

Access Pricing: a key element in effective NGN Access regulation.

How to find the right balance between encouraging investments and fostering competition?

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Presentation Outline

- Short introduction NGN Developments in NL
- Regulatory challenges FttH
- OPTA's regulatory approach on FttH
- Market analyses & remedies (Jan 2009)
- Pricing Principles for FttH unbundled fibre access
- Conclusion and discussion

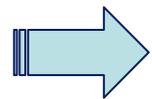
NGN Developments

Infra	Cable	xDSL	FttH
Coverage	National	National	Local
Development	Start DOCSIS 3.0	Start FttC-VDSL	Further Roll-out
# of lines	2 M	3 M	~ 100k

Regulatory challenges

- Stimulate investments in NGN, without disturbing level of competition

- Right access regulation (on NGN)



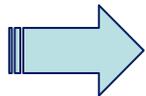
- Regulatory certainty as part of (minimizing) investments risks

- Transition from old situation towards new situation

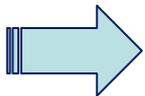
OPTA's regulatory approach: promote infrabased competition (if possible)

- Cable and KPN is not enough – access required
- Infrabased competition is driver for innovation and investments

- Promote infrabased access model - regulation
 - Local Loop Unbundling (LLU)
 - Sub loop Unbundling (SLU)
 - Unbundled Fiber (ODF Access - FttH)



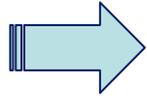
- Minimize WBA regulation
 - No WBA-regulation for FttH



Regulatory certainty and investments in FttH

- FttH requires mayor investments in NL (approx. 1000 Euro per home)
- ➔ • Investors in FttH were worried about regulatory uncertainty
 - FttH business case has in itself risks
 - (possible) regulatory intervention (during the lifetime of the investment) leads to even higher rate of return demands by investors.
 - This might lead to less NGN-investments or even no NGN-investments on a large-scale
- ➔ • Access seekers are worried about regulatory protection (and as a result too high access rates)

OPTA's approach on regulatory (un)certainty



- OPTA's analyses is that one of the main element of investors regulatory uncertainty has to do with (future) pricing (principles) of NGN Access.
- Therefore OPTA has published Policy Rules for NGN Access Tariff Principles
- These policy rules are published at the end of 2008, in combination with the publication of the final decisions of the market analyses.
- The starting point for these policy rules is an effective access of unbundled FttH, which access tariffs supports the business case for infrabased competition on FttH.

Key cost drivers in unbundled fibreline prices

the main characteristics of the business case for FttH

- Investments (capex) per area
 - Mainly construction costs
- Costs of capital / required rate of return
 - Dependent on risks and opportunities of the business case
- Penetration (% of households) – success of the project

- Managing (external) risks and managing the construction costs are crucial factors in limiting cost of capital → essential for (regulated) price level
- Creating success (and the opportunities) is crucial for limiting the costs per line → which in itself (lower prices) stimulates more success (penetration)

Chosen regulatory approach on pricing

- Minimize 'external' risks for the business case FttH
 - Give long term certainty on access prices for FttH as well as on pricing principles
 - Limiting asymmetrical regulatory risks
 - Allow (within boundaries) the optimistic scenario of the business case
- Allowing internal risk measurements in the pricing
 - one-time investment-contribution in line-tariff
 - pricing that stimulates penetration
 - E.g. volume discount schemes
 - E.g. indexed tariffs (that allows for lower entrance tariffs)
 - Different CAPEX-types (and prices) based on different costs
- Determine access price (cap) that is based on realistic business case and parameters
 - That allows infrabased competition, comparable with ULL-business model.
 - With reasonable rate of return for access provider
- In addition to a wholesale price cap the wholesale prices are subject to non-discrimination, which includes a margin-squeeze test.

Two main price measurements

- Setting a wholesale price cap
 - At the start (called To) of the investment
 - Yearly indexed with actual CPI
 - Based on actual CAPEX
- Periodically Rate of return check
 - Check actual IRR with ‘all risk WACC’
 - Every 3 years (regulatory period)
- If the actual IRR is higher than the all-risk WACC then the price-cap is adjusted downwards.

Key parameters used in pricecap-model

- Actual CAPEX per project build (called area)
- Payback period: 25 years
- Penetration level: 60% (after 2 years)
- Expected CPI: 1,5% per year
- IRR (after tax): 7 – 10%*
- OPEX per line: € 12 – 18* (per year)
- Investment contribution: € 80 per line

As a result (for CAPEX-category III (875 – 925 Euro/line) :
€ 16,00 per month (with max discounts: €12,80)

Periodic rate-of return check

- Every 3 years the actual IRR is checked against the so called “All-risk WACC” which consists of three elements:
 - Standard WACC for classic (copper) access network
 - Premium for fiber-project risk
 - Premium for asymmetrical regulatory risks
- For the premium for asymmetrical regulatory risks a minimum value is set *at the start* of the investment, allowing the optimistic business case scenario to be realized without regulatory intervention
- Minimum is set at: 3.5%
 - Derived from an optimistic business scenario of 80% penetration

Conclusions

- Long term regulatory certainty in the pricing principles and actual prices for FttH-access are essential for both investors (of the access) as well as investors (that seek access).
- The policy rules for pricing principles of FttH access have found a balance between encouraging investments and fostering competition
- Currently the tariffs for unbundled fiber are being consulted in the market and notified by the commission.
Final decision to be expected in March/April 2009.
- The next years will have to show if investments in FttH will be done on a large scale and also if and on what scale access-competition via unbundled fiber will be as successful as unbundled copper has been the past years.