above, the draft regulatory frame for NGA created by the NGA Draft Recommendation appears then as not to be suitable, adapted nor adaptable to evaluative markets and technologies of the electronic communications sector and then could block or at least detrimentally limit the NGA roll-out plan the operators have developed to timely catch the train of the very high-speed internet infrastructure creation and market evolution.

On the contrary, in order to provide a regulatory framework supporting and adapted to the NGA roll-out on a long-term basis, the NGA Draft Recommendation should in the regulatory process:

² The application of the principle of gradation of remedies, imposing NRAs to impose only sufficient, least onerous obligations onto SMP operators when required, should remain the basic regulatory norm of the whole NGA regulatory set of rules at it has been since the very beginning of the telecoms sector liberalization. This is also highly supported by several NRAs (such as Anacom, Arcep and Ofcom) and remain the key basis to foster NGA investment incentives to operators.

- (i) take into account the competitive characteristics of different network architectures or different forms of co-operation;
- (ii) ensure that NRAs review the effective situation of competition on a national market through market analyses applying as relevant market segmentation and only impose symmetric remedies where bottlenecks are identified and/or where new NGA monopolies could reasonably occur even regionally or locally;
- (iii) favour business-driven commercial agreements as to co-investment and/or risk sharing of access to NGA infrastructure to ensure that operators be in a position to find appropriate co-operation rules and compromise meeting market needs without regulatory imposing a certain form of co-operation arrangements or certain standard legal provisions or schemes to be mandatory included in such kind of arrangements.

2. Principle of symmetric policy in NGA.

The NGA Draft Recommendation remains limited so far to asymmetric remedies imposed by NRAs to Significant Market Power (“SMP”) operators in current market 43 and 54, while on one side the article 12 of the applicable Framework Directive offers legal basis for NRAs to impose symmetric remedies regarding facilities (such as ducts), which has been reinforced in the Telecom Package, and on the other side the competition challenges in NGA have an increasingly symmetric nature.

As such, to ensure effective and long-term competition in NGA, the consideration of SMP-remedies should be subsidiary to the application of a symmetric regime to all operators and actors as well as to a proportionate regulatory intervention.

3. Developing NGA by other actors, such as cable operators, public bodies and underground network owners.

It appears more and more that cable operators competes directly with telecoms operators, not only in the fields of TV but also – and more widely speaking – of telecommunications and roll-out fibre in their CATV network. As a consequence, cable operators have to be treated on the electronic communications market in the same way as telecoms operators, especially through market segmentation, which should be applied with all relevant granularity as appropriate having regards to the national market involved.

Apart from cable operators and notably in Luxembourg, public bodies, such as e.g. municipalities, invest more and more in their own cable network, while providing directly to inhabitants their own retail service offers or in some cases by vesting the operation of retail services to third parties cable operators. In such cases, the competitors of telecoms operators are directly public bodies which could impeach or limit the deployment on their territories of fibre by telecoms operators, especially when the latter offer IPTV services. To avoid bottlenecks and creation of new local NGA monopolies, municipalities investing in fibre networks should be subject to exactly the same symmetric regulatory rules as other operators, being incumbent or not. To further avoid distortion of competition as well as preclusion of network investors or service providers from properly or timely investing and/or offering their own service portfolio on the network of the concerned municipalities, while the latter have the decision power to allocate civil infrastructure municipalities investing in the network should be refrained from providing retail services to inhabitants and be structurally limited to the investment, development and maintenance of the network into which their invested, which could hinder or delay the delivery of relevant authorisations to open ducts and to deploy fibre.

Underground network owners (such as energy, water, etc.) are also managing and even building more and more infrastructure with extra capacity and ducts to make the most of them by renting them to telecoms operators. To avoid bottlenecks and distortion of competition,

³ i.e. market for wholesale (physical) network infrastructure access.

⁴ i.e. market for wholesale broadband access.

those underground network owners should be regulatory obliged to grant non discriminatory access to their ducts and pipes at fair conditions.

4. Market definition, market segmentation and SMP definition

Even if not officially addressed in the NGA Draft Recommendation, the Commission definitively tries to settle the market definition aspect in promoting an unchanged approach (i.e. the traditional copper-environment one, but without the gradation of remedies) despite the fundamental shifts in technology and services development in the move to NGA.

Indeed, simply integrating new technologies/services into currently existing relevant product market definitions as only constituting so-called “chain substitutes” for all pre-existing services without priory implementing a proper demand and supply analysis does not comply with general regulation and competition rules and does take into consideration the motorway that the NGA roll-out will open to electronic communications sector by providing carriers and users very large bandwidth suitable to integrate fully new technologies/services and to efficiently compete with other platforms. The NGA Draft Recommendation seems to start to take this substantial element into account when it specifies that “*Demand and supply conditions are expected to change significantly at both wholesale and retail level*”, without drawing relevant conclusions there from as throughout the text proposal the NGA Draft recommendation takes the basic assumption that there is and will be only one single SMP operator being the one identified in market 4 while it was confined to copper access network only.

To correctly address the NGA matter and related challenges and constraints, the NGA Draft Recommendation should expressly provide that a “SMP operator(s)” may refer to the SMP operator(s) under the copper access regime in case the market analysis reveals that there is no reason to segment within market 4 and/or market 5 as well as to new entrant(s) where the market demonstrates that a segmentation should be made within market 4 and/or market 5 and in no case rule out segmentation within markets 4 and 5 in terms of capacity, pricing or functionality.

In addition to the above, the NGA Draft Recommendation should expressly provide for a clear possibility for NRAs to analyse local/sub-national geographical markets for SMP status, to designate SMP operators (being either incumbent operators, alternative operators established on the market or even new entrants) and to impose duct/pipe access in those markets. Otherwise, the NGA regulation is likely to lead to unfair and disproportionate regulation of the operator which had been a SMP operator in the copper network, without regulating ducts and pipes, which will nevertheless have a larger impact on the development of the competition.

5. Risk sharing in access conditions and pricing, co-investment.

The NGA Draft Recommendation raises the possibility of “*mandatory access conditions including, if applicable, price controls [that] allow a reasonable return on the capital employed which should incorporate, as appropriate, a project-specific risk premium*” and includes then the possibility for new pricing models, allowing a fairer sharing of the investment risks. In fact, those conditions do not go far enough in providing assurance to potential investors that their long-term network projects have an unproven and risky business model, and even severely restrict the possibility to be applied in practice, thereby hindering their potential to reduce risk and increase investment incentives.

First of all, enabling success of NGA business cases instead of hampering the NGA roll-out requires wholesale and retail pricing flexibility, while:

- (i) The cost-based pricing is inappropriate for “still to be built” networks, as it doesn’t offer to telecom operators investing in fibre network and supporting all the risks related to these investments, a sufficient return on capital employed, while this is the key of any strategic decision-making process.
- (ii) The value-based pricing should be a driver for take-up and roll-out for new-built networks, as innovation in the network leads to the development of high added value products and therefore enables differentiation of retail prices and different profitability - in one word:

competition! - while this will *in fine* be profitable to all, both users and telecom operators, and enhances overall welfare by promoting further innovations and investment in NGA (“virtuous circle” idea).

- (iii) The appropriate “trigger” to withdraw price control remedies should be effective non-discrimination, while the point 40 of the NGA Draft Recommendation - meant to grant flexibility to NRAs - is not consistent given the fact that the functional separation is only imposed onto incumbent operators and that it is thus impossible to guarantee any equivalence of input. Moreover, in order to avoid any discrimination between operators in favour of alternative operators and/or new entrants in the NGA market, distorting competition, functional separation should only be imposed where it is effectively and objectively proven that other remedies have not resulted and will not result in the near reasonable future in effective competition.
- (iv) The increased risk in pricing of wholesale access should be adequately taken into account through:
 - Risk premiums, which should not only be considered in the calculation of costs of fibre cables but also in the calculation of civil engineering infrastructure costs - such as pipes and ducts -, as they represent a very high proportion of the overall investments in any NGA roll-out;
 - Long-term and volume contracts, which should - linked to segmented areas with increasing commitment - lead to a reduction of risk for the NGA investor. Therefore the new access price structures should incorporate fixed network costs or consider volume reduction and the access contracts should be based on long term commitments as the investment requires revenues which are profitable in the long run;
 - A variable wholesale pricing consistent with non-discrimination and a long-term “committed” access price as margin squeeze reference, as variable wholesale pricing based on volume and long-term commitments are consistent with the non-discrimination principle and as in a scale industry with long-term amortisation of assets volume and duration discounts are largely used. Risk diversification contracts should also be regional or local to enable smaller players to engage in a risk diversification on their respective market level. For these reasons, long-term commitment access price must be considered in margin squeeze test.
- (v) The deployment of any extra capacity for other operators should be expressly linked to the certainty for the investing operator that the related costs (including a fair return on investment) can effectively be recovered at short or at least certain given term, while such deployment of extra capacity is only viable in relation with co-investment by third parties.
- (vi) The necessity of consistency of margin squeeze methodology with Competition Law practices and cases, it being specified that the preference for a “reasonably efficient operator” test is not in line with competition practices and law and contradicts the regulatory objectives of supporting service penetration and NGA networks. In fact, the *ex ante* squeeze test proposed by the NGA Draft Recommendation would necessarily lead to inappropriate *ex ante* regulation of retail markets which clearly contradicts competition case law. A price squeeze test is a tool to be used *ex post* and not *ex ante*.

6. Conclusions

Further to the postponement of the adoption of the Telecom Package, it is vital for the sector that clear and proportionate common rules be timely set out to provide network operators and investors with the regulatory certainty required to timely make up their mind as to how, when and where roll out fibre in their network.

The NGA Draft Recommendation is a one-time opportunity to give proportionate and adequate regulatory guidance to promote NGAs in Europe, but needs therefore to provide for remedies duly and fully reflecting future market developments, technological progress and deployment of NGA – not historical copper environment.

As such, and even if it improved since 2008 to some extent, the current version of the NGA Draft Recommendation still need to be further worked out and substantially adjusted as emphasised above to provide the actors of the sector with suitable tools to successfully address the challenges lying ahead with all the regulatory certainty required for such key decisions.