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Investment and Regulation in Germany and Europe

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Telecommunications Act 2004 (1)

- The new German Telecoms Act entered into force on 26 June 2004 transposing the European ECNS Regulatory Framework
- Regulation is still needed, but should be phased out wherever possible
- Promotion of self-sustaining competition and efficient investment
- Technology neutral regulation to best address problems in a converging market environment
- The general rule: strict regulation on the wholesale level, retail level regulation only if wholesale regulation is not sufficient

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Telecommunications Act 2004 (2)

- The rule is therefore ex-post regulation for retail tariffs (sec. 39)

- Differentiated approach of ex-ante and ex-post intervention

- Regulation concentrated on bottlenecks such as the local loop:

  -access obligations are linked with ex-ante tariff regulation acc. to the principle of strict cost-orientation (cost of efficient service provision defined as FL-LRICs, as up to now)

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Special rules for investment

- Section 2 subsec. 2 para. 3

  The aims of regulation shall be -… to encourage efficient investment and to promote innovation; …

- Section 2 subsec. 2 para 3 and 4

  … In considering whether an access obligation is justified …, the Regulatory Authority has to take into account, in particular, the following factors –

  the initial investment by the facility owner, bearing in mind the risks involved in making the investment;

  the need to secure competition in public telecommunications networks and publicly available telecommunications services in the long term, most notably by creating incentives for efficient investment in facilities which will secure more competition in the long term;

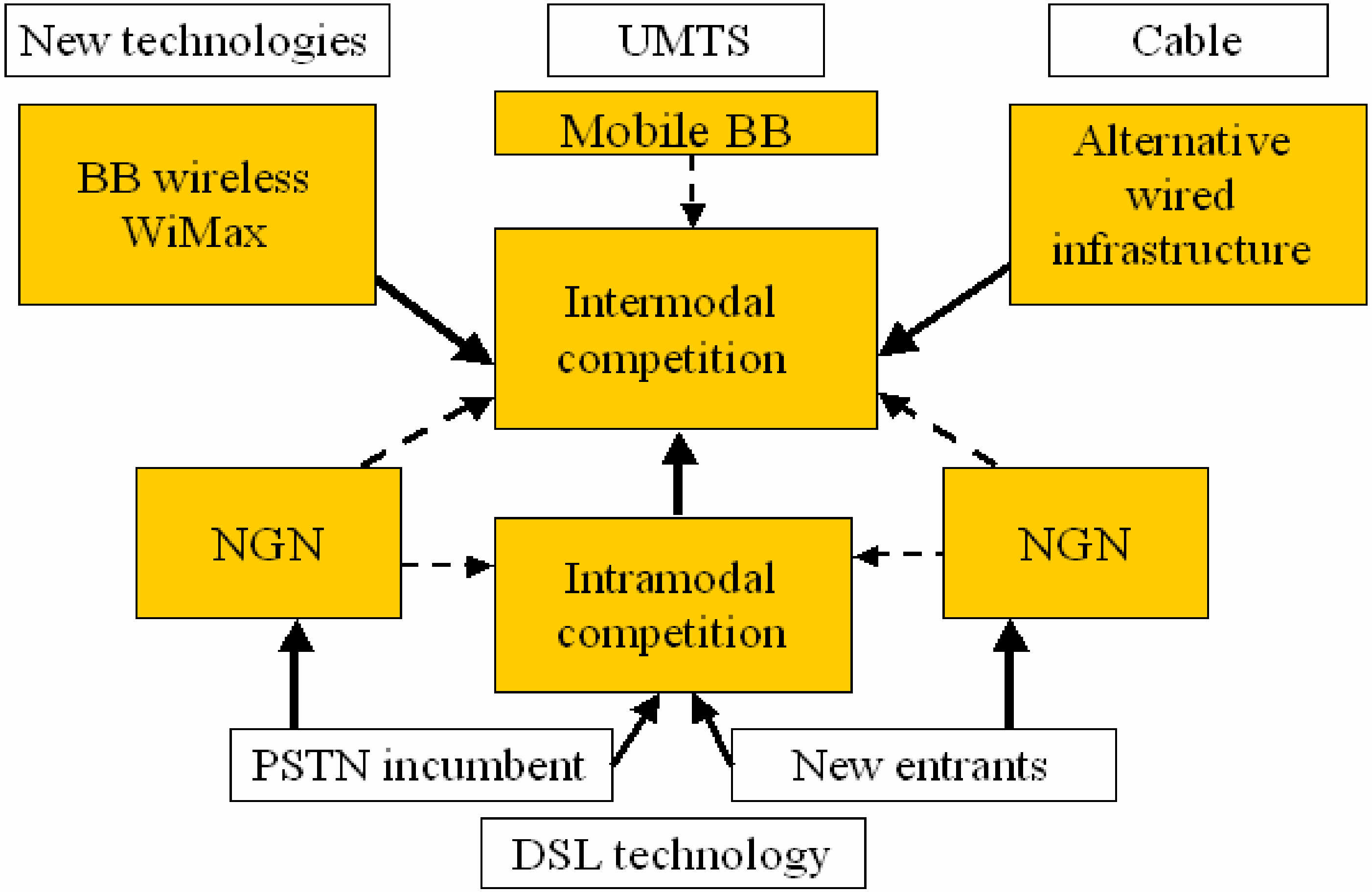
Regulatory approach

- competition is the best mechanism to promote innovation, creativity and efficiency
- network based sectors are natural monopolies in part, which often restrict competition in the downstream markets
- regulation substitutes competition or makes it possible
- precondition for the creation of competition is a “level playing field”

Investment and innovations at DT and the competitions

- access regulation for wholesale products
- importance of tariff regulation
  - cost efficient service provision
    (make or buy; not investing too much or too little in infrastructure)
  - DT should get an appropriate return on investment
  - prevention of price-cost-squeeze
  - consistency requirement

Infrastructure Competition



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Ladder of investment (1)

- It is a device to allow new entrants gradually to enter the market and
- To gradually increase their part of the value chain by investment into own infrastructure and to reach efficient scale thus becoming more competitive
- It is a device to create and support sustainable competition based on alternative infrastructure
- It consists of a collection of access obligations and related obligations
- Relevant portfolio of access products fitting national circumstances

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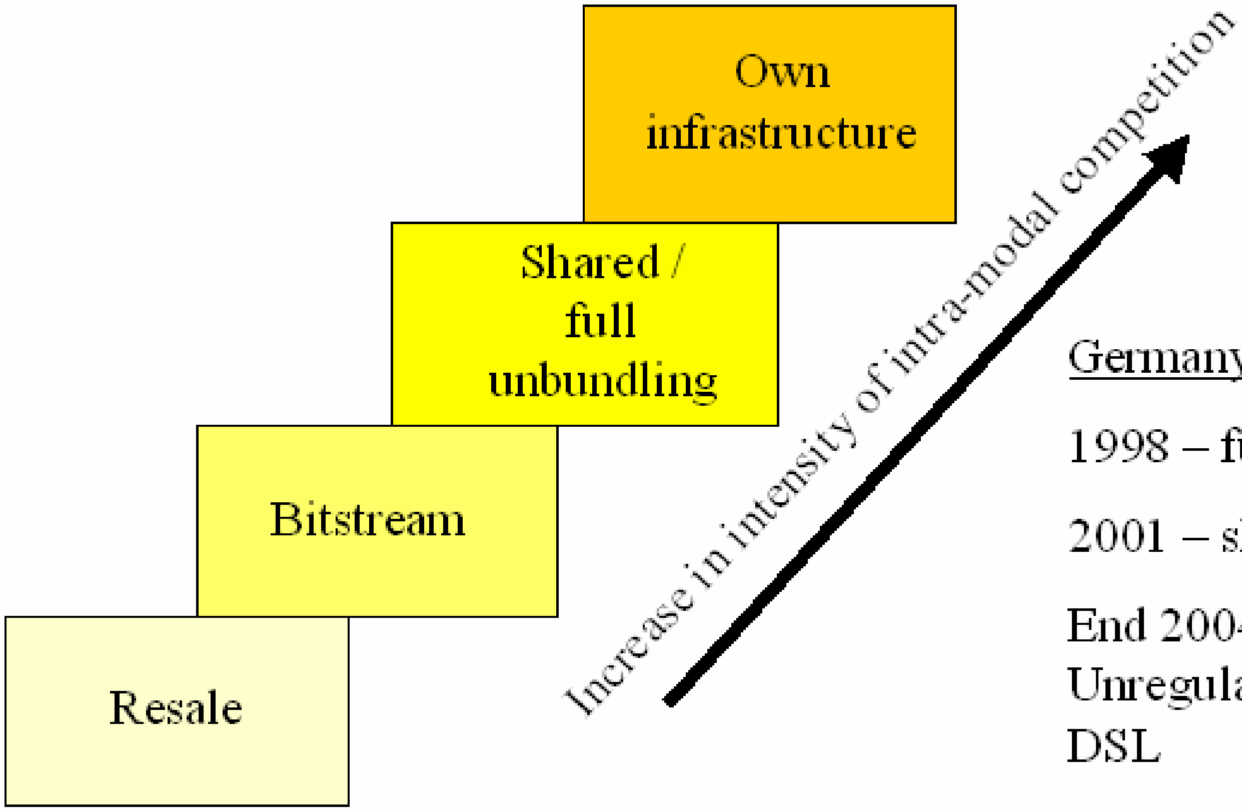
Ladder of investment (2)

- The following **standardized access products** are considered as rungs of the ladder
  - -Resale
  - -Bitstream
  - -Shared / fully unbundled access
- In general a closer grid (portfolio) of standardized products mandated by the NRA eases the process of climbing the ladder
- An approach mandating the access products in logical order starting with the lower rungs provides the best prospective for success, this does not exclude making them available at the same time

Ladder of investment (3)



Germany:

1998 – full unbundling

2001 – shared access

End 2004/beg. 2005: Unregulated Resale of T-DSL

BSA-decisions: market analysis and remedies

Ladder of investment (4)

- The ladder of investment-model worked good in establishing competition
- Access and infrastructure are becoming or already have become a commodity
- The capital market isn’t ready to accept the lower margins for commodity products in the telecommunications market, resulting in lower share-prices for infrastructure-oriented companies
- Funds for network upgrades might become increasingly difficult to raise

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Ladder of investment (5)

- As access and infrastructure become commodities, new revenue streams need to be tapped

- Closer ties between the marketing of content and access could lead to the marketing of high-quality content in conjunction with prioritised network access

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Example NGN (1)

No generic definition of the term, but a general understanding:

- A broadband network that will be packet switched and IP based
- Access, transport, control and services will be separate layers
- Many separate networks converge to form a core NGN supporting a multitude of services
- There will be open, standardised interfaces between the different layers

Example NGN (2)

- Service-related functions and intelligence can be provided independently of the underlying transport technology implying potentially more division of labour
- Faster provision of new services and greater opportunity for innovation
- Different providers will be able to create value at the separate functional levels of access, transport, control and services
- Customers will decide on the provision of services along the value chain: in al more decentralised manner or via vertically integrated providers offering bundles of services

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Example NGN (3)

- New services can be offered and they will be marketed in a different way
- The converged network could lead to “converged markets”, i.e. market boundaries may be shifted
- Chances: more players, potentially more competition, but also
- Risks: leveraging of market power from one market to another

Example NGN (4)

- The converged NGN environment requires the application of the **principle of technological neutrality** more than ever, because players on different platforms compete for the same customers, thus in order to create a level playing field, the same set of rules must apply to all of them in order to ensure infrastructure competition
- In order to cope with the more complex market situation and highly dynamic converging markets, regulators need flexibility to intervene in the most appropriate way
- In order to fine-tune regulation to national circumstances, national regulators are best suited as they are closer to national markets than an Euro-Regulator

Emerging Markets – Germany (1)

- Announcement of DT to invest € 3 bn in VDSL-infrastructure, claim for regulatory holidays
- Controversial discussion of how new (emerging) markets should be treated by regulators, at national and international level
- Proposal of the German Ministry to include a separate provision on the treatment of new markets (draft section 9a) in the Telecommunications Act
- Adopted by the Council of Ministers on 17 May 2006

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Emerging Markets – Germany (2)

- Opening of a “New market” consultation by the Federal Network Agency
    - More objectivity and transparency
    - Aim: definition or criteria which characterize new markets
- Consultation opened to discuss “risks” and “opportunities”
- 35 comments received, among them Ofcom, ECTA, DTAG, VATM, BREKO, operators, academic

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Emerging Markets – Germany (3)

- All comments are published on BNetzA's website
- Comments are currently being evaluated
- 2 groups of answers:
  - those in favour of exempting new markets from regulation for fear of negative effects on investment/innovation
  - those arguing that competition drives innovation and that no new or different criteria for “new” markets are necessary, regular market definition and analysis is sufficient

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What can regulators do?

- Best incentive to invest is confidence of investors in a sound regulatory environment
- Announcing the regulatory strategy in advance to ensure stability and predictability of regulatory environment
- Answer could be:
  - WACC that properly reflects the riskyness of investing in new technologies and upgrading networks
- Both ways – providing a clear vision of the regulatory strategy as well as a signal that risks will be rewarded appropriately – can incentivise investment as it helps building the necessary confidence of investors

Key Messages for the Framework Review

- Framework is fundamentally 'sound' – scope of review should be narrow
- Evidence of Deregulation in some end user and wholesale markets – pace of deregulation differs across member states
- Commission oversight needs to be simplified – need to concentrate on key market notifications and streamlining of Art. 7 process
- NRAs best placed to enforce optimum remedies to competition problems
- Flexibility for NRAs is the key to continued development of the sector – specifically in market analysis and remedies

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What should be the goals of the review?

- Development in IP and convergence will change existing market boundaries – in some cases more concentrated markets, more oligopolies
- Investment by all players and Competition in all markets will be the key to deliver Lisbon goals
- Review needs to ensure technological and service provider neutrality
- Review needs to ensure certainty throughout the process