Promoting competition and investment in fibre networks – Initial proposals – Approach to remedies

UKCTA Response to Ofcom

Submitted to Ofcom: June 2019

Introduction

1. UKCTA is a trade association promoting the interests of fixed-line telecommunications companies competing against BT, as well as each other, in the residential and business markets. We advocate regulatory outcomes designed to serve consumer interests, particularly through competition, to Ofcom and the Government. Details of membership of UKCTA can be found at www.ukcta.org.uk. The views expressed by UKCTA in this response do not reflect the views of Virgin Media. We welcome the opportunity to comment on Ofcom's proposals to on its approach to remedies around promoting competition and investment in fibre networks.

General remarks

2. It is our expectation that Ofcom will conduct and present for consultation a full product market analysis in the market review consultation planned for later this year. This is a key part of the market review process and an essential step in establishing the correct regulatory regime. UKCTA envisages that the remedies proposed may need to be amended once a more robust market definition has been established.

3. An economically robust approach is needed both to support market confidence and for a legally sound regulatory regime. Insufficient economic and evidence-based analysis could harm both residential and business consumers' interests. Ofcom's proposals lack evidential and economic underpinnings and need to be fundamentally revised to ensure that the future regulatory framework is both justified and sustainable.

4. The remedies currently proposed are poorly calibrated to correct BT's SMP in the relevant markets, with too much emphasis on allowing Openreach wholesale prices above costs in the hope that this will encourage altnet FTTP investment. There is no consideration given to the range of market advantages that BT/Openreach hold and an absence of remedies to address them (or indeed consideration of how the proposed remedies might actually add to BT's incumbency advantages).

5. Ofcom greatly overstates the regulatory risks faced by BT, given Openreach's track record of over-recovery, with Openreach already earning returns well above WACC in regulated markets. There is already considerable investment underway based on the current regulatory framework, as shown by CFH's widespread plans and BT's fibre first programme. Ofcom has not made a case for why Openreach needs additional incentives/help such as the RAB based model proposed in category 3 areas.

Ofcom's proposals

Addressing SMP in this market review period

6. Regulation needs to address current SMP and the expected change in SMP over the period under review, particularly where there is significant uncertainty that the level of competition sought by Ofcom will actually materialise. At this point in time, there are credible concerns over the scale of any competitive roll out, with limiting factors such as capacity constraints around physical build, and uncertainty over future investment funding beyond the first phase plans. In these circumstances, it is entirely prudent that regulation should only relax when network competition has actually been realised and is demonstrating an effective constraint on BT's dominance.

7. Ofcom's current proposals pre-emptively relax regulation, by removing any the obligation on Openreach to set cost-reflective prices in most of the UK (Category 2 areas). This will directly harm consumers by allowing higher prices than if the current regulatory approach were to continue. This can only be justified if Ofcom can demonstrate that the higher prices will lead to sufficient increases in investment to offset the costs of those higher prices. Ofcom has not presented evidence to suggest this will be case, with no quantification of the likely outcomes of its relaxation of regulation in terms of higher investment. There is no detailed economic explanation set out around the manner by which higher prices will lead to higher investment.

8. At this point, it is far from clear that higher prices will lead to increases in investment. While a higher 40/10 FTTC price may raise the profit-maximising price for FTTP services somewhat, the extent to which this will be the case will depend upon a finding that 40/10 FTTC, rather than 80/20 FTTC, G. Fast, or cable, will represent the binding constraint on FTTP pricing. Ofcom has not detailed any relationship between 40/10 FTTC pricing and FTTP pricing in the period beyond 2021.

9. There is also an offsetting impact to consider, in that allowing Openreach to charge higher FTTC prices will disincentivise it from investing in FTTP, by allowing them to reap supernormal returns from copper for an extended period, without the need to invest.

10. It is important to calibrate the impact of the proposed price caps. Justifying CPI+0% for both access products and leased line circuits without quantification beyond a desire for 'stability' would be a mistake. Even if higher prices are required to support investment, there is no analysis presented around how much higher prices have to be. It is important that Ofcom understands the necessary trade-offs in its proposals, as it will be consumers paying the higher prices

resulting from them. In particular, it is important that Ofcom knows how much additional investment is expected from each 1% more consumers are asked to pay.

11. In its geographic assessment, Ofcom needs to factor in business broadband availability, understanding whether areas currently under-served today are non-competitive and in need of some form of public intervention to ensure 100% coverage. Ofcom should also be mindful that, given the capacity constraints on roll out (particularly around labour and contractor availability), Ofcom's proposed cross-subsidy from copper products may actually reduce FTTP roll-out in certain areas, by diverting resources to Category 3 areas, which require more resources for each premises passed.

Business markets and competition

12. We believe that any robust product market analysis will conclude that the Business Connectivity Market and Wholesale Local Access market remain economically distinct and that Ofcom is not correct about potential convergence of the underlying network creating a single market. In particular, Ofcom has not recognised the differences between Business Connectivity and Wholesale Local Access markets such as the existence today of more than one full fibre network for Business Connectivity products and the limited constraint that an new FTTP networks will provide on BT's leased line products, given the different characteristics of leased line and fibre access products.

13. The current regulatory structure supports the levels of retail competition pertaining in the Business Connectivity Market. There is a real risk that retail competition for business customers will suffer because of Ofcom's proposals, reducing the choice available to customers. There are also particular concerns that arise from BT being an integrated retail and wholesaler, with higher wholesale profits subsidising lower retail pricing (potentially leading to margin squeeze).

14. The nature of business markets with their long contract periods and switching barriers means that retail service providers will remain reliant on Openreach wholesale services over the next control period. As such, Ofcom should not rely on hypothetical incentives to switch to alternative suppliers without having analysed the extent to which this is practically possible in this product market. Business retailers can experience particular challenges due to the geographical spread of their customers. This will mean that they lack the density of customers to either economically build as Ofcom desires or obtain scale needed to take advantage of wholesale offers that Ofcom expects will arrive in a future competitive market.

15. Ofcom needs to address a wider range of barriers to market entry – DPA needs to be a proven, workable remedy before it can be relied on to compensate for

weakened price control regulation. Enterprise and consumer (FTTP) switching needs to be worked on, as without this the incumbency advantage of BT’s network is buttressed by switching barriers. Likewise, Ofcom needs to consider in detail the potential benefits of a Dark Fibre remedy targeted at improving access in business connectivity markets to address specific enterprise market concerns.

Remedy implementation

16. Ofcom should not assume that the appropriate superfast anchor product by 2021 will be 40/10 VULA and must consider regulating 80/20 VULA. This service will likely be consumed by more consumers than 40/10 VULA by the end of the regulatory period.

17. With respect to the RAB charge control, Ofcom itself notes that this represents a departure from the approach that it has adopted in previous charge controls. This seems to leave a lot of scope for over-recovery by BT due to inflated estimates of the cost of FTTP roll-out in category 3 areas. Ofcom/BT engagement may lead to a "deal" without proper scrutiny by stakeholders across the industry who may be able to comment in detail on the efficient costs of roll-out in certain areas. Ofcom need to provide much more details about their proposals in this area to ensure stakeholders remain informed and can provide informed comment.

18. Where Ofcom believes that charges for copper and FTTC services need to be higher to pay for investment in FTTP network build, the funding obtained by this means should be made as accessible as possible. For example, higher copper revenues should be diverted to subsidise a common EoI input like DPA in the first instance, pushing the benefit wider than just BT. In the alternative, a mechanism must be found to make such funding available to all network builders in these areas (with appropriate network access obligations flowing through in subsidised areas). Such an approach will lead to a more diverse market structure than under Ofcom’s proposals, allowing alternative networks to compete with BT and providing wider benefit to consumers in the process.

A common understanding of success is required

19. It is necessary for all stakeholders to understand, at the outset, the end state that Ofcom is seeking to incentivise. This is necessary to assess the costs and benefits of the proposals and the success or otherwise of the regulatory approach adopted by Ofcom. We are unclear as to whether Ofcom requires the availability and competition between gigabit capable networks as is set out in the Government FTIR or whether a different / lower threshold of network is being considered. Ofcom should therefore clearly set out quantified goals to be achieved by the end of the current regulatory period in 2026, by which the success or failure of its proposals can be judged.