SKY'S RESPONSE TO OFCOM'S CONSULTATION ON "PROMOTING INVESTMENT AND COMPETITION IN FIBRE NETWORKS – APPROACH TO GEOGRAPHIC MARKETS"

Summary

1. Ofcom is consulting on its future approach to geographic markets. In general, we support Ofcom's proposed approach. However, the significance of its proposals is inextricably linked to its approach to remedies in these markets, which it is not consulting on until the Spring. The issues of geographic market analysis and remedies should really be considered together.

2. This is of particular importance in relation to the areas of the UK which will be deemed by Ofcom to be potentially competitive. It is evident that Ofcom's proposed geographic market analysis errs in favour of deeming areas to be potentially competitive. Accordingly, if remedies in these areas were weakened there is a risk of higher prices for significant numbers of UK consumers who may not receive any offsetting benefits from increased infrastructure competition.

3. Ofcom should reject calls for weaker regulation, including weaker wholesale charge controls, in these areas as a way of promoting investment in FTTP. This is unnecessary and would be counter-productive given the current UK market structure.

Given Ofcom's goal of promoting fibre investment, it is appropriate to assess infrastructure competition on a geographic basis

4. Ofcom is seeking to promote more investment in FTTP by both BT and competitor networks while at the same time protecting consumers from BT's significant market power. Ofcom recognises that the conditions for investment and market entry are not uniform nationally because of regional variations in the costs of deploying new fibre networks and the revenues that can be earned from them. Ofcom therefore proposes to assess the state of (and scope for) infrastructure competition on an area-by-area basis and to consider varying remedies according to whether an area is effectively competitive, potentially competitive or non-competitive, when conducting its single market review. Regulation would be withdrawn in regions of the UK in which there is effective network competition.

5. We agree with this approach. Ofcom's proposed approach to geographic markets is a sensible way of seeking to achieve its objective of encouraging greater investment in FTTP, while at the same time protecting consumers. In particular, we support the removal of regulation where there is effective and sustainable network competition.

The issues of geographic markets and remedies should be considered together

6. Ofcom's proposed geographic market definitions mean that a large percentage (around 70%) of the UK will be deemed to be potentially competitive when it conducts the single market review later this year. Ofcom considers that areas where there are at least three competing ultrafast networks could be competitive. In practice, it is likely that this level of network competition will emerge over far less of the UK. For example, Frontier Economics' report for DCMS' Future Telecoms Infrastructure Review estimated that between 30% and 60% could be served by at least three competing ultrafast networks. However, Ofcom is adopting a broad definition because it considers that there would be regulatory failure if it were to classify areas as non-competitive where in fact viable market entry could occur.

7. The significance of this broad interpretation is closely linked to the remedies ultimately applied in potentially competitive areas. Ideally, the two issues of market definition and remedies should be considered together. If regulation that currently protects consumers is loosened in potentially competitive areas, the wide market definition proposed by Ofcom could result in higher prices for significant numbers of UK consumers who may not receive any offsetting benefits from investment and market entry.

Setting high or excessive regulated charges in potentially competitive areas is unnecessary and could be counter-productive

8. Some argue that regulated wholesale charges for superfast 'anchor' products such as 40Mb/s VULA, which act to an extent as a constraint on the prices that can be charged for ultrafast broadband services, should be increased or set significantly above cost to promote investment in FTTP. It is argued that increasing BT's wholesale charges would enable other fibre network operators to charge higher wholesale access prices without a drop-off in demand, with the resulting higher revenues improving their investment cases. Ofcom should reject these arguments.

9. Higher anchor product prices would be counter-productive in the UK because they would weaken the large broadband retailers upon which FTTP networks will depend for their investments to be viable. It is essential for new fibre networks that they attract large volumes of end users quickly, to generate the cash flows that are so important to the success of their investments – something that it is only possible if they sign up large retailers as anchor tenants. Full fibre investment cases are significantly more sensitive to scale than they are to wholesale access prices, with relatively small reductions in market shares extending payback periods by several years.

10. Ofcom considers that high anchor product prices that are not cost-reflective could weaken large retailers and distort retail competition. This is one of the reasons why Ofcom considers it appropriate to cap Openreach's VULA charges. For example, access seekers like Sky and TalkTalk could have relatively weaker incentives to move or acquire more of their broadband subscribers to superfast broadband services. The weaker and smaller these large broadband retailers become, the less attractive their own investment cases will be for being anchor tenants and the less valuable to the new networks they are as anchor tenants.

11. This would be particularly problematic to new entrants looking to deploy full fibre networks at scale because the continued strength of Sky and TalkTalk is essential to their business models. Of the four main broadband retailers in the UK, BT and Virgin Media are effectively tied to their own networks. This leaves only Sky and TalkTalk as potential large anchor tenants for new entrant networks.

12. In short, Ofcom's goal of promoting more investment in the UK by alternative fibre networks hinges on these networks attracting large retailers such as Sky whose scale and strength, for the time being at least, relies upon cost-oriented charge controls on BT's wholesale VULA service.

13. High or excessive regulated prices for anchor products are also unnecessary for the promotion of investment in full fibre. While it is important for new networks to generate high cash flows quickly, for the reasons outlined above, this is best achieved by attracting large anchor tenants. In any event, the business cases for rolling out FTTP will be also based on the long-term cash flows that can be earned over the lifetime of the investment (which can be two decades or more). These cash flows will reflect the wholesale prices that are in play when the new networks have been built and these in turn will reflect the level of infrastructure competition. If competitive entry occurs wholesale prices – including for anchor products –

are likely to be more cost-reflective. Any temporary elevation in anchor product pricing due to higher charge controls is likely to be short-lived should material market entry occur and therefore has little bearing on the investment case of full fibre networks.

14. Worse still, if investors incorrectly assume in their business cases that wholesale prices will remain elevated as a result of higher charge controls then there is a significant risk that unviable fibre deployments will be made. The prospect of a patchwork of failing firms, market failure and exit, stranded investments, partial networks and discontinuity in supply for consumers could be as harmful as an initial lack of investment.

15. In summary, weaker regulation in potentially competitive areas as a tool for promoting fibre investment is unnecessary and could be counter-productive. Further, because Ofcom has adopted a wide interpretation of how much of the UK is potentially competitive – with informed commentators expecting infrastructure competition to be materially less widespread – weaker regulation in these areas could result in higher prices for significant numbers of UK consumers who may not receive any offsetting benefits from increased infrastructure competition.

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