



ETNO Statement on the BEREC WACC-Parameters Report 2021

On June 15, 2021, BEREC published its second Report on WACC parameter calculations according to the European Commission's WACC Notice of 6th November 2019 ('WACC Report 2021').

ETNO had taken a critical stance on the Commission's WACC Notice and the first BEREC Report¹ in January 2021 and provided suggestions for rectifications to achieve the goal of a more harmonized WACC which would indeed provide the opportunity for a fair and simplified WACC setting throughout Europe.

The WACC Notice so far has not been changed and the BEREC Report² now reveals the pitfalls of methodological shortcomings of the Notice: based on the current BEREC calculations national WACCs in a number of member states would fall below 5% (pre-tax, nominal), a threshold which has never been passed by NRAs before the Notice and which would be in contradiction to usual market WACC estimates for the regulated companies. The latter currently stand usually at least at high single-digit levels.

Such wrongly set WACC poses serious threats for electronic communications markets in Europe. It sends negative signals to investors and reduces trust in regulation as it shows that Regulators do not consider investors' expected return on investments and furthermore, they would allow for disruptive decreases.

Although the WACC notice is formally limited to a WACC for legacy network regulation, such legacy WACC decisions could spill over to VHC where the legacy WACC is perceived as benchmark or basis for VHC WACC. Contrary to the Commission's intention to promote the internal market the Notice may create distortions to EU internal market as countries with bigger differences with the current WACC figures for the telecommunication sector would be penalized.

The second BEREC report follows calculation methods of the first report but changes the peer group which is used for assessing major parameters such as the beta, gearing or debt

¹ <https://etno.eu/library/positionpapers/420:etno-statement-wacc-ec.html>.

² Report BOR (21) 86 of 10 June, 2020.



premium for the analysis of the equity risk premium. The net effect of these changes are even lower WACCs in comparison with an unchanged peer group.

The main flaws of the Commission Notice remain. The Notice systematically underestimates the cost of equity in times of artificially depressed low interest rates for governments bonds (the “risk free rate”) by forcing NRAs to combine national low or negative bond yields of the past 5 years with a uniform EU average market risk premium which is derived from historic data on bond yields and equity market return over a very long time period without aligning the outcome with forward looking risk estimates and ignoring the effects of the quantitative easing policy on interest rates. Indeed, while low or decreasing interest rates have allowed companies to raise debt at better terms, the cost of equity did not follow this trend, resulting in an overall WACC estimates at company level significantly above the BEREC estimates following the EC’s notice.

The recent Ofcom estimate for the WACC of BT provides an interesting case study on the outcome of an alternative WACC estimate. Ofcom did not apply the WACC Notice methodology or the BEREC numbers but undertook its own investigation. As a result, Ofcom established a WACC of 7,8% for BT. Based on the first BEREC Report, however, the WACC should not have exceeded appr. 5,3%. Such a large gap is a strong indicator that the WACC Notice might lead to a severe underestimation of correctly estimated WACCs.

Wrongly set WACCs could cause significant harm on investments in European telecommunications. As the Commission has undertaken the review of the Next Generation Access recommendation, the current situation, while limited to legacy assets, might trigger wider damage to very high capacity network (VHCN) investments, at the opposite to the ambitious targets the Commission itself sets on VHCN.

ETNO hence reiterates its concerns and urges the Commission and BEREC to consider appropriate estimates of the WACCs to enable National Regulators to allow for a regulatory environment which supports and values investments.