

**Telefónica comments to the draft Commission Recommendation on regulated access to next generation access networks (NGA)  
[Draft 12 June 2009 for 2<sup>nd</sup> public consultation]**

## **Introduction**

Telefónica welcomes the opportunity to contribute to this second Commission consultation on the NGANs draft Recommendation.

Telefónica agrees with the objectives to provide clear rules and harmonisation of approaches at EU level. We appreciate the efforts made by the Commission to achieve these objectives and facilitate investments in NGANs.

However, Telefónica thinks that rather than facilitate investments, the draft Recommendation will probably do the opposite: under a regime such as the one depicted, it will be hard to attract investment into the deployment of NGNs, with negative impact on the future of European telecommunication operators (which will find very difficult to fund their activities) and consequently the European telecom market.

The general thrust of the draft Recommendation does not follow the basic principles by which NRAs should impose remedies in the market. Namely, it is contrary to the principle of proportionality, because it generally recommends imposing the maximum level of obligations (including cost orientation) at all levels of the network, and not a proportional set to safeguard competition.

It does not follow the principle of technology neutrality, because, as will be seen, it burdens some technology choices with more obligations than others. And, in general, it imposes greater regulatory burden on some types of optical fibre deployment (such as GPON) when compared to other FTTH technologies. It seems to follow the path of steering the market towards particular solutions, leaving other FTTH solutions in a disadvantaged position, which is difficult to reconcile with the general interest.

Moreover, apart from this steering of the market towards certain solutions, the burden imposed implies leaving FTTH in a disadvantaged position with regard to alternative infrastructures with other technologies, which are free of regulatory obligations. Other technologies of other players have to face mainly demand uncertainty, while optical fibre is also confronted with huge regulatory pressure.

The Recommendation is also inconsistent with the current regulatory framework which requires that remedies should be based on the problems identified in the market. By contrast, this Recommendation proposes the imposition of every possible remedy, disregarding the specificities of each national and geographic market.

The current regulatory framework has been defended by the Commission as basically valid also for NGNs, due to its flexibility. However, its application has to be made in a way that takes into account the asymmetric regulatory risk involved in imposing remedies on nascent technologies. Telefónica thinks that this is not the case, the draft seems to apply the current framework basically in the same way as was applied for the copper world, assuming that there will be optical fibre deployment regardless of regulation. In practice, the development of fibre in the EU is limited, and there is no certainty that it will be deployed. Applying the framework to NGNs in the same way as was applied to copper does not provide the adequate framework for facilitating investments.

## **Gradation of remedies**

In its response to the first consultation, Telefónica raised the need to have a minimum, proportional and consistent set of remedies adapted to the different degrees of competition of the different areas. Not all remedies will be necessary at the same time in all geographic areas. And all the remedies have to be studied in a joint, coordinated and forward looking manner.

The draft Recommendation seems to recognize to some extent that gradation of remedies should be taken into account by NRAs. This is somewhat reflected in recital [21] and paragraph [41]. Telefónica supports the rationale of these two paragraphs. However, in other parts of the draft Recommendation the principle seems to be the contrary, as all the obligations for access products seem to apply in all cases. Telefónica thinks that this is not in line with the principle of proportionality and nature of the problem, undermining the business case for fibre.

Telefónica would like to highlight that the principle of gradation of remedies can help to have a proportional and competitive framework, reducing complexity and regulation of wholesale markets where possible. At least a graduated approach to remedies should be possible:

- In geographic areas where infrastructure competition is possible or is considered feasible in the long/medium term, regulation should not prevent this to happen. This can be achieved, for instance, by relying on “passive” remedies.
- In geographic areas where infrastructure competition is not delivering results or is considered not feasible, other type of “active” remedies could play the main role.

This should be seen as logical consequence of the development of networks and alternative providers, that have always concentrated in the most dense and profitable areas. Experience shows that not all remedies and wholesale products in general are necessary everywhere. Moreover, it is precisely the role of NRAs to establish the more suitable set of remedies to each market depending on its specific circumstances.

In any case national differences of competition between the different geographic areas within a country have to be taken into account. There are countries more homogeneous than others that would call for a more careful study of competition conditions and prospective competition conditions and therefore would call for a different application of remedies.

## **The gradation of remedies should recognise the role of access to ducts/ civil infrastructures**

The Commission approach to the role of access to civil infrastructures has changed substantially from the previous consultation. In the previous consultation the Commission recognised that civil infrastructures imply between 50-80% of the costs of deploying networks and that access to these is necessary to facilitate infrastructure competition, at least where possible.

In principle, for FTTH solutions in the densest areas, if there is an effective and non-discriminatory access to ducts, it would imply that alternative operators have access to the deepest economic bottleneck. The obligation of access to ducts could be complemented by an obligation to provide alternative ducts path or providing dark fibre in case there is no space in existing ducts.

The draft Recommendation itself says that NRAs should assess the demand and cost of access to civil engineering infrastructure, and mandate access in accordance with market demand. This appears logical, as obligations for wholesale services should be studied in that way. However, it is difficult to understand why after making a consultation, study the demand and mandating access to ducts, this does not have an influence on NRAs criteria for mandating access for downstream products. For example, in the draft Recommendation, mandating access to civil infrastructures does not have any influence on the obligations for other downstream wholesale products. This is contrary to the principle of proportionality that must be followed by NRAs when establishing the remedies.

In a graduated approach, the availability of a wholesale offer upstream (such as ducts) should lessen the requirement of other wholesale obligations downstream. If ducts are available and provided on a non-discriminatory basis, there is an opportunity of having infrastructure competition for FTTH networks. If wholesale broadband access is regulated and under cost orientation, alternative operators will probably not invest deep in the network, as they will be worse off regarding other competitors.

## **Symmetric obligations for the terminating segment / access to ducts**

Another issue that contributes to make investment in FTTH networks difficult is a key aspect missing from the Recommendation: symmetric sharing obligations for building wiring / terminating segment.

The Recommendation should also include a requirement for NRAs to study and encourage that all types of passive infrastructures (other than the SMP player or telecoms) are shared and made available in order to maximise possibilities to deploy telecommunications networks. This would help to facilitate investment and decrease costs of network roll-out where possible.

Telefónica thinks that this is a key aspect missing, because all the obligations foreseen for access to ducts & passive infrastructures for future networks developed in the Recommendation would not be complete without also clarifying the issue of the treatment of in-building wiring and ducts of other players and sectors.

In this line, the existence of alternative civil infrastructures should be taken into account before imposing any obligation of duct access. For example, in France, only 20% of NGANs deployed by alternative operators are supported on the civil infrastructures of France Telecom.

These two issues, as many others, present several national specificities, but at least the Recommendation should encourage NRAs to lay down a proportional framework at national level of symmetric sharing obligations for the terminating segment and encourage where possible the use of all civil infrastructures.

The last Commission comments to the CMT notification for in-building wiring reflect some doubts about the imposition of symmetric obligations<sup>1</sup>. We understand that the Commission comments were due to Art. 12 of the current Framework Directive that foresees sharing obligations not linked to economic issues.

However, the Art. 12 of the Framework Directive that is to be approved under the revised Directives, provides more room for symmetric obligations based on economic issues. It would be appropriate that the agreed changes of this article are taken into account in this Recommendation.

## **The “favoured” models**

The Recommendation tries to “encourage” certain technical and/or architectural solutions, giving to these solutions a more favourable regulatory treatment.

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<sup>1</sup> Case ES/2008/0820

This is not in line with the principle of technology neutrality and is akin to steering the market towards certain solutions, a decision that should be taken by the investing players and the consumers (by choosing among the alternatives provided by the market).

For example, our reading of the Recommendation implies at least:

- NRAs not to impose cost orientation in case of FTTH multifibre or co-investment + multifibre under certain conditions
- NRAs not to impose remedies in market 5 if fibre unbundling (FTTH) is likely to lead to downstream competition
- NRAs may not apply cost orientation in market 5 if there is effective functional separation that guarantees EoI

These types of possible regulatory “advantages” do not follow the logic of the EU framework and its typical criteria to apply remedies based on the nature of the problem identified, proportionate and justified in the light of the objectives laid down in Article 8 of the Framework Directive.

Furthermore, price control/ cost orientation according to the access Directive may be imposed in situations where a market analysis indicates that a lack of effective competition means that the operator concerned might sustain prices at an excessively high level, or apply a price squeeze, to the detriment of end-users.

Cost orientation according to the access Directive seems to be linked to avoid excessive prices, but not to “encourage” or “give incentives” to specific network models. Especially when there is not real basis or experience to think that these models will imply a more competitive retail market.

They also severely limit the possibilities of NRAs. The Recommendation implies that in national markets where these type of solutions are not used by market players, NRAs have to impose the maximum level of obligations in markets 4 & 5, including cost orientation of all wholesale products, without any possibility to make a graduated approach and without having the possibility to make a cost-benefit analysis of the proportionality of the obligation.

Although many NRAs have not yet set a detailed framework of obligations, NRAs that have studied NGANs in market analysis or that have set policy guidelines have not generally included this maximum level of obligations.

## *Multifibre:*

Regarding multifibre solutions, Telefónica has no experience so far about this type of solution, and as far as we know, there is hardly any experience in the world about these types of fibre development and its subsequent impact on competition.

What seems clear from the outset for an operator that deploys FTTH is that a multifibre approach implies an increase of costs. From a business perspective point of view, an operator will probably not choose a more expensive option, as it will imply higher wholesale and retail prices and more problems to compete. Especially in countries or geographic areas where an operator deploys FTTH in competition with cable networks upgraded to DOCSIS 3.0, it will have to use the most cost effective approach.

## *Multifibre in the terminating segment*

The investment needed for deploying the terminating segment in case of FTTH usually imply a very important part of the total investment, especially in cases where there is space in ducts for the feeder segment and PON structures are used. In these cases, in urban areas the investment for passing homes can reach 50% of the initial investment.

For these reasons, the solutions adopted for the terminating segment can be critical to reduce CAPEX and OPEX, and make the new services viable. There are different technical solutions that are underway and being tested in real commercial experiences. These solutions try to optimise the necessary investment for passing a home, the investment to connect a user, the operating procedures for connecting users, the infrastructures and operating procedures to allow a change of operator.

The optimal technical solution can differ depending of parameters such as:

- Type of buildings (buildings where ducts for wiring are available, buildings with/ without space for laying new ducts, multi-dwelling building or individual houses, etc.)
- The prospects of demand in each area
- The number of concurrent operators

Telefónica is applying technical solutions tailored to the parameters of each case, but there is still limited experience and it is likely that the solutions vary with technological evolution and the practical experience.

For example, a conclusion of the pilot projects has been that in buildings with internal conditions not suitable for wiring, the best solution is to deploy wiring on the façade of the building adapted to the existing demand. This allows to minimise costs per home passed and delay a fair amount of costs of building wiring until there is enough demand. This solution, that is more beneficial from an initial capex point of view, is not easily compatible with a multifibre model, which usually requires a complete wiring of the building.

Telefónica believes that NRAs should not favour specific technical solutions, such as multifibre. Its adequacy to improve competition or optimise costs can vary depending on deployment peculiarities and the moment of network deployment. On the other hand, multifibre has not proved that it is more favourable for competition.

There is no reason to believe that other solutions could not perfectly work from a competition point of view. For instance, a symmetric obligation for efficient and non-discriminatory access to the fibre terminating segment can perfectly work with a monofibre approach. The important issue here is that the change of operator works in a timely and adequate way, rather than the particular technical solution that is followed.

### *Co-investment*

The Recommendation also mentions co-investment and provides to it some regulatory advantages when deployed using multifibre under certain conditions. Telefónica sees co-investment mainly as a business decision that may have logic depending on many factors.

For example, in greenfield areas or in cases where the roll-out of the NGAN requires a roll-out of new civil infrastructure, co-investment can help to reduce capex and benefit the overall market development.

**Telefónica does not see any need to provide regulatory incentives to encourage participation in these kinds of initiatives**, but be seen (co-investment itself) as a means – which may take different forms – to solve particular problems under specific circumstances or geographic areas and which from the outset cannot be easily anticipated; the market, as a result of the competitive play, should be allowed to adopt different solutions over time and across the territories in accordance with the visions, strategies and judgements of competing market players.

### *Fibre unbundling and the choice of fibre technologies: P2P vs. GPON*

The Recommendation seems also to favour P2P FTTH over GPON, when it foresees that obligations for bitstream *should normally not be imposed when there is effective fibre unbundling that is likely to result in effective competition on the downstream market.*

It is difficult to understand why this type of “waiver” for bitstream is foreseen only when there is *effective access to the unbundled fibre loop*, and is not foreseen more generally when remedies in market 4 are likely to result in effective competition on the downstream market (for example, access to ducts + access to the terminating segment in FTTH scenarios).

But apart from that, the choice of technologies should be a prerogative of the investing operator, which has to choose the most efficient technology to meet market demands and

face the competitive situation. In the case of Spain, for example, Telefónica is using GPON and one of the reasons is that it is better suited to a gradual and selective deployment, what is important in view of competition of cable operators. It is also more suitable in places where there is no unlimited availability of space in civil infrastructures. In some urban areas P2P implies building new ducts, that can raise considerably the costs and time of deployment.

### *Functional separation*

It is difficult to understand the logic behind a possible exception to cost orientation in the wholesale broadband market when there is functional separation.

In principle, functional separation in the EU framework has been proposed by the Commission as a regulatory tool *to improve competition in several relevant markets by significantly reducing the incentive for discrimination and by making it easier for compliance with non-discrimination obligations to be verified and enforced. In exceptional cases, it may be justified as a remedy where there has been persistent failure to achieve effective non-discrimination...*<sup>2</sup>

So functional separation is linked to non-discrimination, it has no real link with cost orientation obligations.

It is clear that regardless NRAs and operators approach to non-discrimination, the pricing obligations of wholesale services have to be determined studying the suitability of those obligations in the light of their effectiveness in achieving a competitive retail market.

### **Obligations to deploy networks with specific features/ capacity**

In a number of points, the draft Recommendation implies a number of specific obligations for operators that deploy networks. These obligations imply deploying the network with specific features or capacities. It is necessary to state that this kind of obligations has no precedents in the electronic communications regulatory frameworks, and are contrary to the principle of technology neutrality.

These are the main obligations identified:

- Extra space in new ducts
- Location of the distribution point for the terminating segment, that will be able to place enough number of end-user connections

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<sup>2</sup> Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directives 2002/21/EC on a common regulatory framework for electronic communications networks and services, 2002/19/EC on access to, and interconnection of, electronic communications networks and services, and 2002/20/EC on the authorisation of electronic communications networks and services COM(2007) 697 final

- Multiple fibre lines in the terminating segment ( “encourage” or “oblige”, where legally feasible)
- Size of street cabinets

While some of these features may be undertaken by the operators themselves in some cases, these obligations have an undeniable impact on capex. The uncertainties about NGANs imply also uncertainties about if these costs may be recouped or not.

It would appear more reasonable for the Recommendation to encourage NRAs to make national consultations where these issues are debated to better understand its logic, the possible demand scenarios and the costs involved (as suggested by the draft for access to ducts). The solution cannot simply be to oblige the SMP operator to deploy its network with extra capacities, bearing all the extra costs associated.

In case these types of features/ capacities are demanded by operators willing to use them, the most reasonable solution would be to encourage investment parties and access seeking parties to reach agreements for the funding of these features. If they consider them necessary for their future network roll-out, the most logical solution would be to contribute to their funding by the players willing to use them, or establish a mechanism that allows the investing operator to recoup the costs involved if they are not used, as it is an extra cost based on a decision not made by the investing player.

## **Wholesale broadband access – stop of retail offers**

On point 33, the draft recommends that bitstream services should be available at least six months before the SMP operator markets its retail services.

It is clear that wholesale broadband services cannot be unreasonably delayed, and the difference in timing cannot be used for anticompetitive purposes. However, there should be a balance between safeguards for competition and allowing the market to develop dynamically and allowing the SMP player the necessary freedom to compete in the retail market.

There are countries or geographic areas where the incumbent player competes with the NG offers of cable operators. In some of these areas the cable operator is the market leader in retail broadband, even if the incumbent operator has been found with SMP at the national level. In these cases, a delay in the introduction of retail offers would prevent the incumbent operator to compete in the retail market on equal conditions and with the most advanced offers, what is negative for the market dynamics. This calls for a flexible introduction of this type of requirements.

In any case, this point would imply (depending on the cases) to stop retail offers, meaning a regulation of the retail broadband market, that is not included in the Relevant markets

Recommendation. In the comments to a CMT notification, the Commission view was against the stop of retail offers:

*As described above, the obligation imposed on TESAU not to perform anticompetitive practices is based on a two-step test conducted by CMT aimed at analysing the retail offers of TESAU and intends to prohibit them in case the above test indicates a margin squeeze. This seems to result in regulation of broadband retail offers ... However, the retail broadband market is not included in the Recommendation and it is, therefore, not susceptible to ex ante regulation.<sup>3</sup>*

## **Economic issues**

### *Cost orientation as the default option*

The draft Recommendation follows a line of economic regulation that raises the obligations for wholesale products to cost orientation as the preferred methodology (with the few exceptions for certain “favoured” models).

With NGANs having very limited deployment up to now, and business cases still not clear, Telefónica thinks **that it is very difficult right now to have a sound assessment of the costs and possible ARPUS that can be achieved.**

The room for making mistakes of a cost orientation obligation is especially high for the services and wholesale products involved in future networks (probably with the exception of ducts or sub-loop unbundling).

For several of the wholesale products involved in NGANs, it would be more reasonable to start with a cautious approach to pricing regulation, studying the merits and the need of pricing regulation of the different types of wholesale services in the light of the national conditions. For example, a methodology such as retail-minus and a reasonable price squeeze test could be applied for some of them, as was applied and is applied in several Member States for current wholesale broadband access.

### *Price squeeze methodology*

Telefónica supports that NRAs specify in advance the imputation test, the parameters to be used and the remedial mechanism for price squeeze. Certainty is important for all players when designing business plans.

However, the type of test that seems to be recommended by the Commission:

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<sup>3</sup> Commission comments on Cases ES/2007/0620-626: details of remedies related to cases ES/2005/0326-329, ES/2006/0336-337, ES/2006/0370

*... a "reasonably efficient competitor test" will normally be more appropriate... (recital 27)*

*... NRAs should ensure that a sufficient margin remains between wholesale and retail prices to allow for market entry by an efficient competitor. (Paragraphs 25<sup>th</sup> and 39<sup>th</sup>)*

is different to what has been set by The DGCom and the ECJ in article 82 margin squeeze cases where the criteria is the "equally efficient competitor" test.

The Guidance on the Commission Enforcement Priorities in Applying Article 82 of the ECT to Abusive Exclusionary Conduct by Dominant Undertaking, has recently confirmed this approach in its paragraph 80<sup>th</sup> where the equally efficient competitor test is the reference for analyzing margin squeeze conducts.

Telefónica considers the application of the "reasonably efficient competitor" test, as EC suggests now, by EC and NRAs would be contradictory with its precedents set out in the past and introduces legal uncertainty to operators. If the EC adopted this test in the Recommendation on NGA, SMP undertakings, may end up having to pass two different and, in some cases, contradictory tests.

Those two different criteria for analyzing the same margin squeeze behaviour raise some concerns, about its applicability in the context of NGANs.

For this reason Telefónica view is that a common approach to margin squeeze has to be set by the Commission, whatever the Authority entitled to apply the test (Competition or Regulatory bodies at a National or European level).

## **Annex I - pricing principles and risk**

### *Criteria for setting the risk premium (point 6 of annex I)*

The draft Recommendation quotes a series of reasons that may imply a mitigation of the risk of the project for the SMP player. One of them is the proceeds from the sale of real state.

It should be pointed out that for a telecommunications company the risk of the project depends on the uncertainties about the demand and is independent of the ways of financing of the company. The capital invested in the new networks has to be rewarded with a risk, whatever the origin of that capital is.

The analysis of risk should be carried out on the level of business models due to the fact that different business models (for example FTTC for end customers or FTTB for SME) have different risks attached to them, which should be reflected in the regulatory proceedings.

*Criteria to assess long-term access pricing and volume discounts in case of FTTH (points 7 & 8 of annex I)*

The draft Recommendation tackles long-term access pricing/ volume discounts as a means of risk sharing. Indeed, they could be means of sharing risk, but not exclusively, as different conditions for long / short term contract / volumes is standard practice in any commercial market.

- Probably time commitments are more related to risk, because a time commitment by an access seeking operator provides more certainty to the investing operator, but not exclusively.
- Volume discounts can also be justified by the lower transaction costs, such as negotiation, billing, operation & maintenance, traffic or capacity concentration, etc.

So these types of discounts cannot be exclusively linked to a decrease of the risk of the operator providing access.

So it would be necessary that wholesale pricing of new products based on NGANs are open to these types of schemes. It is also clear that long term access pricing / volume discounts imply better pricing options for larger operators. However, applying these types of schemes does not necessarily mean to discriminate, or more precisely, that undue discrimination exists.

Applying a strict view of non-discrimination in this context would run against the normal business logic applied in most economic sectors.

It will also be against the normal practice of markets and even in some cases applied by NRAs. For example, capacity – based interconnection, working for many years in Spain, favours larger operators to some extent. Peering agreements depend critically on the volume of the operators involved.

Another issue of these two points of the annex is the approach to non discrimination that could be applied by NRAs:

For example, on point 7 about long term access pricing, the draft Recommendation says that it may be abused by the SMP operator *...Long-term access pricing may however be abused by the SMP operator over time to sell its retail services at prices lower than those for its regulated wholesale services (since it would charge its own downstream retail arm low long-term commitment prices), thereby in effect foreclosing the market. Furthermore, alternative providers with smaller customer bases and unclear business perspectives face higher levels of risk. They are unable to commit to purchasing a large number of fibre lines over a long period.*

It is reasonable that long term pricing and volume discounts cannot be designed in such a way that allows for undue discrimination by favouring the SMP retail arm. But they cannot be restricted to the extent that makes viable any kind of alternative provider, even with *smaller customer bases and unclear business perspectives*.

This would mean going too far in the non-discrimination principle, an issue that has not been followed by NRAs so far. In fact, NRAs normally should also promote that efficient competitors enter the market, and the focus of NRAs should not be an extreme protection of the smallest operator.

NRAs should have in mind investment and competition in retail markets, for the benefit of consumers. Probably they should also have in mind the players that invest to an appreciable extent in infrastructures, but not the smallest operator in each national market.

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