

The future of the Economic Replicability Test in the EECC - post copper withdrawal

Introduction

In a previous paper¹ we considered

- the economic replicability test (ERT) introduced in the European Commission 2103 Guidance on next generation networks (2013 Recommendation),
- how certain national regulatory authorities have implemented it, its inclusion in the new European Electronic Communications Code (EECC) under Article 74, and
- the key issues that the commission should now consider in updating the 2013 Guidance in respect of the ERT.

One such key issue is the applicability of the ERT to regulation after the withdrawal of copper-based access services, which is now in progress across Europe.

The implications of the withdrawal of copper-based services for conducting the ERT are discussed in this paper.

¹ Copies of the paper are available by emailing gitas@gos-consulting.com

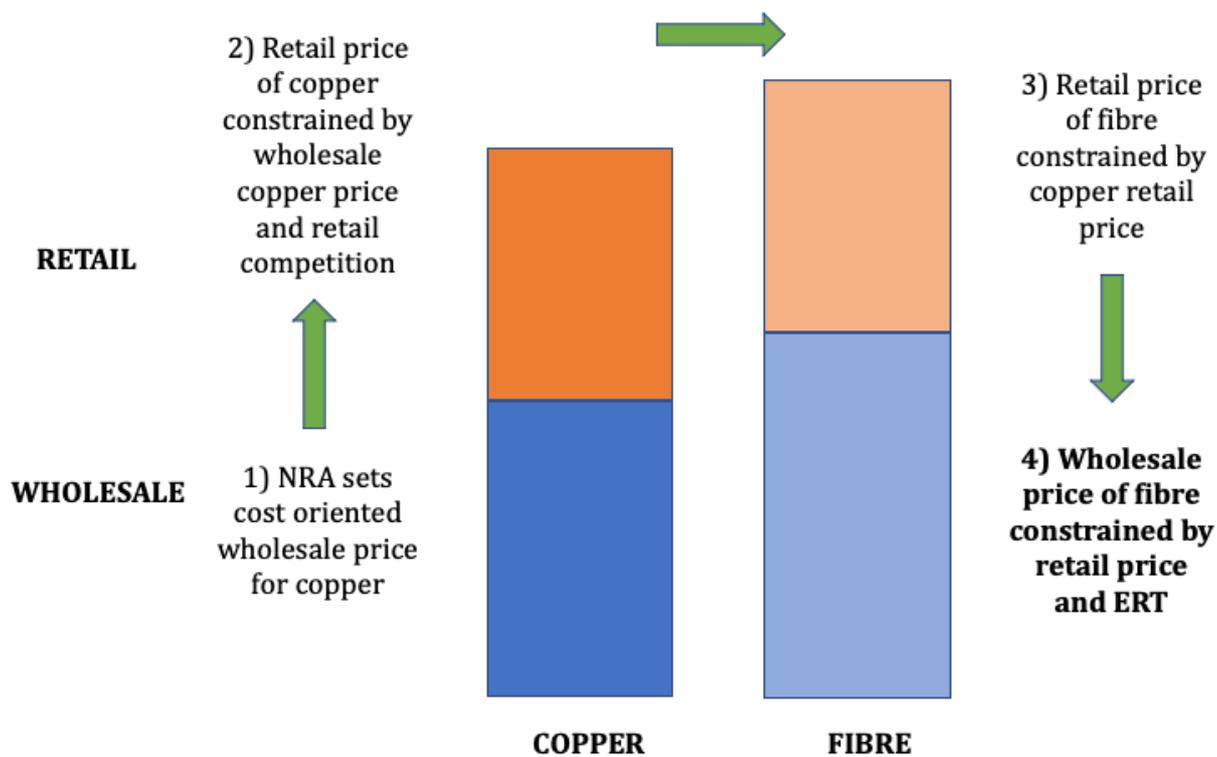


Figure 1 - Use of an ERT to constrain wholesale fibre prices in conjunction with a price control on copper wholesale prices.

How does copper withdrawal affect the retail price constraint?

The withdrawal of copper-based broadband services (or the removal of regulation of copper-based broadband services) will remove one of the elements required for the adoption of the non-discrimination obligations by NRAs for SMP operators, as defined in the 2013 Recommendation.

Cable or other fibre networks, that overlay the geographic footprint of the SMP operator's fibre network, may provide a demonstrable constraint on retail prices sufficient for NRAs to replace regulated wholesale fibre access prices with non-discrimination obligations including ERT.

However, high retail price elasticity due to the presence of alternative infrastructure(s) would suggest effective competition in the retail market, typically resulting in no finding of SMP and therefore regulation of active wholesale services would typically not be required. We are not aware of any examples where an NRA has found SMP where there is high retail price elasticity due to the presence of alternative infrastructure(s), nor can we see how such a finding could be made.

The exception to this is where the alternative operator is dependent on access to the vertically integrated SMP operator's physical infrastructure. In this case, it is assumed that the price of access to the passive infrastructure would be regulated, which follows the approach taken in the 2013 Recommendation.² If this is the case, such an investment by a competing operator may be sufficient to promote entry in downstream markets and competition in the retail market, resulting in a high price elasticity.³

We consider therefore that there are likely to be three broad regulatory scenarios for the wholesale local access market (WLA, Market 1⁴) after the withdrawal of regulated copper-based broadband services. It is unclear to us whether any one scenario will be dominant; it is perhaps more likely that all three will exist within the EU, and even in some cases within individual member states, as different competitive conditions develop in different geographic areas.

In developing its Access Recommendation, which will update the 2013 Recommendation to align with the EECC⁵, the European Commission (EC) will need to consider whether to issue guidance and whether it wishes to encourage the development of any particular scenario(s).

We look at each in turn below.

² 2013 Commission Recommendation (2013/466/EU), paragraph 53 indicates that the price of access to passive infrastructure should be regulated, but the updated Access Recommendation may differ, in which case the conclusion drawn here may need to be revised.

³ More specifically, the price elasticity of interest is that for the SMP operator's residual demand curve in the retail market for its broadband services.

⁴ Commission Recommendation (2020/8750) on relevant product and service markets within the electronic communications sector subject to *ex ante* regulation in accordance with [the EECC]. This was Market 3a in the previous Recommendation (2014/7174).

⁵ European Electronic Communications Code (Directive (EU) 2018/1972)

Examples of the ERT and how copper withdrawal may affect them

We do not yet have examples in Europe of the withdrawal of copper services at a national level, nor of the removal of regulation on these services while the withdrawal is in progress. Nevertheless, we can see some indicators of the likely impact of its withdrawal from current regulatory practice.

Scenario 1 – An operator has SMP in WLA and the NRA imposes a cost-oriented price constraint on active full fibre services

The simplest scenario would be that the NRA finds SMP in WLA and passive service access remedies are not sufficient to ensure effective competition in the market. In these circumstances the NRA is likely to impose a cost-oriented price on the WLA SMP operator, an ERT is therefore unnecessary.

Several examples are already emerging of this scenario.

In **Italy** (outside Milan and the contestable municipalities) there is a full regulated cost-based price mandated for fibre WLA services (and even within the contestable municipalities the constraint will still apply in certain circumstances).

Cost-based price constraints have also now been imposed on FTTH WLA services in **Croatia, Cyprus, Greece, Hungary, Latvia and Lithuania**. All of these member states, except for Cyprus, also impose obligations for passive infrastructure access at cost-oriented prices.⁶

In the **UK** the price constraint is only on one bandwidth of WLA (FTTC and FTTH) as an “anchor price” and the incumbent operator can determine the wholesale price for the other bandwidths. We will discuss anchor pricing further in a subsequent paper.

Where the NRA sets a direct cost-based constraint on the wholesale service price, it need not also impose an ERT to constrain these prices.

There may be other circumstances where an NRA may wish to impose an ERT, these will be explored in a subsequent paper.

⁶ BEREC Report “Regulatory Accounting in Practice 2019” BoR (19) 240

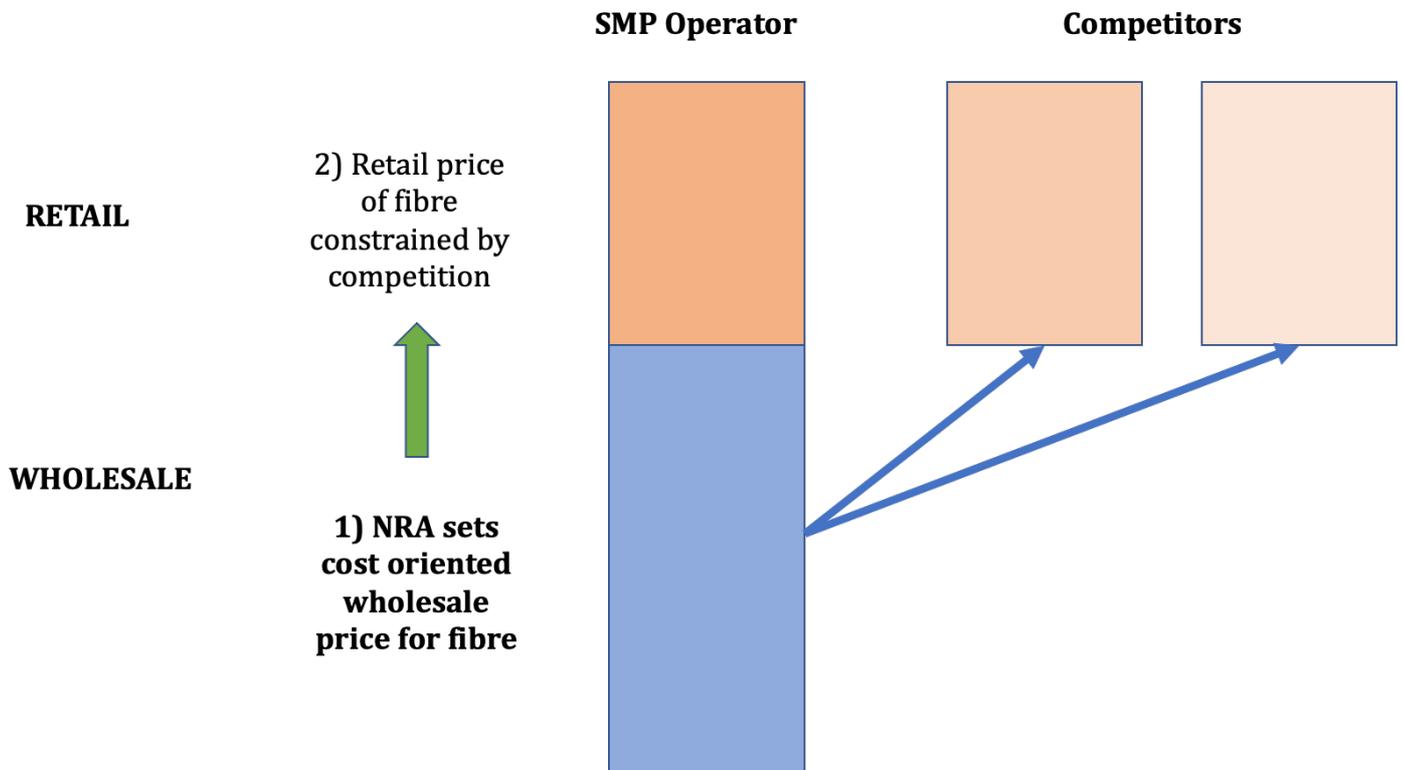


Figure 2 Direct price constraint on wholesale fibre service prices

Scenario 2 – An operator is found to have SMP in WLA, but price controls on passive access services are sufficient to constrain active service prices

In this scenario, although the incumbent is found to have SMP in WLA, a requirement is imposed to provide regulated access to passive upstream inputs (such as ducts and poles⁷ and/or terminating fibre segments⁸), that is considered to permit sufficient competition in downstream wholesale and retail markets. As such, no additional restrictions on the pricing of fibre access services are necessary.

In this case the ERT is unlikely to be needed.

A number of examples of the second scenario are emerging:

1. In **Italy** the NRA has defined “contestable” (i.e. more competitive) municipalities, where there is direct competition available at a wholesale level from competing providers of infrastructure services. In these areas TIM will be permitted to depart from the price specified by the NRA on WLA full fibre services, in certain circumstances. An ex-ante ERT is still imposed here as well, but this appears to be to ensure that there is no margin squeeze at a retail level rather than to constrain the wholesale prices. Access to physical infrastructure at cost-based prices from the SMP operator, TIM, and symmetric access to terminating fibre segments at “fair and reasonable” prices are also mandated.

There is a proposal to merge the two main competing wholesale networks in Italy during 2021, so the competitive situation here may change significantly.

2. In **Spain** the NRA has defined certain “Ultra-Fast Broadband municipalities”, where the infrastructure competition is considered sufficient that no remedies over full fibre WLA services are required. There is however a requirement to provide access to physical infrastructure at cost-oriented prices.
3. In **France** access to physical infrastructure must be provided by the incumbent, Orange, at a cost-oriented price and symmetric access to terminating fibre segments at “reasonable” prices are required in most areas. Therefore price controls over active full fibre residential WLA services are not imposed.

In this scenario, the regulation of access to passive infrastructure upstream of the active service enables competition at the active service layer and may provide an effective constraint on the downstream wholesale price.

⁷ Under EECC Article 72, NRAs may impose obligation on SMP operators to grant access to, and use of, civil engineering.

⁸ Under EECC Article 61, NRAs may impose obligations on any operator to grant access to wiring and cables and associated facilities inside buildings or up to the first concentration or distribution point outside the building.

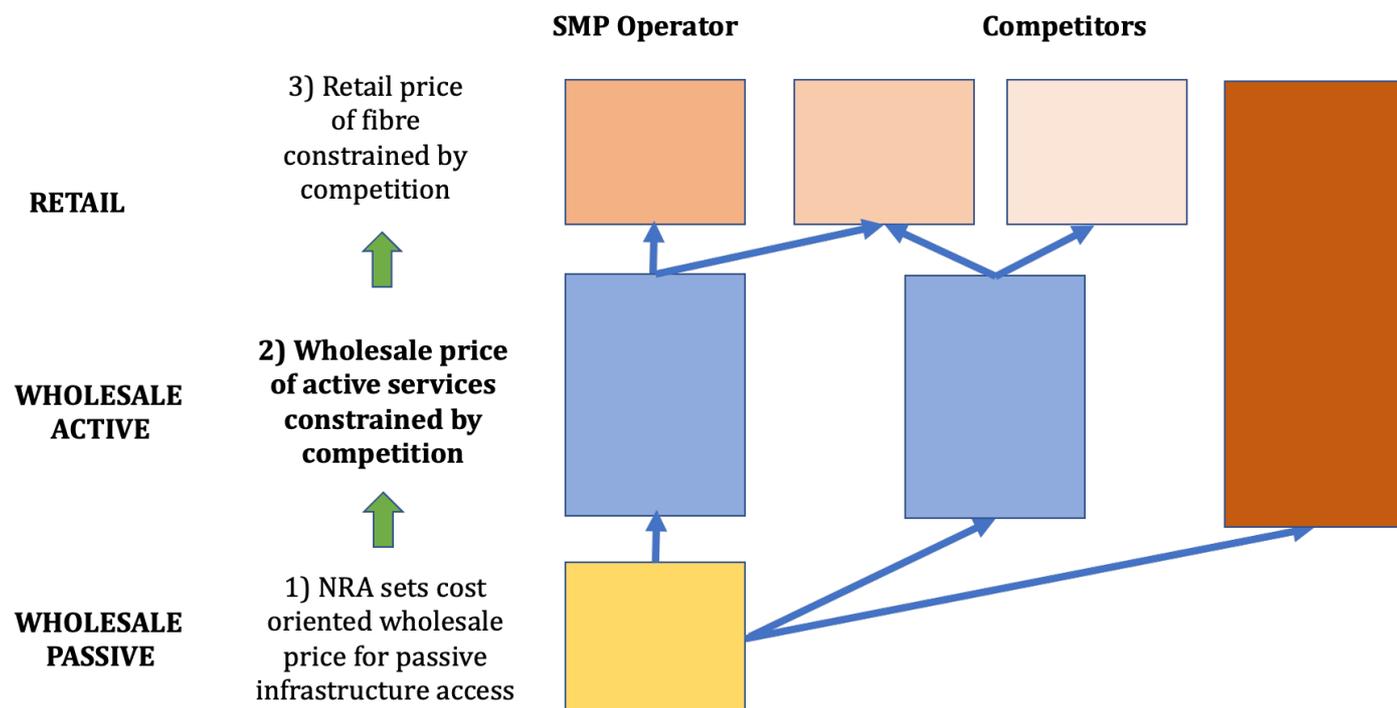


Figure 3 – Passive services provide constraint on active service prices

Scenario 3 – No operator is found to have SMP in the wholesale local access (WLA) market

No operator will be found to have SMP at retail or any wholesale level in the local access market where there would be effective competition at a retail level in the absence of any SMP regulation.⁹

Effective competition can be possible where there are competing infrastructures, although NRAs must also consider whether operators of different infrastructures may have SMP jointly, particularly where there are only two infrastructures, each with a significant share of the market.

Competing infrastructure networks could be:

- Full fibre networks (FTTH/FTTB) supplied by:
 - vertically integrated operators (these will typically be incumbents)
 - operators using physical infrastructure supplied by incumbents, another telco or another utility (e.g. electricity distribution), either under the broadband cost reduction directive (BCRD) or on commercial terms.
 - retail operators using open access telecoms infrastructure supplied on commercial terms by a wholesale-only operator, which may in turn use physical infrastructure of another operator.
- Hybrid fibre-coaxial (HFC) networks (usually operated by vertically integrated operators)

Fixed wireless access may also emerge as a market constraint, although currently NRAs typically do not consider that it provides a substitute for local access services due to limitations on speed, capacity and coverage. With 5G rollout, NRAs may reach different conclusions in future reviews.

Such fully competitive areas, although still comparatively rare, are starting to emerge.

1. The municipality of **Milan** has been found to be a separate, effectively competitive, market from the rest of Italy, with competing full fibre networks with their own infrastructures. In this case, however, the competitive conditions would change, should the proposed merger between the wholesale operations of the two largest operators be permitted.
2. In **Romania** and **Bulgaria**, the NRAs have not found SMP in the WLA market as there is extensive full fibre and HFC coverage and physical infrastructure access available in the main cities under the BCRD. However, in assessing competition the NRAs also include legacy copper access services as part of the market. Once copper is withdrawn, SMP findings may potentially re-emerge, at least outside the main cities.

It should be noted that in these cases, the BCRD is effectively used as a substitute for an SMP finding in which access to passive infrastructure at reasonable prices is mandated.

⁹ EEC, Recital (59) “If it is concluded that a retail market would be effectively competitive in the absence of ex ante wholesale regulation on the corresponding relevant markets, this should lead the national regulatory authority to conclude that regulation is no longer needed at the relevant wholesale level.”

- In the **Netherlands**, no SMP has been found for WLA due to the national presence of an HFC operator in competition with the incumbent. In this instance the NRA had found joint SMP and imposed remedies on both parties, but this finding was overturned by the national business appeals tribunal.¹⁰

If an NRA does not find SMP, then it cannot impose any remedies, including ERT.

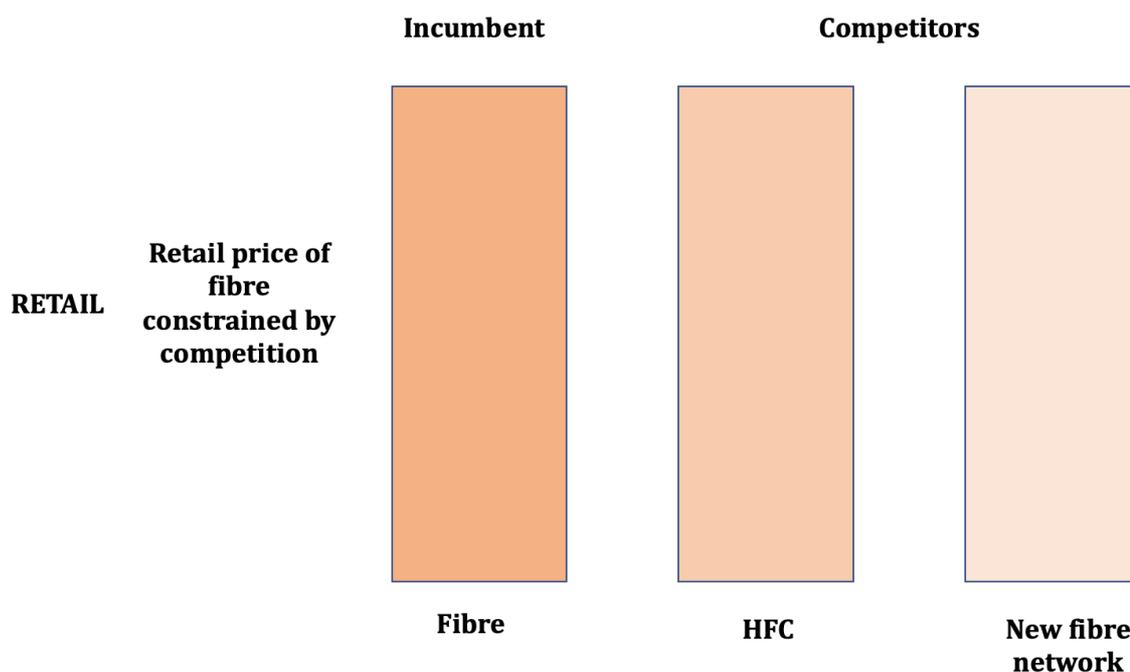


Figure 4 - Where effective retail competition is found in the absence of SMP remedies, then no such remedies would typically be imposed.

¹⁰ College van Beroep voor het bedrijfsleven, Case ECLI:NL:CBB:2020:177

Conclusion

Article 74 of the EECC continues the approach of the 2013 Guidance in permitting NRAs not to impose a cost-based price constraint on wholesale services, where retail prices of these services are constrained by infrastructure competition and certain other safeguards, including an ERT, are in place.

However, EU NRAs are only taking this approach in practice where it is the incumbent's regulated copper services that provide the retail competition that constrains the fibre service prices. Once copper services are retired (or regulation is removed) this particular constraint will no longer apply.

After regulated copper services are withdrawn, we suggest that the outcomes in each geographic area are likely to be one of the following broad scenarios:

- There is a finding of SMP in WLA, that is addressed by the imposition of cost-oriented price constraints directly on all services or on an anchor bandwidth.
- There is a finding of SMP in WLA, that is addressed by regulating access to upstream physical infrastructure and/or fibre terminating segments (thus resulting in a competitive constraint on downstream active WLA prices).
- In some cases, there is no finding of SMP for local access services at all (although there may be access to physical infrastructure mandated under the BCRD), due to constraints emerging from alternative infrastructures, whether other fibre networks, HFC or perhaps even wireless.

It is unlikely that any single scenario will dominate across the EU, and indeed sub-national markets, where NRAs impose different solutions within a single member state, may become the norm. The EC may wish to consider if it should provide additional guidance to assist NRAs in choosing between these.

In all examples to date, an ex-ante ERT has only been imposed where it is the incumbent's regulated copper services that are constraining prices of fibre services. Thus, we consider that the possibility of using an ERT to constrain prices under Article 74 of the EECC may become less relevant once copper services have been withdrawn, unless alternative anchor product is introduced.

There may however be circumstances where an ex-ante ERT is still an appropriate remedy to deter margin squeeze. We will consider this further in a later paper in this series.

In its forthcoming Access Recommendation, the EC may therefore wish to consider and address explicitly how the use of the ERT will change after copper withdrawal.

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