

Price regulation of unbundled broadband services

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Agenda

Outline of regulatory issues
Price regulation in the EU
Conclusions

Before setting pricing policies, regulators have a number of issues to consider

- Broadband pricing drives affordability so there is a major temptation to intervene in retail price levels
- Broadband take-up is also driven by demand-side factors particularly disposable income
- Broadband tariffs drive the business case for new infrastructure investments – regulatory intervention that affects the ability of operators to invest could prove counterproductive
- In many countries broadband is still an emerging service, raising the risk of regulatory intervention

Particularly relevant for NGN roll-out

Regulatory frameworks usually try to achieve one or more objectives...

- focus on the promotion of competition
- safeguard the interests of consumers of services
- provide regulatory predictability to all market players
- maintain a level-playing field between SMP operators and alternative operators
- follow the principle of technological neutrality and avoid to pick winners or cut off technological options
- be transparent, consistent and proportionate
- lower the degree of regulation in line with the achieved level of competition

...and at the same time attract the necessary investment

Regulatory pricing of broadband in Europe is now facing ambitious political objectives

- In 2010 the European Commission launched the Digital Agenda for Europe with the aim of promoting ultra-fast Internet connectivity in Europe a component of the EU2020 strategy for growth
- The goal was (and still is) that all Europeans should have Internet access with speeds above 30Mbit/s in 2020, out of which 50% should be above 100 Mbit/s
- In order to achieve these ambitious goals, it is necessary to accomplish a **wide deployment** of Next Generation Networks (NGN's)

The need for NGN's to accomplish the political goals led the Commission to issue a Recommendation in 2010

- In this recommendation the EC strictly believes that it can enhance NGA roll-out by means of a consistent cost-based access pricing approach over time (and less important for our discussion, across all member states) expressing clearly that there will be a need for ex ante regulation
- To enhance the economic rational:
 - "Recommendation on **costing methodologies** for key wholesale access prices" addresses the problem of transition of technology between the "old" copper network to the "new" fibre one*

* Replacement effect in telecom can be defined as the effect of operators not investing in new infrastructure to replace old ones. For example, the more profit the incumbents make from the old infrastructure, the higher the replacement effect

NGA Recommendation (I)

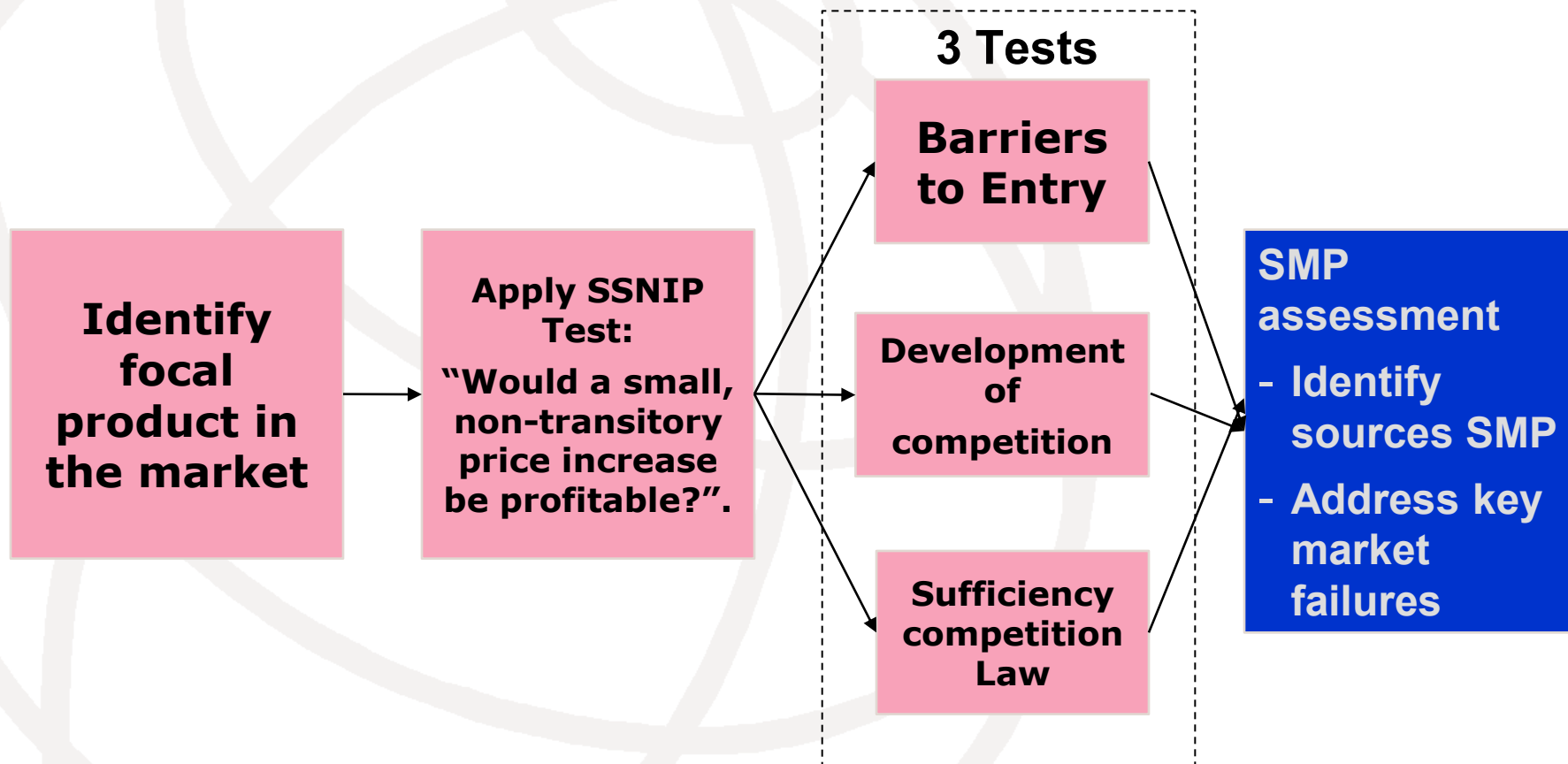
- Cost-orientation remained the rule but NRAs could grant a **risk premium** when setting regulated *ex ante* access prices
- Costing of NGAcess should be based on bottom up LRIC, with some inclusion of common costs (BU LRIC +)
- It recognised **co-investment schemes** between operators in order to diversify the investment risk, which could lead to a **relaxation** of *ex ante* regulation (examples in Italy, Netherlands, France, Switzerland, Portugal)

Source: COMMISSION RECOMMENDATION of 20 September 2010 on regulated access to Next Generation Access Networks (NGA) available at <http://eur-lex.europa.eu/LexUriServ/%20LexUriServ.do?uri=OJ:L:2010:251:0035:0048:EN:PDF>

NGA Recommendation (II)

- Geographical Markets
 - The EC framework allowed NRAs to introduce differentiated remedies within a national market (Directive 2009/140/EC, "Better Regulation Directive")
 - The NGA Recommendation also invited NRAs to examine the possibility of differentiated remedies
- NRAs Decisions on Market Definition for the (DSL) broadband markets:
 - Geo wholesale markets and differentiated remedies for different (competitive vs not competitive) areas in UK, Portugal, Finland and Hungary.
 - National markets (with uniform remedies) in France, Germany, Spain, and Italy.

Over the years the EC framework has build a solid approach for the assessment of markets that may require ex ante regulation



The new Recommendation on non-discrimination and costing methodologies

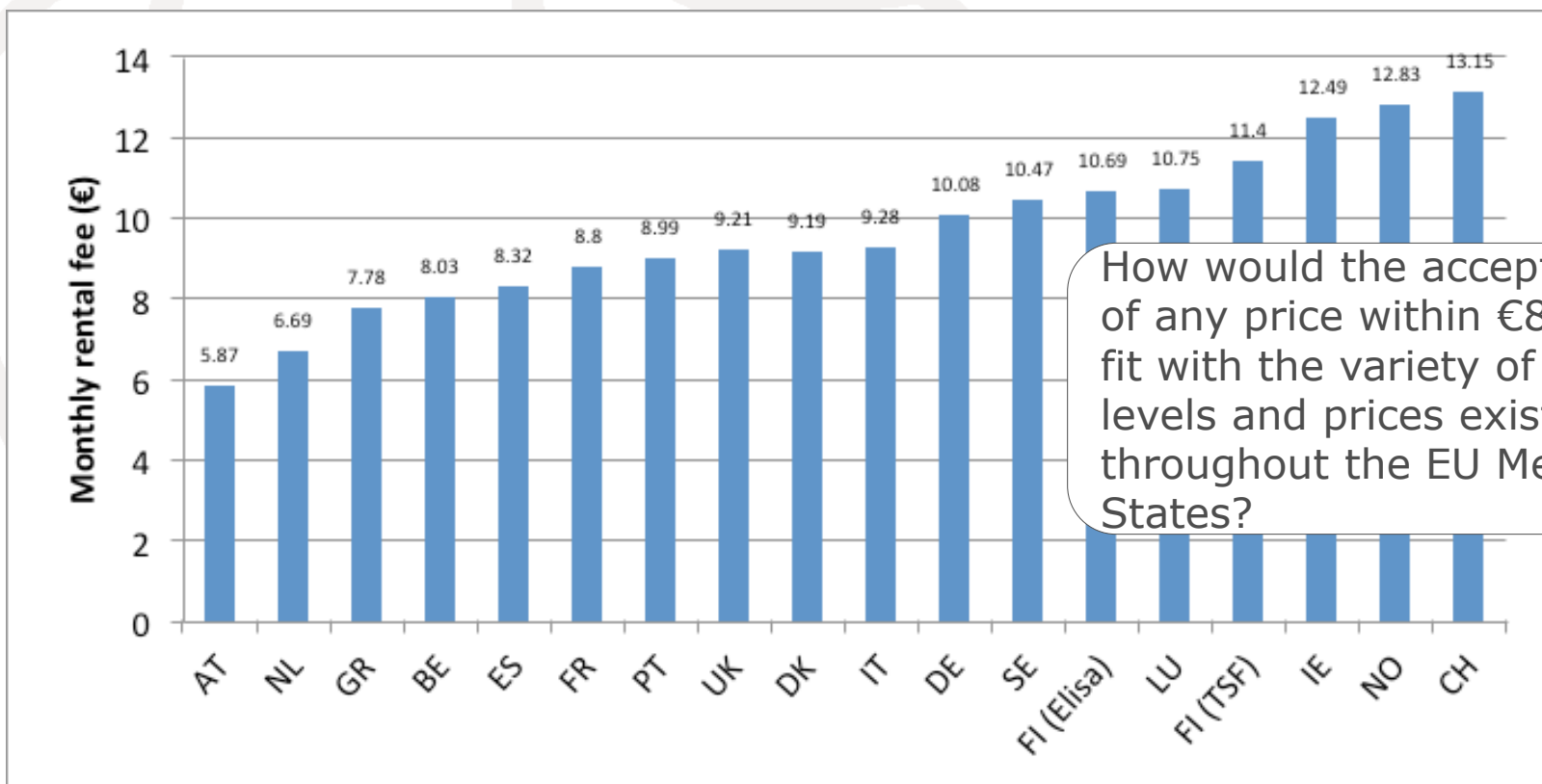
- **The equivalence model:** The draft Recommendation states that effective non-discrimination is best achieved by the application of Equivalence of Input (EOI). NRAs should examine whether it would be proportionate to provide relevant wholesale inputs on an EOI basis and where EOI found to be disproportionate NRAs are recommended impose the Equivalence of Output (EOO) provision of the wholesale products
- **Non-imposition of cost orientation with preconditions:** The draft Recommendation states that NRAs shouldn't impose cost orientation on NGA services if these are provided on an EOI basis and subject to **significant competitive constraints** as well as technical and economic replicability

Source: COMMISSION RECOMMENDATION of 11 September 2013 on consistent non-discrimination obligations and costing methodologies to promote competition and enhance the broadband investment environment

The new Recommendation on non-discrimination and costing methodologies (II)

- **The costing model:** In the draft Recommendation the Commission proposes greater consistency in the costing methodology applied by NRAs, in particularly BU LRIC+, and stable wholesale prices for copper LLU in the range of €8-10/month
- **The economic replicability test:** The draft Recommendation states that NRA should impose an economic replicability obligation as one precondition to lift the cost orientation obligation

Local Loop Unbundling prices in the EU



total monthly rental fees (Voice + ADSL Services)

Source: Cullen International (October 2012)

BEREC on non-discrimination

- BEREC agrees with the Commission that effective non-discrimination rules are essential to creating a level playing field and recognizes the potential effectiveness of EOI as a non-discrimination remedy
- BEREC has asked the Commission to clarify in the final Recommendation whether
 - The proportionality test must determine the most appropriate form of non-discrimination (e.g. EOI or EOO) and the outcome of the test should not be deemed or presumed
 - A voluntary offer to implement EOI is not in itself sufficient

*Source: Commission draft Recommendation on non-discrimination and costing methodologies
BEREC Opinion 26 March 2013*

BEREC on cost orientation

- BEREC agrees with Commission that pricing flexibility is key in the context of risky investments but it is keen to avoid possible unintended consequences of the link
- BEREC believes that the conditions listed in the draft Recommendation under which the cost orientation could be lifted describe only one of several possible scenarios
- BEREC has also asked the Commission to clarify in the final text
 - whether the NRAs have the discretion over the timing of the lifting of the cost orientation and
 - on the reintroducing cost-orientation (with no market analysis) if the SMP operator fails to meet a pre-specified EOI/EOO milestones

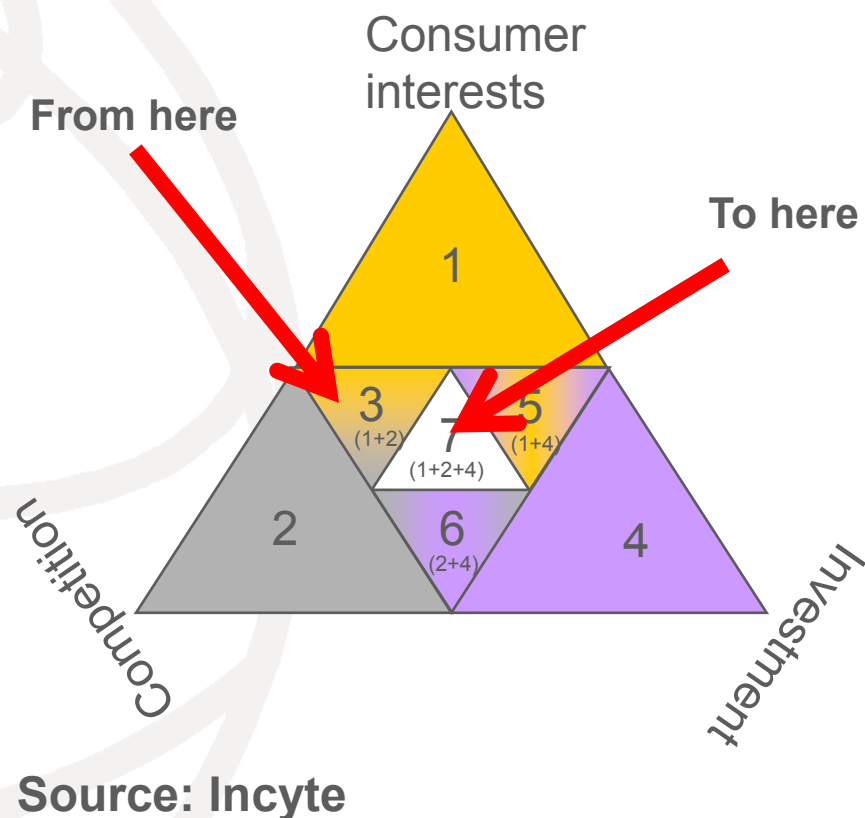
*Source: Commission draft Recommendation on non-discrimination and costing methodologies
BEREC Opinion 26 March 2013*

Berec on cost modelling

- BEREC sees a consistent approach to costing methodologies as a long term goal and supports the Commission's aim of achieving stable copper prices in line with the principle of cost-orientation but believes that a single modeling approach may not necessarily deliver this goal
- BEREC proposes instead, more flexibility and agreement on the key principles that any costing model developed by NRAs should fulfill
- BEREC also proposes that the €8-10/month price range should not be mandatory

Price regulation of broadband will need to address a far more complex environment

- Price regulation of new broadband services will require a more balanced approach to ensure sufficient investments are attracted to meet other policy goals as well, for example on universal access
- Price regulation of legacy networks will still be of paramount importance
- Consumers interests may be conflicting with political objectives
- These often conflicting policy targets will need to be redefined and re-aligned



Where did this shift come from?

- Addressing the EU regulatory approach regarding pricing of NGA is important because EU example is cited as a best practice that other countries want to study/follow
- It also shows that even if you are experienced designing a consistent and stable policy is not an easy task
- Commissioner Kroes has admitted herself that “the question whether a rise or fall of copper prices would spur NGA investment is complex. Different factors pull in different directions and vary in relative strength: according to context and in their effect on alternative and incumbent operators”

Should NGN access be regulated?

- “But more importantly, after examining all the evidence, and given the significant competitive relationship between copper and NGA networks, we are not convinced that a phased decrease in copper prices would spur NGA investment. Indeed, we now see fibre investment progressing relatively well in some Member States where copper prices are around or above the EU average”
- The soft regulatory approach is also said to originate from the success example of the US with a much lighter approach.
- The economic “feeling” is that a demand side problem exists and operators don’t see an immediate business case to invest in fiber deeper into the local access

Price regulation of broadband services needs to be approached in a new context

- The pricing model has changed for service providers – it is about the price of a bundle and revenue retention, not about any form of retail price maximization
- The regulator's goal has changed – now we are concerned with investment but also inclusion of marginal customers and digital divides (hence the emphasis on affordability of entry level services and prices)
- Price control beyond entry level is likely to be dangerous, ignorant and distorting for broadband development

Additional topics and questions

- **What should be the government role?**
 - National Broadband Plans/European Digital Agenda type
 - State Aid/Public funding? Implications for pricing?
- **What is the role of the NRA?**
 - Promote sustainable competition
 - Promote efficient investment
 - Safeguard consumers/citizens benefits
- **Other public bodies, other regulators?**
 - Co-Investment approval?
 - Infrastructure sharing with other utilities



Thank You

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