

Co-investment: incentives and nudges

BiTS seminar
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Firm incentives

- So many co-investment models, and each model so complex, that very difficult to generalise about anything
- Incentives for firms to co-invest depend on the counterfactual:
 - Non-SMP firm will co-invest if economics better than and/or risk lower than:
 - Standalone network investment
 - With/without duplication
 - With/without regulation (i.e. pricing power vs investment risk)
 - Regulated wholesale access to SMP network
 - SMP firm will co-invest if economics better than/or risk lower than:
 - Standalone network investment (w or w/o duplication, w or w/o regulation)
 - Doing nothing
- The counterfactual also affects who they would co-invest with:
 - If SMP firm believes no credible threat of duplication or competition for the market then co-invest unlikely....
 - ...so co-investment often requires initial standalone investment by non-SMP firm/s and is rarely the starting point in the game

Regulatory nudges

- Various ways for regulators to make counterfactual less attractive than co-investment, but all problematic:
 - If you make regulated wholesale access less attractive for non-SMP firms, this encourages them to co-invest BUT discourages the SMP firm to co-invest
 - If you need to make standalone network investment by non-SMP firms easier (to trigger co-investment by SMP operator), then SMP firm may then prefer co-investment to duplication BUT not obvious the regulator should!
 - If you make standalone network investment by SMP firms less attractive this may encourage them to co-invest BUT may also discourage standalone network investment by non-SMP firms
- My conclusion is that any attempt to influence to counterfactual to favour co-investment over standalone investment or regulated wholesale access is as likely to be counterproductive as productive
- So I now focus on the factual

Regulatory nudges

- How do you make the co-investment factual more attractive?
 - EC proposes that an existing SMP operator deploying ‘new network elements’ which contribute to VHC would not be regulated if they:
 - Are open to co-investment offers on terms which sustain competition in the long term
 - Are flexible on timing of participation (the terms of co-investment can vary to reflect this)
 - Allow participation to increase over time (subject to minimum initial commitments, again with terms that may vary to reflect changing risks)
 - Allow participation rights to be assigned to other co-investors or third parties
 - Award ‘reciprocal rights’ of access if individually and separately responsible for different deployments
 - Leave existing users of regulated products undisturbed

Regulatory nudges

- None of these is crazy, but the key issue, which I think the EC recognise but do not address explicitly, is that a reduction in retail competition (vs the counterfactual) may be required before any firm (SMP or non-SMP) will co-invest:
 - The lower the barriers to participation and the more firms who participate, the less attractive co-investment will be for all
 - The higher the barriers to participation and the fewer firms who participate, the better prospects for co-investment
 - Where to draw this line, and who does it, is the key issue...
 - ...and that might change depending on your view of the counterfactual (e.g. you may tolerate less competition if the counterfactual is no investment than if it is standalone network competition, but may also need to consider 'tied' cases)
 - ...so in reality NRAs will get drawn into adjudicating on these issues on a case by case basis
- So whilst I understand the EC's wish to provide ex ante rules for prospective investors, I think any 'tick box' approach is fundamentally flawed, bound to produce serious errors and/or the need to be flexible will reduce commitment and certainty

Regulatory nudges

- My alternative is simple (in theory):
 - Each co-investment proposal would be submitted to the NRA (akin to a Form CO) and be examined on its individual merits (working in co-operation with the NCA)
 - The presumption would be that the co-investment proposal would result in a new geographic (and potentially product) market, for which the NRA would immediately undertake a new market review (effectively 'market testing'). The geographic market outside this area would remain unchanged and would not require further review
 - The NRA would be required to issue a decision (within, say, 9 months) setting out its position on the market, SMP and the regulatory conditions, if any, to be applied to the co-invested network.
 - This decision would be binding on all parties for the term of the co-investment agreement. If the terms of the co-investment agreement alter or the parties change in way which is likely to alter the analysis, then the NRA would be able to revisit its conclusions earlier.
 - The EC would develop guidelines (or modify the SMP Guidelines) in order to assist NRAs as experience develops (as with mobile network sharing)

Conclusion

- My approach formalises what I think would happen anyway under the EC approach, which is that NRAs would want to 'market test' proposals and undertake something akin to a market review with a new counterfactual
- It allows co-invested networks to be removed altogether from the scope and risk associated with SMP, rather than relying upon exemptions which can easily be reinterpreted
- But it does also require a change in the conduct of NRAs, who will be required to act like NCAs in merger cases (and co-operate with them) in making an irrevocable decision about whether the structural changes arising from the co-investment project alter the regulatory landscape
- Firms would then retain all the normal rights of appeal, as they do in market reviews (which is also not obviously the case under the EC approach)