TalkTalk
For Everyone

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7 November 2017

Dear Brian

BT Retail migration of customers from 55/10 to 80/20

I am writing to you regarding three important developments in the retail market which should affect your forecasts for the next charging period. In the absence of amendments to your forecasts to reflect these developments, Openreach is likely to systematically over-recover its costs of providing GEA over the next control period, according to our estimates by over £[✂] per line in 2018/19.

The first of these – the migration of up to [✂]m BT Retail customers from 55/10 to 80/20 FTTC products, announced by BT in late September as a 'speed boost', and with the programme due to complete by mid-November– has two significant implications for the ongoing WLA review which you are currently leading: [1]

1. it will significantly increase the revenues which should be allocated to Openreach during the upcoming regulatory period, meaning that Ofcom should lower its proposed 40/10 GEA price cap to reflect these increased revenues; and,
2. it demonstrates a much faster migration of the market to the 80/20 product than had been projected by Ofcom at the time of its March 2017 consultation paper.

This letter also sets out:

3. [✂]; and,
4. recent evidence from Virgin Media which indicates that its Project Lightning is likely to have a lower impact on Openreach line volumes than previously anticipated.

The overall implication of these new events is that there are likely to be a greater number of FTTC customers than previously forecast, and that the mix of FTTC customers is likely to be considerably more weighted towards 80/20 customers than previously expected. This should lead to significantly lower price caps for 40/10 GEA than have previously been proposed by Ofcom. TalkTalk estimates that the BT 'speed boost' alone may have the impact of lowering the price cap for 40/10 GEA by over £[✂] per line in 2018/19. It is therefore an important development, which Ofcom should consider as a priority.

[1] http://bt.custhelp.com/app/answers/detail/a_id/56165/c/346

1. The migration will significantly decrease the costs that should be allocated to 40/10 GEA

TalkTalk understands that the BT migration from 55/10 to 80/20 will apply to all BT Retail Infinity 1 customers who currently receive 55 Mbps download broadband, but whose lines can support speeds greater than this. TalkTalk estimates on the basis of its market intelligence that it will apply to between [✂]m and [✂]m customers.

At §§2.36-2.49 of Volume 2 of its March 2017 consultation, and at Annex 11 to the same consultation, Ofcom sets out its approach to allocating common costs between different bandwidths of FTTC products. In essence, this amounts to allocating an 80/20 customer 18% more common costs than a 55/10 customer.[2]

There is therefore a significant effect from upgrading at least [✂]m customers from 55/10 to 80/20 speeds– the impact on Openreach's revenues is similar to the immediate addition of [✂]k-[✂]k 40/10 customers to the network, or over [✂]% of the existing FTTC customers on the Openreach network.

Ofcom should revise its cost allocations to different speeds of GEA product to take into account the substantial change in the proportion of customers taking different speeds of product. This should lead to meaningfully lower price caps for 40/10 GEA rentals; TalkTalk's estimate is that the price cap in 2018/19 would be £[✂]-£[✂] per line lower from this factor.[3] Ofcom will hold the data to be able to assess accurately the impact of this change.

2. The market is rapidly moving towards the 80/20 GEA product

TalkTalk considers that BT's upwards migration may be at least in part a response from BT to the success of Sky's 'Sky Fibre Max' FTTC product. This package, based on Openreach's 80/20 GEA wholesale product, offers a minimum download speed of 55 Mbps, above the maximum speed which was previously offered by BT to its customers on the Infinity 1 product. Sky has been heavily promoting Fibre Max in its recent advertising, and customer losses to Sky may have driven BT's move.

Such a speed race between operators indicates that the market may be converging on 80/20 broadband faster than previously expected. Following BT's change, the only superfast customers with its BT Retail brand not on the 80/20 product will be those who are technically incapable of receiving it. This may be a prelude to BT withdrawing altogether from differentiating its Infinity products on the basis of the maximum speed which they can offer, by removing its Infinity 2 product from the market (or relaunching with a differentiating factor other than maximum speed).

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[2] 134%/114% = 1.18

[3] We are not in a position to calculate this with greater accuracy because doing so would require knowledge of the bandwidth mix of GEA customers both prior to and after BT's 'speed boost'.

In light of the increased focus on 80/20 products by both BT and Sky, Ofcom should revisit its volume assumptions for the mix of different FTTC speeds which will be used over the next three years, and increase the pace of the transition to 80/20. On current trends, it is plausible that by March 2021, the only customers taking FTTC products with speeds of less than 80 Mbps from BT Retail and Sky will be those whose lines are technically incapable of benefitting from such speeds. That means, as well as starting from a higher base proportion of 80/20 lines (due to BT's speed boost programme), the speed of switch of the remaining base should be faster, as it is increasingly likely that remaining ADSL customers upgrade straight to 80/20 services, without using 40/10 GEA as an intermediate product.

[✂].

These market developments make it more important than previously that Ofcom applies a safeguard cap to the pricing of 80/20 GEA, as argued by TalkTalk at §§2.13-2.16 of our June 2017 submission. With potentially over half of all Openreach FTTC customers taking an 80/20 GEA wholesale product by the end of the regulatory period, it is unlikely to be sustainable to allow fully unconstrained pricing of the 80/20 product. In addition, these trends may indicate that 40/10 GEA will impose a somewhat weaker competitive constraint on 80/20 GEA than Ofcom had previously thought to be the case, increasing the risk that Openreach will be able to maintain prices for 80/20 GEA significantly above the competitive level. There is hence a greater risk of high prices which would themselves impact a greater number of customers. Given that there is already a considerable risk of excess pricing which would harm consumers, it would be inappropriate for Ofcom to accept a potential further increase in prices, to the detriment of consumers.

3. [✂]

[✂].

[✂].

[✂].

[✂].

4. Virgin Media's Project Lightning is substantially underperforming, reducing competitive pressure on Openreach

In Annex 10 to Ofcom's March consultation, it set out that it expected around 1.6m customers to move from the Openreach network to Virgin Media's network as a result of the Project Lightning build programme. This projection seems unsustainably– and increasingly– high given the details of the project which have emerged through Virgin Media's quarterly releases.

In its Q3 preliminary results, VM admitted that it had passed 147k premises in the quarter, meaning that in the first nine months of 2017 it had passed a cumulative total of only 376k, against an expectation of 700k-800k during this year.[4] As such, Project Lightning has passed fewer than a million of the c.4m homes which it is intended to pass, and has only released 857k homes for commercial marketing.[5]

In light of this slow progress, it is unsustainable for Ofcom to continue to forecast that Project Lightning will have passed 4m homes, and released those homes for marketing, by the end of the next regulatory period. Assuming that VM is able to sustain the pace of work from Q3 2017 (the highest quarter to date), it will have passed only around 2.8m homes by March 2021. This is a very significant change from the 4m currently assumed by Ofcom.

At the same time, Project Lightning's uptake has been weak. In Q3 2017, only 31k net adds were in Project Lightning areas, whereas Ofcom's forecasts would require over 100k net adds per quarter over the next period. This likely reflects the ongoing very poor performance of the Virgin Media network, with some customers receiving less than 10Mbps of notional 200 Mbps speeds at peak time.[6] The delays in physical roll-out will also give less time for marketing, and further lower the rate of customer acquisition.

Ofcom should therefore amend its estimates of the impact of Project Lightning to reflect 2.8m premises being passed in the next regulatory period, with low, medium and high penetration scenarios of 25%, 30% and 35% respectively. This will provide a much more appropriate view of the line volume impact of Project Lightning than Ofcom's current estimates, which are now demonstrably incorrect.

Conclusions

In conclusion, the developments set out in this letter mean that it is appropriate for Ofcom to:

- Review its volume forecasts, at an aggregate GEA level, to ensure that they reflect the most recent evidence regarding likely volumes in all three years of the charge control for BT, Sky and TalkTalk;
- Amend its estimates to reflect that a considerably greater proportion of demand, in all three years of the charge control, is likely to be for 80/20 GEA products than was likely on the basis of evidence six months ago, particularly for customers of BT Retail; and,
- Reduce its estimates of the impact of Virgin Media's Project Lightning on both GEA and MPF line volumes over the next three years.

In the absence of these amendments, Openreach is likely to systematically over-recover its costs of providing GEA over the next control period.

[4] Virgin Media Preliminary Fiscal 2016 Results.
[5] Liberty Global Third Quarter 2017 Fixed Income Release, at page 3.
[6] http://www.bbc.co.uk/news/technology-40504354

I hope that these points are interesting and relevant to the review which you are currently undertaking. If you need any more explanation of them, we will be happy to help in any way which would support Ofcom’s deliberations.

Yours sincerely,

Simon Pilsbury

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