Access price to the copper local loop and fibre investment

Will the industry be able to achieve the ambitious objectives of the Digital Agenda for Europe on very high speed broadband availability in 2020? This question is the background to the public consultation held by the European Commission between October and November 2011 on the methodologies for calculating wholesale access prices for electronic communications, in particular for copper unbundling access prices.

An ambitious political objective for Europe: the deployment of high speed broadband

The Digital Agenda underlines the importance of broadband access or Next Generation Access (NGA) to promote social inclusion and competitiveness in the EU. It seeks to ensure that, by 2020:

- All Europeans have access to much higher internet speeds of above 30 Mbps.
- 50 per cent, or more, of European households subscribe to internet connections at or above 100 Mbps.

To reach these targets it is necessary to develop a comprehensive policy, based on a mix of technologies (fixed and wireless), in order to guarantee a universal broadband coverage and to foster the deployment of NGAN at 100Mbps.

The Digital Agenda establishes that the Commission will provide guidance about key regulatory concepts, under the electronic communications rules, in particular on costing methodologies.

The content of the consultation on costing methodologies

The Commission’s guidance concerning costing methodologies will take the form of a recommendation, to be used by National Regulatory Authorities (NRA).

At present, the Commission claims that national telecoms regulators apply different cost approaches when setting cost-oriented wholesale access prices, leading to a considerable divergence of access prices across Europe. The variations result in entry barriers within the internal market which jeopardize investment in NGA. The Commission assumes that this harms European consumers who may not be able to enjoy better service and lower prices due to lack of competition and investment. Moreover, the Commission also states that the general level of wholesale access prices to copper networks may significantly affect incentives to invest in new networks.

Therefore, the consultation focuses on a range of different costing methodologies and on investment incentives in the transition period from copper to fiber-based networks.
Cost methodologies
Cost methodologies are defined by
- the cost allocation principles: ‘long run incremental cost’, (LRIC) vs. ‘fully distributed costs’, (FDC);
- the asset evaluation principles ‘current cost accounting (CCA) vs. ‘historical cost accounting (HCA), or ‘investment renewal accounting’, (IRA);
- and the modeling approach (‘top-down’ (TD) or ‘bottom-up’ (BU).

One question in the consultation asks whether the use of CCA-BU-LRIC approach in relation to copper networks, which is popular among European NRAs, may lead to an increase in copper prices if customers switch to alternative platforms.

The questionnaire suggests that NRAs could make a distinction between non-replicable and replicable network assets. For assets that cannot be economically replaced, such as ducts, alternative costing approaches to CCA-BU-LRIC could be used.

The migration from copper to fibre
The Commission wonders if migration from copper to fibre is a pre-condition for achieving the Digital Agenda target and posits the possible virtue of a mandated switch off of the copper network.

The Commission suggests scenarios to create incentives to invest in fibre network like a ‘glide path’ for copper-based access prices, linked to credible NGA investment commitments or higher copper prices in return for investment.

Stakes for NRAs, for investing and for non-investing operators

The Body of European Regulators for Electronic Communications (BEREC) provides reports and expert opinions to the Commission. Through Article 19 of the Framework Directive the Commission has to take ‘utmost account’ of these. In its report, Regulatory Accounting in Practice 2011, BEREC provided an assessment that cannot be easily reconciled with the Commission’s picture of divergent NRA approaches to cost methodologies.

BEREC’s message was that the degree of harmonisation seems high and accommodates the use of parameters that reflect national circumstances. The analysis of the key wholesale markets – Unbundled Access (Market 4), Broadband Access (Market 5) and Leased Lines Terminating Segment (Market 6) – showed a clear preference for cost orientation, a trend towards using CCA and a fairly even distribution of LRIC and FDC accounting methods.

BEREC notes that the change of cost base from HCA to CCA is particularly relevant for Market 4 of Unbundled Access. The use of CCA is likely to remain relevant in a time of roll-out of fibre access networks and could send better investment signals to promote infrastructure-based competition.

Investing and non-investing operators have diverging positions on copper access prices
Investing operators, mainly incumbent as well as cable operators, support a stable and predictable regulatory regime in order not to jeopardize the current investment projects in NGA networks. They also underline the negative effect of an access copper price decrease on the overall value of the fixed market, including the future fibre one. Furthermore, they consider that a decrease of the copper access price would encourage the end–users, as well as the operators which benefit, to stay with copper services instead of going to fibre. Financial analysts share this view.

Non-investing operators, which buy unbundled access, state that reducing the access copper charge would provide incentive to the incumbent to invest in fibre. However, some of them acknowledge that their incentive to invest in fibre would decrease with lower copper prices because lower unbundling charges represent a more profitable copper-based service.
The position of Orange

Orange France Telecom Group fully shares the aims of the Commission’s Digital Agenda for Europe and has committed itself to a programme that will provide almost 60 per cent of French households with access to fibre-to-the-home (FTTH) by 2020.

Orange answered the Commission’s questionnaire from the combined point of view of an incumbent operator in France and Poland – and as an alternative provider elsewhere.

Harmonisation of national cost methodologies: the need for further harmonisation is not self-evident. As observed by BEREC, cost methodologies and regulated prices are already well harmonised across the EU, taking into account local factors. The variation, in the EU 27 of prices for local loop unbundling is much lower than the statistical range seen in other economic variables, such as GDP per head.

Choice of cost methodologies: disruption would jeopardize fibre investment. As described earlier, the Commission consulted on various possible cost methodologies for the copper pair and their associated valuation methods. These were principally ‘historical cost accounting’ (HCA) and the ‘bottom-up long run incremental costs using current costs’ (CCA BU-LRIC).

HCA, when interpreted as relying on book values, has largely been set aside by both BEREC and the Commission. Furthermore, it has been explicitly rejected by the European Court of Justice. HCA has many shortcomings: incorrect lifetimes from an economic point of view; no accounting for inflation; a high dependency on the specific national context and no forward-looking component. Finally, HCA would lead to a complete loss of harmonisation in methodology and outcomes - all of which run against the stated aims of the Commission. Methods such as HCA, Infrastructure renewal accounting (IRA) and, even less welcome, “Short Run Incremental Cost” SRIC, could spark a long, sterile controversy during which fibre investment would come to an abrupt halt.

Orange believes the wiser alternative is to use cost methodologies based on actual costs, as referred to by the ECJ. This means a choice between an actual series of investments over time - or modelled costs to fully rebuild the actual network capacity with “Modern Equivalent Assets”.

In both cases current values, inflation adjusted, and the real economic lifetime of assets should be used. Economic lifetimes need to be related to investment plans: investments in FTTH shorten the lifetime, and thus increase the depreciation rate, of copper. Finally, costs common to copper and fibre (such as ducts and poles) should be allocated in a consistent and effective manner.

Accelerated copper switch-off: migration should be left to customer choice and be guided by pace of investment, service improvement and marketing. The Commission consulted on whether an accelerated switch-off of the copper network, with a regulation-steered migration of customers to fibre, would encourage investment in high-speed networks. The Commission proposed a scheme based on conditional copper prices – dependent on fibre investment – to reward investors.

While Orange shares the view that the FTTH business case is influenced by the way public migration from copper to fibre takes place, Orange does not support the disruptive way proposed in the consultation. Predictability is vital for investment.

Some of the measures under discussion raise profound questions of property rights and administrative competence. The necessity of exploring some of these implications will only add further uncertainty and delay. A mandatory migration to FTTH would appear counterproductive in the sense that it would prevent investors from getting the higher revenues needed to justify and sustain FTTH investment.
Such a process would increase the overall migration costs for the end-user which would then be absorbed by operators and delay the geographical extension of FTTH by diverting resources away from investment. It would also raise the concerns of banks and shareholders involved with the industry.

There may well, however, be value in the further consideration of incentives for the development of new services, delivered directly to users, which might boost low levels of migration. Any action by member States to relieve operators of the burden of providing mandatory services solely through copper networks would be welcomed.

- Orange would not recommend increasing existing uncertainty by manipulating the cost of copper prices.
- To encourage fibre investment, stability in copper prices and in the current national implementations of copper cost methodology are essential.
- Policies aimed at artificially moving customers to fibre networks are most likely to degrade the fibre business case.
- Conversely, demand stimulation could actually improve network development.