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The European NGA Recommendation: the Banal, the Controversial and the Inconclusive

On 20 September 2010, the European Commission finally adopted its much awaited Commission Recommendation on Regulated Access to Next Generation Access Networks (the NGA Recommendation). The gestation period was almost three years, and involved at least three formal drafting stages, and public consultation and scrutiny from all stakeholders. It has finally emerged, but only after a series of important policy reversals.

The nature of those policy shifts pays testimony both to the difficulty of the subject matter at issue and the dangers inherent in subjecting key policy developments to such a protracted process. Having gone through that process, we are inevitably left with a compromise document which falls far short of its avowed goals at the moment it was first conceived.

NGA Policy: Guiding Principles

NGAs present fundamentally new regulatory problems. Most EU Member States have ubiquitous copper networks, in which the investment has been sunk for decades. Accordingly, NRAs have been able to impose an access regime of their choice on them without fear of significant consequences. Fibre networks in Europe are mostly conspicuous by their absence, to the extent that only 1% of fixed broadband connections in the EU are fibre-based, while the proportion in Asia, where per capita incomes are lower, is already 10%.

The three drivers of NGA investment are competition, public finance and regulation.

Competition: Where there are competitive networks in Europe, including areas where cable networks can be or have been upgraded to high speed broadband, investment in fibre-based networks is more likely to occur. This includes the Netherlands, Sweden, parts of France and Italy, and many Central and Eastern European countries where independent fibre networks are proliferating. The effects of competition are not felt universally, but it does help. However, with only about 20% of EU homes currently being passed by two fixed networks, this effect is not widespread.

Public finance: This need not entail the re-nationalisation of the sector, of the kind proposed in Australia. More modest finance from central and local governments can trigger the construction of an open access fibre network, under the relatively permissive EC rules for State Aids for high speed broadband.

There is a dilemma between the industrial policy motive for the expenditure – getting the network installed in the major areas of production, where it probably will in due course be viable in any case, and the social policy objective of avoiding a high speed "digital divide". A more basic problem, however, can be the lack of public resources (especially in the context of a recession).

Regulation: The more rigorous the access regime applying to fibre, the more a monopoly incumbent will be inclined to delay investment until demand uncertainty has diminished. This explains the stratagems used to counter this which are being employed by NRAs, such as the conferral of greater pricing freedom on incumbents so as to prevent their delay in the provisioning of particular access products (for example, bitstream or access products capable of supporting the higher speeds which a fibre network can provide). To be effective in incentivising the incumbent out of the attractive option of delay, these concessions have to go beyond simply elevating the allowed rate of return in order to take account of the greater risks inherent in fibre investments.

How the NGA Recommendation seeks to reconcile the conflict between the objectives of bringing forward investment and maintaining competition is thus an important challenge, not least because this balancing act will also determine which of Europe's key stakeholders in the respective fixed incumbent and alternative operator camps are more likely to be satisfied with it.

The NGA Recommendation: A Snapshot

A review of the NGA Recommendation of 20 September 2010 suggests that a number of policy themes emerge from its text, especially when compared to the "look and feel" of its predecessor versions.

Some of those themes are: banal, insofar as they do little more than confirm existing Commission and NRA practice and existing thinking from the world of copper-based telephony networks; others are controversial, insofar as they introduce new and often divisive policies (as measured by the interests of the respective members of fixed incumbent and alternative operator lobby groups); while another cluster of provisions is inconclusive, insofar as it gives mixed signals to various stakeholders. The characterisation of those themes is drawn in large measure from our views of whether the NGA Recommendation can achieve the list of key policy drivers which have overtly underpinned the Commission's overall policy exercise,[1] namely:

» the need to achieve harmonisation so as to prevent distortions of the single market ("preventing and inappropriate divergence of regulatory approaches, while allowing NRAS to take proper account of national circumstances").

» the importance of promoting efficient investments by all operators.

» creating legal certainty for all investors.

» promoting sustainable infrastructure competition.

The Banal

At one level, one is hard-pressed to identify why the gestation period for the Recommendation resembled that of an elephant, given the size of the end product. Because it took so long to conclude, the NGA Recommendation in large measure simply confirms much of what the NRAs of the Member States have been concluding over the past four years or so in their administrative practice.

This, in turn, has by and large been confirmed by the European Commission itself in its decisional practice on the relevant markets for wholesale physical network infrastructure (LLU) and wholesale (bitstream) broadband access (Markets 4 and 5 respectively of the 2007 Relevant Markets Recommendation) under the Article 7 review procedure of the EU Framework Directive.

This was to be expected, given the inordinately long period over which the Recommendation was the subject of such open public debate and

1 Refer to Articles 1, 2 and 3 of the *NGA Recommendation* and Recitals 3, 6 and 16 thereof.

the divergent positions of stakeholders. But as a result, the Recommendation does little by way of giving "guidance" to the interpretation of a new set of issues. Rather, it spends many of its paragraphs confirming what is already very much a fait accompli.

The Controversial

The NGA Recommendation also includes a number of stated positions which constitute a very significant break from the current EU regulatory framework, thus reflecting the different inputs of stakeholders received during the course of the public consultation process. In summary:

1. With a view to an operator mitigating its investment risk in deploying an NGA network, the Recommendation foresees the possibility of the investing operator being able to offer volume discounts in return for the conclusion of long term wholesale contracts with access seekers for large numbers of lines (Recital 24; Article 25; cf. Annex I).

The introduction of this provision is an oddity. Given that *ex post* competition rules have a long enforcement history in relation to such practices, it is difficult to comprehend why *ex ante* rules need to play any role here. Moreover, given the potential for such arrangements to lead to discriminatory practices and to the foreclosure of smaller operators, the provision creates a potential "Trojan Horse" through which incumbent operators might be able to engage in a variety of strategic anti-competitive practices.

2. The Commission has expressed the view that the margin squeeze doctrine in an NGN environment is best performed on an *ex ante* basis (namely, tariff controls) by reference to the "reasonably efficient competitor test". The test must also be applied "over an appropriate time-frame" (Recital 26; Article 27; cf. Annex I).

This provision sits a little uncomfortably with the existing *ex post* practice of the Commission's DG Competition and the jurisprudence of the European Courts. It would not be an exaggeration to say that the success of broadband policy in Europe has been built upon the aggressive application of the margin squeeze doctrine by competition authorities. That doctrine has been inevitably applied at the relatively early stage of broadband take-off in the EU, as fixed incumbents were leveraging from their ex-narrowband monopolies into the world of competitive broadband.

While there can be no absolute objection to a "reasonably efficient competitor" test being used as the benchmark for *ex ante* price controls, provided entry promotion is found to pass a cost-benefit test, it is also important to take account of the fact that the *ex post* legal standard developed by DG Competition and endorsed by the European Courts is clearly that of the "equally efficient competitor".

Moreover, given the overall "migration" philosophy of the Commission from the world of copper to that of fibre, it would appear that the limitation on the effective scope of the margin squeeze remedy – by arguably extending the relevant reference period for the abuse – potentially dilutes it of much of its impact in the NGN world. In doing so, DG Information Society again seems to be unnecessarily limiting the scope for manoeuvre of its DG Competition colleagues. Unless a sectoral regulator has dual competition powers, thereby allowing it to balance the pressures of applying a different legal standard for *ex ante* price screening and *ex post* competition law prohibition, the application of such dual standards might be fraught with complexity and will inevitably lead to a lack of legal certainty.

3. For those who consider legal certainty to be a primary driver of the NGA regulatory regime, the Recommendation might be said to be somewhat more "forward-looking" in its approach to access issues than could have been originally expected. Thus, the Commission (at Recital 21; cf. Annex I) makes it clear that NRAs should be encouraged to mandate transitional measures which mandate alternative access products.

Moreover, an operator's choice of particular network architecture should not preclude the provision of access. Thus, in those cases where some operators might choose to deploy NGA architecture that are not conducive to third party access, physical unbundling will nevertheless be mandated "as soon as is technically and commercially feasible" (often pending the use of transitional measures). In addition, an NRA might need to specify that "specific interfaces be required to ensure efficient access" (Recital 16; Article 16; cf. Annex II).

Thus, the Commission has left the door open for equipment manufacturers to develop access

products, which will make it "technically feasible" to open up hitherto closed networks. This marked departure from the current EU regulatory framework is very much in favour of access seekers in an NGA environment. Currently, SMP-designated operators are only obliged to grant access where the SMP operator has itself already deployed access technology into its network.

By compelling operators to open their networks where a technical access solution is available, the Commission has at best adapted and at worst ridden roughshod over the idea that the regulatory framework is "technology neutral". An operator now knows that it is better off investing in an open access architecture sooner, rather than later, as its network will become accessible at some point in time when equipment providers are in a position to unlock networks.

The statement that the access possibility must be both "commercially" and "technically" possible is of little importance, as it would difficult to envisage of circumstances where the denial of access on commercial grounds alone was a viable defence if access were possible from a technical perspective. Of course, if a technical access solution is unlikely to materialize, the provision would be arguably worse, as it becomes little more than "wishful thinking" in relation to certain types of fibre configuration.

4. A blanket statement is made in Recital 20 of the Recommendation to the effect that NRAs may, "in exceptional circumstances", refrain from imposing unbundled access to the local loop in relation to those geographic areas where the combination of network competitors and the existence of wholesale access offers is likely to result in "effective competition at the downstream level".

What is made clear in this statement is the fact that the availability of competing networks is not sufficient in and of itself to justify regulatory forbearance; instead, there must also be in existence "competitive access offers". This is an important statement of intent, as those who had hoped for signs of greater regulatory forbearance in an NGA environment (similar to the US) will be disappointed to hear that strong end-to-end network competition will not of itself mean an end to regulatory intervention.

In doing so, the Commission has in effect turned its back on its much vaunted "race to investment" scenario which it had promoted in the earliest versions of the Recommendation. The provisions also fail, as usual, to pay adequate attention to conditions in Central and Eastern Europe, where independent fibre operators are installing enviably competitive fibre networks. It is also promoting a concept of competition which is at odds with the much broader concept of sustainable competition that would be invoked by *ex post* competition authorities.

5. The statement is made that "[the] appropriate array of remedies imposed by an NRA should reflect a proportionate application of the ladder of investment" (Recital 3; cf. Annex I). This statement might at first blush appear to be odd, given that a likely byproduct of investment in NGA will be the shortening of the ladder of investment in most markets (both because of technical issues and because of the changes in investments based on scale-driven business opportunities). This position therefore appears to be harking back to the days of the copper network being adapted to provide broadband services. However, it sits less easily with the world of fibre-based networks.

6. There is explicit recognition of the fact that NRAs have the flexibility to impose "differentiated remedies and access products" (Recital 9; cf. Article 9) in those situations where an NRA witnesses diverging competitive conditions between different areas in a geographically defined market, but those differences are not sufficient to justify the definition of a sub-national geographic market.

Two comments can be made in this regard. First, the practical application of this guidance will be that the use of the concept of a sub-national market will become obsolete, as the number of pockets of competition in smaller geographic regions will grow in number as a result of the dynamics of NGN deployment (creating various scenarios of local monopolies, duopolies, co-investment, and so forth).

As a result, the concept of sub-national markets, which was developed over time in the context of broadband deployment, will effectively become unworkable in practice. Second, it is somewhat odd that the current EU regulatory framework speaks implicitly of differential remedies being applied across relevant product markets (i.e., to particular market segments), whereas the NGA Recommendation does so explicitly with respect to relevant geographic markets. Does the inclusion of the latter exception exclude the former for

NGA? Should both exceptions be read together? There seems to be no particular rhyme or reason for the different levels of remedy selection being identified in different legal instruments; the Commission may thus have added an unnecessary layer of uncertainty to remedy selection while not having provided any economic justification for having done so.

7. The Recommendation requires that a retail bitstream offer which cannot be replicated by competitors other than through access to the SMP-designated operator's network cannot occur in the absence of a comparable wholesale offer being made available to the marketplace (Recital 33; cf. Article 32). An access seeker will, in turn, be given up to six months notice prior notice of a new retail offer so that it can adjust its network configurations.

At first glance, this type of approach seems to go further than reverting to the old EU regulatory framework, by apparently harking back to the old ONP-style of regulatory approach. At least under the current EU regulatory framework, one is obliged to ask the fundamental question of whether the retail market is effectively competitive before one engages in wholesale regulation if it is not one of the list of candidate relevant markets listed in the Relevant Markets Recommendation.

This is not the case under the new NGA regime, which simply asks whether the service is replicable. Moreover, there must be some question mark as to whether such an obligation might result in a "chilling effect" on innovation, given that service differentiation would seem to be a laudable consumer welfare goal in a "multi-play" market. At the very least, one would have imagined that it was legitimate for NRAs to make such enquiries.

8. The earlier versions of the Recommendation had devoted a significant amount of space to discussions regarding the treatment of NGA networks where some degree of co-investment was involved (previous Annex III). That discussion has now completely disappeared, other than very general positions (Recitals 27 and 28; cf. Article 28) regarding the relevance of co-investment decisions in reducing the costs and the risk incurred by an investing operator (and thus leading to the more extensive deployment of FTTH). While it might be true to say that many co-investment issues are best dealt with under *ex post* competition rules or under State aids guidelines, it is also true that their relative importance is such that true guidance on their application cannot be found in a few glib references at the level of general principle.

9. The observations in the Recommendation about the risk-adjusted allowed rate of return qualify as controversial by virtue of their banality alone. It goes without saying that cost-based prices should embody a rate of return which allows realistically for the existing level of systematic risk. The question is whether this approach, which is likely to be grudgingly applied, is enough to persuade fixed networks not subject to competition to make a once-in-a-hundred-years massive investment. Given Europe's fibre broadband shortfall (1% of connections as against 12% in Japan) and its macro-economic problems, one would have expected consideration to be given to more radical approaches.

The Inconclusive

As one can see from the above list of issues, the NGA Recommendation seems to be replete with "mixed" messages. A heady cocktail has been brewed consisting of some provisions which favour access seekers, provisions which favour access providers, provisions which favour NRA freedom of action, and rather implausible provisions designed to create the pan-European supply of NGA services.

The outstanding question which needs to be asked, however, is the extent to which innovation and investment are expected to take root in an environment of such strongly conflicting principles clashing with one another, or whether they are destined to fall between the proverbial cracks apparent in the forging of such a compromise.

Of particular concern is the fact that certain types of issues have changed their fundamental "look and feel" over the course of the protracted debate between stakeholders on the content of the NGA Recommendation. This will inevitably be a blight on the process of legal certainty. Because of the structure of the current and future EU regulatory framework, legal interpretations of its policies are mainly the subject of litigation at the national level.

National judges will be forced to interpret the legal value of "soft" European law in the form of a (strictly speaking, non-binding) Recommendation which, of itself, has taken no less than three distinct policy courses. Thus, a national judge will be in the invidious position of having to determine

whether the balancing act an NRA has achieved is consistent with the dictates of a "race to investment" policy or one in which emphasis needs to be given to the importance of "migrating" existing remedies in the copper-based world into that of the fibre-based world.

Even if the national judge opts to emphasise the importance of the migration policy, will he or she be as willing to revert back to regulatory principles which precede the existing EU regulatory framework? How will that same judge interpret a provision which emphasises the need for a "cost-based" formula for access while at the same time permitting non cost-based exceptions? Will that same judge interpret the exclusion of the old Annex III on co-investment as a denial of the principle, or will he or she simply defer to the views of the *ex post* regulator on such issues? How will a judge apply the general provision which appears to encourage volume discounts when the prior regulatory framework appeared to frown upon them? How is a judge to reconcile the commitment to promoting infrastructure competition with a migration strategy which appears to presume the existence of a ubiquitous and unassailable incumbent operator, surrounded by access-seeking dependents? How do State aids grants impact on investment decisions and the level of risk borne by an NGA access provider?

The soft law of the Recommendation does little to help a review judge in arriving at these hard decisions. It is particularly unhelpful when the policy underlying the soft law has been the subject of some very notable changes of heart by the European Commission. In such situations, soft law becomes decidedly mushy.

Conclusions

On balance, the biggest winner among the various shareholders in this exercise have been the NRAs themselves. A document whose avowed purpose was to ensure that their national policies did not diverge unnecessarily now provides NRAs with ample room to adopt policies which are very much tailored to meeting "national circumstances".

Thus, the goal of harmonisation has clearly lost out. On a philosophical note, perhaps that was always the destiny of this document, given the multiple network topologies that account for the "NGA" world and the varied patterns of State and private investment in fibre-based networks.

As regards the pursuit of the avowed goal of legal certainty, the closest we get to achieving that goal is the specification in the NGA Recommendation that migration measures should be limited to a 5-year time horizon (Recital 40; cf., Article 39). For the reasons explained above, however, there must be serious doubts as to whether the taking of the "utmost account" of the terms of the Recommendation by NRAs has the potential to imbue the process with any degree of legal certainty.

The twin goals of investment incentives and infrastructure competition are arguably the two biggest losers under the final version of the NGA Recommendation. In creating a compromise document in which the guarantee of a migration strategy for alternative operators was counterbalanced by assurances about "risk premiums", "volume discounts" and "differential pricing" for the range of different services provided by today's fixed incumbents, what we have in effect is a document which strikes an uneasy truce between two hostile forces.

The uneasy truce is further complicated by the tendency of the Recommendation to encroach its *ex ante* thinking into the domain of what would otherwise be *ex post* competition rules, while at the same time having the Commission adopt a liberal State Aids policy in the context of broadband investments.

The one thing that is certain is that the prospect of an incremental unravelling of *ex ante* regulation as a result of the deployment of NGA networks no longer appears to be a realistic policy possibility. If anything, the role of *ex ante* regulation will become even more intrusive in an NGA environment. The emergence of this fact is something of which we should all take "the utmost account".

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