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By email only

Review of the market for standalone landline telephone services

This is Three's response to your recent consultation on the market review for landline telephone services. Three is supportive of Ofcom's decision to complete this review, and we are grateful for the opportunity to comment on your proposals.

In the consultation Ofcom sets out to address concerns in relation to rising prices for standalone landline services despite sustained reductions in wholesale costs. We support Ofcom's intentions of ensuring that it is not only customers who purchase bundles that benefit from the reduction in wholesale rates.

Three is a mobile only player, and does not offer fixed landline services to customers. However we are nevertheless concerned that Ofcom's analysis should take full account of the future impact of market power in standalone fixed on competition across the wider telecoms market.

Ofcom are correct to regulate standalone fixed line services through retail price control

Three supports Ofcom's findings that BT has significant market power, and agrees that regulation should be implemented.

The market for landline only customers is small, 2.9 million customers, and is declining as customers move from a standalone service to a bundled offer. In addition over 70% of standalone customers have either never switched operator or have no intention to switch operator.

While regulated wholesale products are available for new entrants (or existing CPs) to enter the standalone fixed market, they face increasingly reduced incentives to do so for a declining

market characterised by sticky customers. Such barriers to enter in the form of high customer acquisition costs act as a source of market power to BT.

Ofcom's analysis of market outcomes demonstrate that BT has been able to exploit this market power. Regulated wholesale prices have fallen by 26% in real terms since December 2006, whereas over the same time period line rental prices have increased between 25% - 49% in real terms. Ofcom's pricing analysis has also shown that the market responds to BT's price changes; where BT increases prices, competitors follow. This is consistent with Ofcom's conclusion that BT has SMP (significant market power) which they are able to exploit by not passing on reductions in the regulated wholesale price. Absent any credible competitors in the market BT has no incentive to make changes to offer greater benefit to consumers.

Three supports Ofcom's SMP finding and its decision to reduce consumer harm by imposing retail price controls to reduce charges for standalone landline customers.

Information remedies will not be sufficient where there are unengaged consumers

Ofcom has proposed a remedy which requires BT to provide standalone landline customers with information on current offers, details of the most appropriate tariffs and detail on their options to switch providers. In theory providing this information to consumers should increase competition.

However for this remedy to work the market needs engaged consumers who can access, assess and act on information about other offers in the market. In a market where 70% of customers have never switched provider, a remedy of sort alone would do little to address the harm to the vulnerable consumers most likely to be impacted by rising retail prices.

In the absence of effective competition, a retail price control on BT's standalone services is most likely to address Ofcom's concerns around vulnerable, unengaged consumers.

Ofcom's analysis of harm is incomplete.

Whilst we largely agree with Ofcom's conclusions with regards to the adverse impacts specifically relating to fixed standalone customers, we are concerned that Ofcom has neglected to consider the future impact on competition across the wider telecommunications market.

In particular, Ofcom has not considered the extent to which BT is able to leverage its market power in fixed standalone to other telecommunications markets. For example, by increasing prices in standalone markets to encourage customers onto bundled services, or by using excess profits earned in the fixed standalone market to cross- subsidise products in related markets.

While customers who migrate to bundled offers may benefit in the short term through lower prices, Ofcom must also consider the long term impact this may have on future competition, and ultimately end-users across the telecoms sector. Although triple and quad-play services in the UK are still in their infancy, evidence from Europe (where the market for bundled services is more advanced) provides some indication of the potential competition effects of fixed mobile convergence.

For example, customer churn for quad-play customers on Vodafone in Spain is only 6% compared to 27%¹ for its mobile only customers. Similar trends are seen in Belgium², suggesting that product bundling may ultimately result in increased customer inertia.

Whereas high rates of switching encourage competition and the provision of good value, high quality and innovative services, increasing customer inertia benefits incumbent operators. This is to the detriment of smaller standalone providers, and ultimately end-consumers.

1

https://www.vodafone.com/content/dam/vodafone/investors/financial_results_feeds/half_year_30september2016/p_halfyear2016.pdf

2

<https://www.proximus.com/sites/default/files/Documents/Investors/Reports/2016/q3/Q3%202016%20Quarterly%20report.pdf>

