

Position of Telekom Austria on the EC's Recommendation 2nd Draft

"Next Generation Access Networks" ¹

July 24th 2009

¹ 2nd Draft: COMMISSION RECOMMENDATION on Regulated Access to Next Generation Access Networks (NGA)

POSITION OF TELEKOM AUSTRIA ON THE EC'S RECOMMENDATION ON NGA

I. KEY REQUIREMENTS:

1. **Leave** detailed features of cooperation and roll-out to the market (network architecture & cooperation arrangements between operators should be business driven).
2. **Allow** fair calculation of risk and of costs (e.g. **Full risk premium should be granted for all NGA-related investments**)
3. **Promote** additional risk-sharing options in order to stipulate investments;
4. **Enhance** pricing flexibility to enable the success of the NGA business case;
5. **Acknowledge** competitive pressure from other platforms and include alternative prevailing infrastructure as regards NGA access obligations;
6. **Consider** the conditions of competition at national or sub-national level and take full account of geographic differences in competition
7. **Establish** a policy that does not subject investors to more risks than in other sectors.

II. INTRODUCTION:

"The deployment of Next Generation Access (NGA) networks based on optical fibre requires substantial investments in the coming years. To this end, efficient investment and innovation in new and enhanced infrastructure should be promoted, taking due account of the risks incurred (...)"²

In March 2009, the **European Council**³ recalled the **fundamental role of telecommunications** and broadband development in terms of European investment, job creation and overall economic recovery. In addition, the **EU Commission** publicly announced that it **welcomes the development of future networks** and referred to it as a means of facilitating **innovation** and **long-term consumer welfare**. The overall consent on the positive impact of successful development of high-speed

² Brussels, Draft 12 June 2009 for 2nd public consultation; Draft Commission RECOMMENDATION on Regulated Access to Next Generation Access Networks (NGA)

³ See Recital 17 of the *Conclusions of the European Council* of March 19/20, 2009 (Document number 7880/1/09)

broadband and on the decisive role of the sector for economic gains could have led to a revised Recommendation on NGA which fully mirrors this opportunity. But the 2nd draft on NGA does not yet succeed in shaping a truly innovative regulatory environment that could trigger investment on a large scale.

Unfortunately there seems to be a **bias on essential economic and technological decisions** in the 2nd draft which even risks **conflicting with the EU Commission's own announcement to foster innovation**. We would like to point out that this bias **contradicts major principles of the current EU directives** (technology neutrality; proportionality) and **is not completely in line with** the proposals of the **EU Parliament** and the **European Council for a future legal framework**.

Telekom Austria is surprised that despite the fundamental shifts in technology and services development in the move to NGA, the draft *Recommendation* assumes - and partly recommends - an unchanged approach to market definition and remedies⁴ and thus ignores competitive pressure from other platforms. We thus appreciate the opportunity to submit our position on the 2nd draft.

III. PROPOSED AMENDMENTS FOR THE RECOMMENDATION:

Although we appreciate the EC's announced ambition to strengthen the innovative potential of the European marketplace, we do not consider the current *Recommendation* to be an adequate legal and regulatory answer to this goal.

As even **European regulators have criticised**, one of the **major flaws of the Commission's approach** in the 2nd draft recommendation is the **repeated technological and regulatory bias**. We thus see the necessity to amend the current Recommendation as follows:

⁴ See points 32, 34

1. ACKNOWLEDGE ECONOMIC AND TECHNOLOGICAL FEASIBILITY

The prevailing *Recommendation* **exclusively focuses on a sole model** for the technological implementation **(multi-fibre)** and **on a rigid, predefined model of cooperation for NGA**. According to the EU Commission **this concept should be the unique blueprint for all 27 EU countries**.

Unfortunately, this approach is technology biased. It undermines the principle of technology neutrality under the EU Framework directive. Technology neutrality implies that investors can choose the most appropriate high-speed broadband technology that suits market needs. Telekom Austria is surprised that the EU Commission is convinced that linking **a specific network topology with the degree of market intervention** has a basis in the EU legal framework, as this approach clearly ignores heterogeneous market conditions.

The current approach might even undermine economic **feasibility and economic efficiency**: For instance, from a technical point of view, multi-fibre requires FttH. But not by all means and in every circumstance would FttH be the most cost-efficient solution for the roll-out.

As recent figures show, so far there is no clear 'leading technology' in FTTx markets worldwide. Yet the Recommendation focuses on fibre unbundling⁵ as an obligation irrespective of the technology used. This attitude is likely to discourage deployment of a specific technology versus others⁶. In addition, the provisions in the *Recommendation* for setting the risk premium depending on the technology used, limits entrepreneurial freedom of choice in advance and might impede economic efficiency, which we feel could also be endangered by the EU-Commissions's regulatory approach towards wholesale prices (preference for the "reasonable efficient competitor" test) in the nascent NGA market.

⁵ See point 20: Telekom Austria strongly opposes the focus of the new draft Recommendation on "fibre unbundling" which was not present in the previous draft Recommendation.

⁶ One of the most common technologies used for FTTH roll-out, GPON, currently does not allow physical "unbundling" at the 'MPoP' (metropolitan point of presence)

The use of the “reasonable efficient operator” test as suggested in the Recommendation either lowers penetration by raising retail prices or lowers incentives for investment by artificially lowering wholesale revenues.

Moreover, the EU-Commissions preference for a “reasonably efficient operator” test risks to conflict with competition case law and the policy objectives of the framework to promote service penetration and new investment.

Telekom Austria thus encourages the Commission to allow investing operators to set market based wholesale prices. Telekom Austria is concerned that the prevailing proposals in the Recommendation could lead to inefficient investment and suboptimal results in the market.

We therefore need an economically truly efficient, business driven approach (this includes market based wholesale prices) that clearly enables companies to recoup their heavy investments.

2. EXPAND ECONOMIC SCOPE FOR EFFICIENT ROLL-OUT:

In addition to the **technological bias**, which could hamper the success of efficient roll-out, the *Recommendation* limits **the economic scope** of undertakings by **predefining the amount of cooperation partners** which would qualify according to the EC, as a trigger to possibly ease regulation.

Yet the *Recommendation* leaves open as to why this particular amount of partners has been chosen as an indicator for potential deregulation. As the present consultation document is not accompanied by an explanatory note or an impact assessment, it is not clear why the Commission has included specific new cooperation models in its draft.

A bias against a particular form of cooperation would undermine the ability of investors and competitors to agree on the most suitable form of cooperation and

ownership structure. A bias against a particular NGA roll-out scenario could result in less NGA investment.

Moreover, a centralised, **one-size fits all approach would also endanger the promotion of innovative products** and services and ignores different market realities. Austria, for instance, has been at the **forefront in Europe** as regards **fixed to mobile substitution** (for voice and meanwhile even broadband services⁷) and platform competition **is highly advanced**. Therefore, it seems highly unrealistic for the Austrian market to reach an agreement with **at least** four partners⁸ to jointly roll out an NGA network, as suggested in the Recommendation. Therefore, specific local circumstances and market conditions must be considered.

The *Recommendation* should not preclude the development of specific market trends and heterogeneous features of demand. Rather, the *Recommendation* should ensure that NRAs **consider the conditions of competition at national or sub-national level** and **take full account of geographic differences in competition**.

3. ACKNOWLEDGE PRINCIPLE OF PROPORTIONALITY in REGULATION:

Overall, the EU Commission still considers the ladder of investment as a reference concept and continues to impose **very strict obligations on established operators** in advance, without properly acknowledging the impact of other platforms and industries on the market, except for a very specific sub-set of the multi-fibre and co-investment scenarios⁹.

The **draft foresees the parallel imposition of all available access remedies in the relevant wholesale markets** (unbundling of the local loop, duct sharing and wholesale broadband access). This contradicts fundamental principles of the EU

⁷ Customers in Austria embrace mobile broadband as a valid alternative to fixed net access (via DSL or CaTV. As a consequence 39% of all broadband connections within Austria have been realised through mobile access (datacards) as of the end of May 2009.

⁸ In areas with presence of cable operators at least three partners

⁹ See Rec. points 23 – 26, 37 – 39, Annex III).

Regulatory Framework¹⁰ (competition law principles, principle of proportionality¹¹) which have explicitly been emphasized by the European Parliament as the main principle for any regulatory intervention, **especially to avoid risks for innovation at an early stage.** It also disregards existing regulatory approaches adopted towards NGA by some NRAs in Europe¹², who have started with a more gradual approach.

Another point of critique lies in the **regulatory bias** of the prevailing *Recommendation*: Despite the increasingly **symmetric nature of competition challenges** in NGA, the imposition of overall remedies remains **asymmetric** - imposed solely on current SMP operators¹³. Hence, in this respect Telekom Austria would stress that the local access bottleneck may be present **irrespective of a SMP-position** in market 4, e.g., when a **utility provider, an entrant or a cable operator** deploys fibre on the 'last meters' to the home. **Any of those investors listed may have SMP on markets 4 and/or 5.** It is thus very regrettable that despite these facts, under the current regulatory practice, an SMP-designation in these cases may remain a rare exception.

Unlike the situation in 1998, where it might have been justified to break up already existing networks by imposing special access obligations on SMP-operators it is no longer appropriate to stick to the old SMP-approach, since incentives must be found to trigger the roll out of new networks. Additionally, the ECs Recommendation does not take into account networks established by alternative operators, utility providers or cable operators.

Hence, the *Recommendation* should address the possible need for **access to basic facilities** in the access network technology-neutral manner and **irrespective of an SMP-position. Competitive pressure from other platforms** must be **taken into account.**

¹⁰ The telecoms framework rather foresees a limited set of ex-ante obligations which generally constitutes an **upper limit** of intervention (s. Art.8 (3) Directive 19/2001/EC).

¹¹ Art. 8.3, 12 Access Directive

¹² E.g. Netherlands, France, Portugal: Regulators apply graduated obligations with different nuances graduated obligations.

¹³ current markets 4 and 5

As stated in the beginning, given the consent on the positive impact of the roll-out it is surprising that the draft *Recommendation* assumes - and partly recommends - an unchanged regulatory approach despite fundamental shifts in technology and services development in the move to NGA.

4. ALLOW FAIR CALLCULATION OF RISKS AND OF COSTS :

Telekom Austria welcomes the integration of investment risk in the draft *Recommendation* and its attempt to address it through new forms of commercial contracts for risk diversification. However, the proposals still fail to adapt concepts like the cost-orientation principle and the margin-squeeze test to the nascent NGA market.

Although the draft *Recommendation* recognises the benefits of flexible pricing of wholesale products for NGA investment, it denies these benefits to all but one particular investment and/or roll-out scenario. This constitutes one of the major missed opportunities of the draft *Recommendation*. Pricing flexibility should be applicable in all roll-out scenarios and irrespective of the specific form of enforcement of non-discrimination by NRAs¹⁴.

Cost-orientated prices for all regulated wholesale products for NGA networks are foreseen. Strict cost-orientation as a form of price control, however, would in many instances undermine the NGA business case of the investor which critically relies on pricing flexibility for new services. The appropriate measure regarding the determination of the wholesale price level should be the retail price level instead of a rigid cost-orientation obligation.

Usually products and services at the upper end of the performance and quality scale (QOS, reliability, bandwidth) allow higher margins than standard mass market products (best effort). This price differentiation is driven more by different values of benefits rather than by different cost functions.

¹⁴ Delete Point 40 which appears inconsistent with the EU legal framework.

Pure cost-orientation would therefore lead to a distortion of existing price structures and profit erosion. Effective competition at retail and wholesale level can be ensured without cost-orientation of bitstream products.

A similar distortive effect would be implied by the imposition of the pricing rule outlined in annex I. *“The price of access to physical infrastructure should not be a geographical average in the presence of substantial cost differences between various areas”*¹⁵. The principle of averaging in the area of ULL-costing is widely accepted in the EU and is a contribution to bridging the digital divide. Cost-based pricing based on different costs per region tends to result in lower prices in urban areas in comparison to rural areas. Therefore, competition in urban areas would be exacerbated (areas where platform competition already exists) and the establishment of infrastructure-based competition in rural areas would be prevented. Therefore, Telekom Austria suggests deleting this clause.

Regarding the consideration of increased cost of capital (risk premium) Telekom Austria does not agree with the proposed approach by the draft *Recommendation*. The investment in NGA, independent of the technology mix/network layout chosen by an operator, leads to a significant higher business risk. This increase in risk is associated with the investing company as a whole. This is because investment in NGA depends on several uncertain factors such as assumptions of significantly higher ARPU or increased demand and market shares.

Therefore it does not seem appropriate to reduce the addition of a risk premium as part of the calculation of costs, only to the FTTH-case.

IV. MAIN PROPOSALS FOR AMENDMENTS:

1. **Adequate calculation of risk & of costs** to allow for profitable business case:

- **Pricing flexibility** instead of strict cost-orientation should be applicable in all roll-out scenarios.
- **Full risk premium should be granted for all NGA-related investments**

¹⁵ See clause 3 of Annex I

- **Additional risk-sharing** options should be supported in order to promote investments
- **Regional price differentiation should be avoided** to reduce the danger of digital divide

2. **Entrepreneurial freedom of choice** to allow for economically and technically efficient roll-out:

- **Preference for network architecture** should not trigger regulation. Choice of most suitable national network topology depends on feasibility and efficiency criteria.
- **Cooperation models** should be subject to entrepreneurial wisdom and efficiency. Legal ex-ante preference for detailed features of cooperation (e.g. number of partners) should be avoided. A bias against a particular NGA roll-out scenario could result in less NGA investment.

3. **Proportionate, technology-neutral, symmetric regulatory approach** to reflect competitive pressure from other platforms and to acknowledge heterogeneous market conditions:

- **Symmetric regulatory approach:** The *Recommendation* should address the possible need for access to basic facilities in the access network in a **technology-neutral** manner and **irrespective of an SMP-position**. Prevailing alternative infrastructure **e.g. of utility provider, an entrant or a cable operator** should be taken into account as regards NGA access obligations.
- **Geographic differences** (*competition at national or sub-national level*) should be fully taken into account.
- **Graduation of remedies** *should reflect competitive pressure from other platforms (delete focus on fibre unbundling)*
- **Deletion of Annex 3** in the *Recommendation*;

V. CONCLUSION:

The *Recommendation* should be careful not to promote a particular technology, network architecture, or form of commercial cooperation. Such an approach would

contradict the principle of technology neutrality under the EU Framework directive and the **spirit of innovation necessary to strengthen the European Union**. In addition, the *Recommendation* should **fully acknowledge** the fact that **economic and technological feasibility of next generation architecture also depends on size, structure and demand features of the national market**.

Guidance on regulatory treatment of NGA should thus fully **reflect** that **effective** competition can be achieved under **several deployment types, risk-sharing or cooperation arrangements**. Hence, an **unbiased Recommendation for the sector** would be a **key requirement** that is still to be met by the EU Commission.

Especially with regard to the **risk premium** and the **proportionality of regulatory interventions**, Telekom Austria **calls for**:

- ***A technology-neutral and more economic approach*** that truly supports efficient large scale investments
- ***An innovative framework*** that does not subject investors in the telecommunication sector to more risks than in other sectors

The process of shaping the legal framework for further investments in the sector is not only a process of paving the way for further competitive conditions in Europe. It is also a process that mirrors the degree of commitment decision-makers are willing to put into the innovative potential of the European Union.