



**Joint UK submission from the Department for Business, Innovation & Skills
and Ofcom to the second public consultation on a revised draft
Recommendation on regulated access to Next Generation Access networks
July 2009**

Introduction

The UK welcomes the revised draft Commission NGA Recommendation and recognises that the Recommendation is a significant advance on the previous draft, consulted on last year. However whilst the UK is of the view that the draft could be further improved the UK would like to take this opportunity to recognise the European Commission's effort to achieve the difficult balance between the need to promote competition and the necessity of creating an appropriate degree of certainty for investors.

The UK is also of the view that achieving such an objective, in the current economic climate, coupled with the risks associated with NGA technologies, rollout and the uncertainty of demand for the services delivered over NGA networks, represents a considerable challenge to all stakeholders not least national regulator authorities (NRAs) as well as communications and service providers.

This underlines the need for the European Commission to offer appropriate guidance to NRAs in relation to these matters, but also to encourage innovative thinking in the face of such challenges. This is particularly important given that we are still at such a nascent stage in the rollout of such networks and the delivery of new content and services carried over them.

Consistency in the implementation of the regulatory framework across the EU 27 is an important factor in enabling the development of a single European telecoms market. Failure to achieve this will create barriers inhibiting the capacity of service providers to meet the needs of large-scale business customers with pan-European operations.

We are nevertheless generally of the view that the types of remedies, including how and when they are and are not to be applied, may appear be overly prescriptive in the draft Recommendation as it stands. Indeed, we are keen to ensure that elements of the draft Recommendation should not be interpreted as fettering

independent national regulators discretion with regard to application of such remedies, irrespective of the conclusions of a market assessment carried out under the EU Framework.

Rather the UK believes that there is a need for the appropriate market reviews to define the relevant market, assess competition within them, assess whether anyone has significant market power (SMP) in the relevant market, and tailor regulatory remedies accordingly.

We therefore offer a number of comments and suggestions within this response, which we feel would address the concerns of the UK and would, in our view, significantly advance the practical adoption of the Recommendation throughout the EU to the benefit of its business and individual consumers. In particular, we would like to highlight to the Commission our comments and suggestions in relation to the need to ensure:

- 1) flexible approaches to pricing and cost orientation;
- 2) a competition-based approach to co-investment models;
- 3) the benefits of cooperation between national regulators and industry in the development of standardisation of networks and services;
- 4) flexibility in the approaches that NRAs may adopt in relation to margin squeeze tests set in place of cost orientation obligations and urges against the use of generalised, mechanistic criteria to perform *ex ante* margin squeeze tests in this fast evolving part of the sector; and
- 5) effective migration and phasing out

Our comments are made on the draft recommendation in its capacity as a self-contained document: although we understand that it is the intention of the Commission that it should be viewed as one component, amongst others –including e.g. the guidelines on State Aids- of a larger body of work to be developed into the Commission’s Broadband Strategy later in 2009.

Nothing stated in this response should be taken to imply any particular position by the UK on that strategy, which we will consider following its publication.

1) The need for flexible approaches to pricing and cost orientation

Whilst we recognise that cost-orientation requirements for active products may be warranted, we nevertheless welcome that **Recital 43** states:

“Where appropriate [emphasis added] wholesale bitstream access prices should be cost-oriented.”

However the Recommendation **Article 36** states that:

“ NRAs should in principle impose cost orientation on mandated wholesale broadband access products in accordance with Annex I.”

We propose that the Commission ensures greater consistency between the two paragraphs by amending Article 36 so say that cost orientation for products is applied *where appropriate*.

This is particularly important under circumstances where demand is uncertain, forecasting costs and revenues is likely to be very difficult, and a cost orientation obligation could carry the risk of stifling investment if prices are set too low and reducing consumer benefit if prices are set too high. Whilst pricing flexibility may carry a risk of high prices, we feel the Commission should recognise that such a risk could be mitigated by the constraining effects on pricing at the retail level from a number of factors.

These factors could include competition from services provided alternative network infrastructure and current generation broadband competition, in addition to the constraints such as functional separation outlined in Recital 45 that help to achieve fully equivalent access upstream.

Of course, the recognition of the need for pricing flexibility should not negate the need for each NRA to monitor the outcome of particular pricing approaches and remain vigilant to the risk of distortions in competition, including the need to tackle margin squeeze, as appropriate.

2) A competition-based approach to co-investment models

We welcome that the draft Recommendation recognises the importance of competition and encourage the Commission to state that competition and investment are mutually reinforcing. Like the Commission we are open to the idea of co-operative investment models and see in particular the attractions to co-operative investment in less densely-populated areas of the country.

However, the UK does not believe that there should be an automatic presumption that co-operative models remove the need for any regulatory scrutiny. Whilst Annex III provides useful examples of factors that NRAs could use as guidance to consider if regulatory obligations should or should not apply, we do not consider that these are a substitute to carrying out the necessary market analysis under the EU Framework and take other factors into account.

In particular, there is the possibility of co-operative investment schemes which have the effect of segmenting the market between only two or three players – creating a highly concentrated duopoly or oligopoly market which may not operate in the

interests of consumers. In such a scenario, imposing regulatory obligations may still be required following the necessary market analysis.

It may be appropriate to make more explicit that circumstances permitting regulatory forbearance should not be interpreted as implying that the normal rules regarding competition law can also be suspended: coupled with a reminder that it is the **abuse** of market dominance which needs to be prevented, rather than the development of market dominance per se.

3) The benefits of cooperation between national regulators and industry in the development of standardisation networks and services

The UK welcomes Article 35, specifically that NRAs could facilitate the development of standards by the industry, including working with the relevant standards bodies and industry stakeholders. We consider that standardisation of products and services around Ethernet Access is critical if wholesale and retail products are to reach as many consumers as possible across the EU.

4) Flexibility in the approaches that NRAs may adopt in relation to margin squeeze tests set in place of cost orientation obligations

As indicated above, the UK recognises the importance of NRAs remaining vigilant to the risks in the distortions in competition that could result from particular pricing approaches applied by SMP operators. This could include issues of margin squeeze. Specifically, the UK strongly supports the need to be vigilant against margin squeeze practices. Indeed the UK NRA, Ofcom, has stated explicitly that in relation to NGA:

“Wherever we [Ofcom] were to see evidence of or the risk of margin squeeze, we would expect to take action to prevent it. This may include to exercising our competition law powers and moreover reviewing our overall approach to pricing.”¹

Equally, we consider that where the draft Recommendation which, absent of cost orientation, requires that NRAs set margins between wholesale and retail services and consequently specify the parameters of the margin squeeze test on an *ex ante* basis is too prescriptive and that the Recommendation needs to reflect to a greater extent the difficulties that an *ex ante* margin squeeze test entails.

¹ See para

8.34, http://www.ofcom.org.uk/consult/condocs/nga_future_broadband/statement/statement.pdf

Specifically, we call on the Commission to recognise within the main text of the Recommendation, that any margin squeeze test and its associated parameters will need to depend on the specific circumstances of each case. A universal set of parameters cannot apply, although examples could be provided to serve as guidance and recommend that Recommendation Article 25 is amended to read as follows:

“In the absence of an obligation of cost-orientation, NRAs, at the reasonable request of an operator enjoying rights of access or on their own initiative, should monitor the SMP operator's pricing behaviour, including by applying a properly specified margin-squeeze test. Where an NRA applies such a test it should, where appropriate, ensure that a sufficient margin remains between wholesale and retail prices to allow for market entry by an equally efficient operator.”

Our justification for such an amendment are outlined below.

We believe that it is not possible as a general rule to specify what remedy may or may not be appropriate, without conducting a market review. The European Framework specifies that NRAs need to conduct market reviews in order to establish whether a communications provider has Significant Market Power (SMP).

Subsequently the NRA is required to set such SMP conditions that it considers are appropriate to remedy the identified SMP. Determining the appropriate remedy will depend largely on market conditions. It is therefore not possible to prescribe a particular remedy in advance of a market review or on the basis of general mechanised criteria.

Moreover, it is extremely difficult to derive a general set of principles on margin setting and the associate parameters, without knowing the specifics of the relevant products and prices concerned. There will be considerable uncertainty about the structure of costs, the level of costs and the nature of costs. A regulator will have to determine which should be allowed for.

Setting the parameters accurately is extremely difficult at the best of times, However it is particularly challenging in the context of NGA where the demand for new retail services requiring NGA networks remains largely unknown and there is likely to be great fluctuation before product offers and prices settle down in the marketplace.

It is also more likely that retail NGA-related broadband offering will be sold as part of bundled offerings. It will be very difficult to forecast the basis on which these bundles will be offered with any certainty and this is likely to lead to frequent reviews by an NRA, each time potentially subject to legal challenge and further uncertainty.

Finally on a more detailed point we would also like to point out to the Commission in relation the text of Annex 1 that cost accounting is normally pursuant to Article 13 of the existing Directive and not Article 11 which deals with non-discrimination.

5) Migration and phasing out

The UK agrees with the Commission that it is important to pay attention to issues relating to migration and phasing out of existing services particularly to avoid such transition resulting in anti-competitive outcomes. However, the UK does not believe that a 5-year transition period as outlined in the draft Recommendation guarantees such an outcome per se. Instead, the UK proposes that the Commission to recommend that NRA must ensure that any transitional arrangements are well signalled and well managed in an inclusive manner.
