

1. Telefonica UK Ltd (“Telefonica UK”) welcomes the opportunity to respond to Ofcom’s consultation on the Business Connectivity Market Review (“BCMR”)¹
2. As Ofcom is aware, Telefonica UK is a mobile network operator with around 25m retail customers, through its O2 and giffgaff brands. Telefonica UK is also a major wholesale mobile provider, with customers including Tesco Mobile, Sky and Lyca.
3. Telefonica UK has supported Ofcom’s strategic approach, adopted in its review of digital markets in 2015/16 and culminating in its July 2018 approach to future regulation document². In particular, we agree with Ofcom’s goal to require BT to provide unconstrained ducts and poles, as a means of boosting investment in fibre; Telefonica UK’s principal interest in this is to generate greater competition in the provision of mobile backhaul services. The rollout of 5G networks in the UK relies heavily on the provision of high capacity, cost effective mobile backhaul. Ofcom is aware of the importance the Government attaches to the roll-out of 5G networks in the UK³.
4. Ofcom accepts that the current price of Very High Bandwidth (“VHB”) services is extremely high and considerably above cost; see, for example, Table A10.1 of the consultation document. The published annual rental charge for an Openreach Ethernet Access Direct Local Access 1 Gbit/s leased line is reported as £1,950; the equivalent charge for a 10 Gbit/s leased line is £4,146. Indeed, the cost differential is greater, now, following the reduction in the annual rental charge for an Openreach Ethernet Access Direct Local Access 1 Gbit/s leased line, to £1,620.⁴ The recurring cost of providing the services is identical (as Ofcom notes elsewhere in the consultation document, the only difference between the services is the equipment at either end of the leased line and the cost of that equipment should properly be reflected in the one-off connection charges. In any event, these are considerably higher in the case of 10 Gbit/s leased lines: £5,565, compared to £1,850 in the case of 1 Gbit/s leased lines.)
5. Ofcom notes, at paragraph 3.53 of the consultation document, that demand for mobile data is growing at a CAGR of around 50% and that the introduction of 5G services in the period covered by the review may lead to an increase in the density of mobile networks and an increase in demand for leased lines.
6. Indeed, 5G is likely to lead to an increase in demand for VHB based mobile backhaul. For example, EE (wholly owned by BT) has announced its initial plans for 5G deployment, stating that⁵:

¹ Business Connectivity Market Review, Ofcom, 2 November 2019. See:

https://www.ofcom.org.uk/data/assets/pdf_file/0025/124729/lcc-bcmr-2018-volume-1.pdf

² Ofcom, 2018. Regulatory certainty to support investment in full-fibre broadband – Ofcom’s approach to future regulation, Ofcom, 24 July 2018. See: <https://www.ofcom.org.uk/.../investment-full-fibre-broadband.pdf>

³ See, for example Next Generation Mobile Technologies: An Update to the 5G Strategy for the UK, DCMS, 19 December 2017. See: <https://www.gov.uk/government/publications/next-generation-mobile-technologies-an-update-to-the-5g-strategy-for-the-uk>

⁴ See:

<https://www.openreach.co.uk/orgp/home/products/pricing/loadProductPriceDetails.do?data=0d0zetWgShsjqKWicN2Y5WJA8BGGqsBLxL7lgSM4fRpZ6rNZujnCs99NbiKJZPD9hXYmiiXh6wr%0ACQm97GZMyQ%3D%3D>

⁵ See: <https://newsroom.ee.co.uk/ee-announces-5g-launch-locations-for-2019/>

“The first **1,500 sites that EE is upgrading to 5G in 2019** carry 25% of all data across the whole network, but only cover 15% of the UK population....

EE is upgrading transmission to 10Gbps links at each 5G site, and has tested the new links – the fastest in use anywhere in the UK – at its trial sites in Canary Wharf and across East London” (emphasis added)

7. Because competition in the mobile market is very well developed, it is likely that:
 1. Other mobile network operators will seek to rollout their 5G networks on a similar scale to EE's; and
 2. There will be further network rollout beyond that which has already been announced, within the timeframe contemplated by the current BCMR (i.e. by 31 March 2021)
8. However, in formulating its proposals for this market review, Ofcom appears not to have considered the increase in demand for VHB services that these market trends are likely to generate, or the repercussions for the rollout of 5G networks and competition in the downstream mobile market, of the current high prices of VHB services (which would not be curtailed at all by Ofcom's proposed price freeze).

Risks associated with high VHB prices, in excess of costs

9. In Telefonica UK's view, VHB 10 Gbit/s Ethernet circuits will be required for 5G. This is because 5G sites are likely to carry far more data than existing mobile sites (and mobile operators are likely to introduce 5G in parts of their networks which carry most data). EE's announcement, that it intends to upgrade transmission to 10Gbit/s at each 5G site (see above), demonstrates that this is a reasonable assumption for all mobile operators.
10. To put this into context for an individual operator, each 10 Gbit/s Ethernet circuit procured by EE represents a charge in excess of the costs of supply of around £2,500 per annum. Connecting EE's target of 1,500 sites by the end of 2019 would therefore result in an overcharge of around £3.75m per annum. This figure would rise proportionately with further 5G rollout throughout the period covered by the BCMR. So, for example, if EE rollouts its 5G network over 3,000 sites by the end of March 2021, depending on the speed of the rollout, the charges for 10 Gbit/s Ethernet circuits, in excess of the cost of supply, would be in the order of around £10m - £12m, for the two year period covered by this current market review.
11. Of course, as noted above, EE is wholly owned by BT, so there is no “overpayment” as such, as far as it is concerned. Conversely, each of the other mobile network operators that wish to rollout their 5G networks and connect sites with 10 Gbit/s Ethernet circuits, in the same way that EE intends to do, in order to compete with EE, *would* face significant overcharges (charges in excess of the cost of supply), quite possibly in the order of £10m - £12m (or even more if 5G network rollout is accelerated) over the two year period covered by this BCMR. Telefonica UK believes that there are several consequences of this:

1. Such excessive costs might impact on 5G network rollout plans by mobile network operators other than EE. This is because the charges they face in excess of the cost of supply are likely to result in a slower and more limited network rollout, compared to the case where charges reflect the cost of supply;
2. Consumers are likely to face higher prices, as the mobile network operators are likely to seek to pass the higher costs through to higher prices, in order to protect margins; and
3. Competition in the downstream mobile market is likely to be distorted. This is because each of Vodafone, Telefonica UK and Three would each face charges in excess of cost in the order of £10m - £12m over the two year period covered by the BCMR. Further, the recipient of these excessive charges, BT, would be able to use them to subsidise its mobile network operator, EE. Relatively speaking, BT/EE would benefit in the order of around £40m - £48m. These sums are significant.

Excessive VHB service charges in the context of CPI-CPI regulation

12. It should be noted that the above analysis is based on the current charge differential between 1 Gbit/s circuits and 10 Gbit/s circuits, given Ofcom's proposal that both should be subject to *CPI-CPI* charge controls.
13. Telefonica UK notes Ofcom's analysis, in Annex 18 of the consultation document, in relation to cost modelling for active services. In that, Ofcom concludes that, were it to seek to impose cost based charge controls on active services at 1 Gbit/s and below (as it has done in previous BCMRs) then it would be minded to set the value of *X* (in the *CPI-X* formula) between 9.75% and 1.25%. Further, Ofcom says that:

“we would expect values of *X* closer to the middle of the range to be more likely than those close to the limits of the range”⁶.
14. Ofcom goes on to say, at paragraph A18.101, that:

“compared to a cost-based *CPI-X* control, a flat nominal *CPI-CPI* cap is most likely to lead to some over-recovery to BT (of around £50 to £65m)...”
15. Therefore, the real impact of Ofcom's proposals, taken as a whole (and including the proposal for *CPI-CPI* price caps for active services), is likely to be far greater than just the impact of the charge differential between 1 Gbit/s services and VHB services (i.e., our assessment of the relative benefit to BT/EE of between £40m and £48m, or even more if 5G network rollout is accelerated, is likely to understate the risk).

⁶ Paragraph A18.100 refers

Reliance on unconstrained duct and pole access

16. It is clear that, in formulating its proposals for this BCMR, Ofcom has been mindful of its proposals to require BT to provide unconstrained duct and pole access in the parallel Physical Infrastructure Market Review. For example:

“The remedies we propose take into account our proposals for unrestricted access to BT’s ducts and poles”⁷

17. In Telefonica's view, there is a significant risk that unconstrained duct and pole access might not result in the additional investment in fibre it the way Ofcom expects, for two broad reasons:

1. Ofcom cannot know that BT will be required to provide ubiquitous unconstrained duct and pole access from April 2019, as it proposes. This proposal is subject to consultation in the parallel Physical Infrastructure Market Review, and any decision that Ofcom makes is capable of being appealed under the relevant provisions of the Communications Act 2003; and
2. in any event, the extent to which unconstrained duct and pole access, provided in accordance with any regulatory requirement, would be commercially useful, is unknown.

18. In making its proposals in the BCMR, Ofcom appears to be assuming that BT will be required to provide unconstrained duct and pole access across in all geographic markets for the entire period covered by this BCMR and that such access will result in an increase in investment in fibre and greater upstream competition. In Telefonica UK's view, formulating remedies in the BCMR on that assumption is imprudent.

19. In Telefonica UK's view, Ofcom should consider its approach in the BCMR, if its assumptions about unconstrained duct and pole access are proved to be incorrect.

Ofcom's statutory duties

20. Ofcom has set out the relevant statutory duties in Annex 5 of the consultation document. We do not repeat them, here, suffice to say that it is not apparent that the risks set out above are consistent with the duties to further the interests of consumers, promote competition, encourage investment and encourage the availability of high speed data transfer services throughout the UK.

Ofcom's strategy

21. Ofcom repeats its broad strategy in the opening sentence of the BCMR:

⁷ Paragraph 1.9 refers

“Ofcom’s strategy is to promote investment and competition, complemented by timely public interventions where there is no commercial case to build networks.”⁸

22. Telefonica UK agrees that Ofcom must make its regulatory judgements in the BCMR in the context of its broader regulatory environment, including in relation to its broad strategic approach. However, in making such a judgement, Ofcom’s statutory duties require it to consider the impact of its proposals on electronic communications networks, in general, and not simply *fibre* networks, which are central to Ofcom’s analysis in the BCMR. There is no evidence presented in this market review of an analysis of the impact of Ofcom’s proposals, on the rollout of 5G networks.
23. For the reasons stated above, Telefonica UK believes that the approach that Ofcom is proposing on active services in general, and VHB services in particular, are likely to have a significant and detrimental impact on the rollout of 5G networks in the UK and this is particularly the case if Ofcom’s proposals on unconstrained duct and pole access do not result in workable regulatory obligations or if, for whatever reason, unconstrained duct and pole access is not commercially useful. Telefonica UK believes that these are significant risks. Competition in the mobile market and the interests of mobile consumers are similarly likely to be adversely affected in these circumstances, all contrary to Ofcom’s statutory duties.

Approaches that better balance Ofcom’s strategy and statutory duties

24. Ofcom must ensure that the remedies it pursues in the BCMR do not have the unintended consequence of impeding the rollout of 5G networks or competition in the mobile market. Such outcomes would be contrary to Ofcom’s strategy and statutory duties to promote investment and competition. For the reasons set out above, Telefonica UK believes that Ofcom’s current proposals carry such a risk.
25. Our principal concern relates to the charges for active services and VHB services, in particular. As set out above, the current charges for VHB services are obviously well in excess of cost. Telefonica UK believes that there are several ways of addressing this (which are not necessarily mutually exclusive):

CPI-X charge controls – Ofcom’s traditional remedy in cases where it has found SMP in upstream markets and where it has concerns about charges, is to introduce cost-based charge controls (*CPI-X* charge controls). Indeed, *CPI-X* charge controls for active services have been adopted in previous BCMRs. Ofcom could choose to apply *CPI-X* charge controls, instead of *CPI-CPI* charge controls in this BCMR for all active services, including for VHB services, in all geographic areas in which BT has SMP (including HNR areas). In the case of VHB services, there would, additionally, be a need for a *PO* adjustment, to bring the charges down to cost from the beginning of April 2019.

In Telefonica UK’s view, this approach would be best designed to promote investment in 5G networks and competition in the mobile market, because it would ensure that a significant

⁸ Paragraph 1.1 refers

operating expenditure element in running a mobile network is cost-based. Accordingly, this would be Telefonica UK's preferred approach

Access to dark fibre - Ofcom is proposing to introduce a requirement for BT to provide access to dark fibre on reasonable request for inter-exchange connectivity circuits from BT Only exchanges⁹. The purpose of this is to reduce backhaul costs, significantly. Ofcom explains its rationale for not proposing to extend the proposed dark fibre remedy to CI Access services:

“In parallel with this consultation we have published proposals for unrestricted access to BT’s physical infrastructure. In designing those proposals, we have undertaken a thorough analysis of the potential impact of unrestricted duct and pole access on network deployment. Our view is that unrestricted infrastructure access significantly increases the likelihood that new access networks will be built. In order to avoid an overlap with areas where competing access networks will emerge we are not proposing to extend our proposed dark fibre remedy to CI Access services.”¹⁰

As set out above, we believe that it would be imprudent for Ofcom to assume that BT will be required to provide unconstrained duct and pole access in all geographic markets, for the entire period covered by the BCMR and that this will necessarily result in the provision of suitable mobile backhaul be providers other than BT. Accordingly, Telefonica UK advocates the extension of the proposed dark fibre remedy to CI Access services.

PO adjustment - alternatively, Ofcom could introduce an additional SMP condition which would have the effect of making a *PO* adjustment to the rental charges for VHB services, to bring them down to a level similar to the current rental of 1 Gbit/s services (which Telefonica UK believes is reasonably close to the current cost of providing such services, and certainly no less than cost). Ofcom has used *PO* adjustments in the context of charge controls in other markets (e.g. voice call termination charges), so such a provision would be well understood and is tried and tested. Further, it could simply be added to the existing proposed remedies; it would be complementary, rather than replace any remedy that Ofcom has proposed in the BCMR consultation document.

This approach would be unlikely to result in cost-based active services and would, therefore, involve some risk that 5G network rollout and competition in the downstream mobile market would be adversely affected. However, the risk would be less than under Ofcom’s current proposals. Further, this approach might be considered to balance better Ofcom’s broader regulatory priorities, since it would provide a clear incentive, to communication providers (including mobile operators) to invest in fibre in order to provide mobile backhaul services.

26. Answers to selected questions can be found in the Annex to this response.

⁹ Section 10 of the consultation document refers

¹⁰ Paragraph 10.27 refers

ANNEX

Answers to selected questions

Question 8.1: Do you agree with our proposal not to regulate the low bandwidth TI services market on the basis that it no longer fulfils the three-criteria test set out in the EC Recommendation? Please provide evidence to support your views.

No. We do not agree with Ofcom's assessment that the three-criteria test set out in the EC recommendation is not satisfied. We do not believe that the CI services market will increasingly constrain the low bandwidth TI services market significantly, for the reasons set out in paragraph 8.37 of the consultation document. Therefore, we think that the second criterion is satisfied.

We note that BT has provided Ofcom with an assurance that it will not increase prices for legacy services by more than CPI+8%. We also note that BT intends to provide such services until the end of 2025, and that it would provide three years' notice of withdrawal of such services.

In the circumstances, Telefonica UK believes it would be prudent for Ofcom to impose obligations on BT to provide legacy services, subject to a safe-guard price cap of CPI+8%. This would require BT to do no more than it has already offered. However, such regulatory obligations would provide certainty for BT's customers.

Question 10.1: Do you agree with our proposed approach to remedies? Please provide reasons and evidence in support of your views.

We do not agree with Ofcom's proposal to introduce lighter regulation in respect of CI Access Services in HNR areas. Telefonica UK relies heavily on Openreach supplied active services throughout the UK, despite adopting a commercial policy of favouring another provider (Virgin Media), if at all possible. [X].

Accordingly, we believe that in all geographic areas in which BT has SMP in CI Access Services, it should face a cost-based charge control.

Question 11.1: Do you agree with the general remedies that we propose? Please provide reasons and evidence in support of your views.

No. See our response to question 10.1.

Question 13.1: Do you agree with the specific network access remedies that we propose for CI services at all bandwidths in the business connectivity markets? Please provide evidence to support your views.

No. Telefonica UK believes that Ofcom should impose regulation to remove the risk that the rollout of 5G networks might be impeded by an absence of cost oriented, high capacity mobile backhaul. Telefonica UK's preference would be to maintain cost based charge controls for active service (extended to include VHB services) and extend the proposed dark fibre remedy to CI services in all geographic areas in which BT has SMP (including HNR areas). At the very least, additional regulation to reduce the currently excessive rental price of VHB services is necessary. In our view, Ofcom has not taken into account sufficiently the risk that these current rental charges (which Ofcom's proposed approach would not tackle) might threaten the rollout of 5G networks and, additionally, distort the downstream market for mobile services.