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# A New Regulatory Paradigm for the Digital Sector in Europe

The new regulatory framework in the digital sector in Europe is likely to fall short of expectations. A fragmented digital market with insufficient incentives for investment is the probable outcome. European regulators should abandon their approach in favour of a new and more flexible set of ideas discussed in this paper.

White smoke rose over Brussels on 6 June 2018 when negotiations over the new telecoms regulatory framework, the European Electronic Communications Code (EECC), were completed. Not surprisingly, representatives of the European Parliament and the Commission expressed their satisfaction with and pride in the task accomplished in recent years through various press releases. Industry and investor circles, on the other hand, initially responded to the negotiations' outcome with scepticism or even disappointment, expressing serious doubts as to whether the package would ultimately fulfil the original intentions of the European Commission – that is, after being implemented in national law by each of the member states within the next 24 months. One of the objectives, clearly, was to substantially improve connectivity within the EU in order to allow broad participation of its citizens and to move forward with the digitalisation of the economy. The primary aim here was to increase public welfare by utilising the socio-economic effects generated through digitalisation. Correspondingly, within the EU and beyond, public policies for awarding spectrum were to be harmonised and improved in order to avoid an unsatisfactory situation similar to that arising through the fragmented award of 4G spectrum by individual EU member states. Roberto Viola, Director General of DG Connect, commented at an event in late 2016 that 4G licensing in Europe had been a disaster. It was the European Commission's explicit objective to create stronger incentives for investing in new, fibre-based infrastructure as part of a bid to resolve the investment bottleneck that

had built up around Europe's digital infrastructure.<sup>1</sup> At the same time, however, the regulatory focus sought to encourage competition, and avoid any conflict between investment incentives and competition. So much for the fully justified intentions and the general expectations aroused as a result.

## The EECC will not reach objectives

The progress and final result of the negotiations was sobering. There are concerns that the outcome of the implemented regulations will fall far short of the intended – justified and important – objectives of the EECC. Stated briefly, this assessment applies to four elements:

- With regard to *spectrum policy*, the European Commission presented sound proposals for an encompassing reform of spectrum award policies, taking into account licensing methods, the periods of use as well as the overall schedule for awarding spectrum in the member states. Yet the legislative process has diluted these proposals to the point of inefficacy, so that no fundamental improvements are to be expected at this point. Minor progress has been achieved only in relation to the licensing term, set at 20 years or 15 years plus a five-year renewal option. With sovereignty over spectrum continuing to be the rule at the national level and spectrum policy consequently remaining completely

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<sup>1</sup> The European Commission expressly pointed out the need to close the investment gap; see European Commission: A new, modern Multi-annual Financial Framework for a European Union that delivers efficiently on its priorities post-2020, COM(2018) 98 final, 14 February 2018, p. 9.

fragmented, the stated aim of making Europe a global pioneer in the introduction of 5G appears unrealistic.<sup>2</sup>

- The *Significant Market Power (SMP) regime* has proven itself in the past and is well established. Today it serves as the starting point and determinant for any regulatory measure. Softening this regime has resulted in a completely watered-down mixture of elements that are partly contradictory consisting of SMP regulation, joint dominance approaches and symmetric regulation.
- The *co-investment* model had aroused hopes among its supporters that investment incentives would massively increase; this model has now degenerated into a highly complex, “micro-managed” system, involving so many detailed rules, sub-categories and exceptions (i.e. red tape) that it is highly doubtful whether the system will ever actually trigger any significant incentive for additional investments.<sup>3</sup> We need to remember that the international investor community has found the European telecoms sector unattractive for the last 15 years, causing a European investment gap that has widened to as much as 150 billion euros over the years.<sup>4</sup>
- There remains a lack of clarity surrounding the rules for *state aid* and the future structure of *universal service*.

The essential concern is whether the future system of regulation will ever function at a practical level, as it will be based on SMP regulation, symmetric regulation, universal service and state aid – without clear distinctions between these base points and without any clear definition of the interdependencies among them. A clear definition of the base would provide the foundation for the regulatory framework. In short, the negotiating parties appear to have planned the framework in great detail while failing to lay a solid foundation.

2 Recently, a prominent non-European industry representative commented to me, perhaps with some exaggeration, that Europe’s ambitions to take over 5G leadership were completely unrealistic, claiming instead that, as far as 5G supremacy is concerned, Europe is currently engaged in competition with the US and several Asian countries in a ‘race to the bottom’.

3 Additional investments beyond the minimum investments, which (having always been made in the past) will continue to be required.

4 Estimates vary depending on the source but are between 106 and 150 billion euros. The Boston Consulting Group arrives at a figure of 106 billion euros in W. Bock, P. Soos, M. Wilms, M. Mohan: Five Priorities for Achieving Europe’s Digital Single Market, BCG, October 2015, available at [https://etno.eu/datas/publications/studies/FINAL\\_BCG-Five-Priorities-Europes-Digital-Single-Market-Oct-2015.pdf](https://etno.eu/datas/publications/studies/FINAL_BCG-Five-Priorities-Europes-Digital-Single-Market-Oct-2015.pdf).

## EECC: A missed opportunity?

The EECC, as it is taking shape, is likely to emerge as a missed opportunity for Europe, threatening to fall far short of its original objectives. Market participants will therefore likely adopt a wait-and-see attitude due to speculation that shifts in this parallelogram of forces or interpretations of National Regulatory Authority rules could eventually result in more favourable investment conditions. How would we respond to such a wait-and-see attitude among market participants and investors? In a piece published a week before the negotiations were completed, I advocated going back to square one of the whole process, starting with a clean slate and installing a clear, flexible and highly simplified regulatory framework.<sup>5</sup> Although such an approach – admittedly a drastic move – plainly has no chance of implementation in the realm of *realpolitik*, there is something to be gained from reconsidering matters at this point.

## Moving away from a Digital Single Market

There are, of course, those who argue that things are never as bad as they seem. Some observers point out that the regulators’ most important and proven tools – market analysis and SMP regulation – will probably continue functioning for the next few years as it will take time to implement the EECC in all member states. Conversely, others warn that great change is coming and no one is certain of what will be important then. What may affect the regulatory situation after EECC implementation is an initiative in certain EU countries to introduce symmetric regulation based on joint dominance assessment. Despite the dubiousness inherent in this method, it could change the face of the market. During the trialogue negotiations, several member states strongly advocated enrichment of the regulatory toolbox through the addition of new methods such as a joint dominance assessment and symmetric regulation.<sup>6</sup> These regulatory tools are a measure of last resort, equipping the National Regulatory Authorities (NRAs) with an effective means of proceeding against suspected cases of tight oligopolies. A positive take away from this regulatory measure may be the fact that no requirement for cost-based access to cable

5 See G. Serentschy: European Electronic Communications Code (EECC) – Back to Square One, 30 May 2018, available at <http://www.serentschy.com/european-electronic-communications-code-eecc-back-to-square-one-contribution-to-the-discussion/>.

6 After the DG Competition had indicated no willingness to relax the joint dominance threshold, Dutch NRA, the Netherlands Authority for Consumers and Markets (ACM) apparently made use of the option of an “eased burden of proof” under the new SMP guidelines to identify joint dominance, as presented at the WIK Workshop “Revising the SMP Guidelines”, 27 March 2018, Brussels. ACM is expected to notify the market analysis for M3a/M3b in late 2018.

networks has been specified in the EECC.<sup>7</sup> It is, however, more than doubtful whether this will ultimately mean a real boon to the investment climate. This conclusion is all the more likely when considering the degree to which NRAs vary in their views and to what extent they make use of such regulatory tools. The result is a “regulatory toolbox” that is full to the brim with an excessively large margin of discretion for NRAs. Consequently, the EU, instead of converging towards a Digital Single Market (DSM), could drift apart to become, in effect, a completely fragmented arrangement of individual national markets.<sup>8</sup> While this may gel with the political buzzword “subsidiarity” in the EU’s current debate on fundamental principles, it is clearly a move away from creating a DSM.

### Progressive versus conservative regulators

The problem with this development is that, more than ever, the NRAs will determine whether there will be a pro-investment climate in their jurisdictions or whether they will simply maintain the status quo. Progressive NRAs will realise the potential good that can be achieved for the market and investments by observing a regulatory “hands-off” policy to some degree under *ex post* supervision, and they will have the courage to experiment. Conservative NRAs will be tempted to stick to tested formulas based on principles going back to the time when markets were liberalised and will interpret the rules more restrictively. This scenario is not favourable to creating conditions for driving additional investments on a large scale in Europe.

### Can co-investment provide a boost?

Great expectations have arisen around the principle of co-investment. However, in view of the highly complex rules defined for co-investment, both investors and co-investors will be exposed to several massive uncertainties:

- the need for projects to be approved by the NRA as a prerequisite for regulatory forbearance;
- the rights of access-seekers not involved in co-investment projects and the impact of such rights on those projects;

7 The wording of the EECC in this context is “fair and reasonable terms”.

8 To respond to this risk, the “double-lock” system was introduced to Art. 59 for the case referred to here (and to Art. 74 for co-investment). This means that application of such a regulatory measure by an NRA can only be blocked jointly by the European Commission and the Body of European Regulation for Electronic Communications (BEREC). Yet this does not really improve matters, as these two institutions pursue differing sets of interests. Rather, this example strikingly demonstrates the extent to which the EECC has become entangled in regulatory micro-management in this matter as well.

- the practical implications of the “double-lock” safety mechanism involving the European Commission *and* the Body of European Regulation for Electronic Communications (BEREC), and the rulings to be expected from the two institutions based on their varying interests.<sup>9</sup>

When taken in their entirety, it is obvious that these factors do not help improve investment certainty; therefore, it is doubtful whether this model will result in any significant increase in willingness to invest.

### Reminder from the past

After the unsuccessful attempt in 2012 to update the legal framework by adopting the Telecoms Single Market Regulation,<sup>10</sup> the European Commission again proceeded to present a variety of models for modernising the legal framework, and finally proposed the EECC in 2016 as draft legislation for a complete reform. Now, after lengthy negotiations with all 28 member states under six-month council presidencies, each with its own differing priorities, and under massive pressure from various lobbyists, a mere modest outcome has been achieved. That is not the European Commission’s fault but is mostly due to the EU’s extremely complex legislative process.<sup>11</sup> In any case, this sobering insight should offer an incentive to rethink our approach.

### Rethinking regulation

At this point, it is worth stopping for a moment and considering the options for responding to the threat of a wait-and-see attitude in the market and the resulting paralysis in market development. In the worst case scenario, Europe consistently fails to produce a convincing incentive to invest and fails to close the investment gap (or does so only partially). Its ambitious connectivity goals are met, if at all, by only a small number of member states while competition suffers – a truly disastrous outcome. To add insult to injury, the situation would last for years, because

9 Ibid.

10 The European Commission’s Telecoms Single Market Regulation originated from seven separate initiatives aimed at modernising the entire legal framework for regulating electronic communications. Of those seven initiatives, only two became law, namely the Net Neutrality Regulation and the Roaming Regulation.

11 It should also be mentioned here that the frequently bemoaned slow pace of the EU’s legislative process is largely due to the principle of democratic participation as practised in this process. It would be worthwhile, in any case, to give thought to ways of streamlining and accelerating the legislative process while maintaining democratic participation, or to consider whether a flexible framework, controlled by principles and involving *ex post* supervision, might be more appropriate for the digital sector.

the change was newly implemented – albeit inappropriately!

The digital sector progresses at the speed predicted by Moore's law,<sup>12</sup> generating up to now a constant flood of innovations and applications that in many cases are disruptive. This fact would make it obvious that a legal framework based on the previous regulatory regime and the EECC can no longer contribute anything substantial towards developing infrastructure, encouraging additional investments or digitalisation. It is becoming increasingly clear that there is a widening gap between regulation and the speed with which the sector is evolving. In Europe, this is aggravated by the fact that NRAs are drifting apart in their regulatory practices and that BEREC, as it is currently structured,<sup>13</sup> is apparently not able to control these centrifugal tendencies. The following proposals point out a few possible alternatives to the existing, *ex ante* form of regulation, which is intricate, highly-prescriptive and more of the same:

- Like any other system practised for decades, the *ex ante* regulatory system, along with its stakeholders, has long since taken on a life of its own. It is constantly on the lookout for suspected competition issues i.e. new matters requiring regulation. This process leads to the *ex ante* regulatory system becoming set in stone. It would be worth considering which serious and sustained competition issues actually require *ex ante* regulation today. It would also be worthwhile to give thought to new responsibilities for regulatory authorities.<sup>14</sup>
- Regulatory sandboxes encourage more experimentation and consistent deregulation of new fibre-based infrastructures funded completely through contributions from private investors.
- Another take on co-investment: Joint investments in "Fibre to the Home". Access to such infrastructure could be released from regulation and made subject to agreements under private law and to *ex post* supervi-

sion. This would quickly reveal how willing market participants and investors really are to make investments, while regulatory authorities or anti-trust authorities could step in and stop any abusive conduct.

- There are lessons to be learned from leading countries in fibre rollout in Europe and elsewhere.
- It would also be a good idea to consistently utilise existing passive infrastructure (such as cable ducts and masts) and support cooperation models that include electricity providers and their fibre-based infrastructure. The wide-spread availability of backhaul capacity from energy utilities can also serve as an accelerator for a faster and more efficient 5G rollout.
- Wholesale obligation in cases where public funds play a role in network rollouts should be based on commercial terms under *ex-post* competition oversight.
- With regard to the regulation of certain over-the-top (OTT) services,<sup>15</sup> the existing regulatory framework already provides for options that would allow a level playing field to be set up for services that are considered real substitutes for traditional services. In the event that a detailed evaluation of the situation revealed actual substitution, appropriate regulation could be quickly and pragmatically introduced.
- Finally, if the policymakers in the EU do not abandon the plan to create a DSM, there will be no way around the expansion of the European Commission's executive powers and developing BEREC to become a European regulatory authority. The alternative would be for Europe to prolong its state of national particularism and effectively give up all claims to leadership in the digital world.

To avoid the paralysis that threatens to bring "digital Europe" to a halt, it would be worthwhile to give full consideration to proposals such as the ones outlined above.

12 Moore's law – actually not a law but an empirical observation – states that the storage capacity and processing speed available in integrated circuits double every 18 to 24 months.

13 We should remember here that the European Commission's original proposal for the EECC also included further developing BEREC towards becoming a European agency. The majority of member states opposed this plan vehemently, while BEREC insisted that it was "rooted in the independent NRAs". BEREC thus took itself out of the game, so that now there is no possibility of overcoming the centrifugal tendencies mentioned above that inhibit a Digital Single Market.

14 It could be very worthwhile to utilise the expertise gathered by NRAs and to diversify their activities by adding new responsibilities, related for example to digitalisation, or to monitoring internet access quality and ensuring high "quality of experience" for the user.

15 A relevant legal precedent in this context is the dispute between Google and the German Federal Network Agency (BNetzA), after the BNetzA had classified Google Mail as an electronic communications service. The case is currently before the ECJ pending a ruling. This is a noteworthy case from the perspective of the EECC: if the BNetzA wins the dispute before the ECJ, it could actually turn out to be a Pyrrhic victory, since Google Mail is an OTT-1 service (according to the BEREC definition in BoR (16) 35), while under Art. 20 of the EECC such services, as "number-independent interpersonal services", are not subject to registration but only to reporting requirements. In other words, OTT-1 services, while generally falling under the EECC, have to meet fewer obligations. Correspondingly, we can expect some NRAs to require the "big" OTTs to submit a security plan, yet, with no registration required, not all OTTs will be effectively enrolled, so that this provision, lacking consistent enforcement, would remain largely a cosmetic measure.