

# Wholesale Fixed Telecoms Access Market Review

Promoting competition and investment in fibre networks  
– Pricing wholesale local access services in Geographic  
Area 3 with a BT Commitment to deploy a fibre network

## UKCTA Response to Ofcom

**Submitted to Ofcom: September 2020**

## 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](http://www.ukcta.org.uk). This response does not necessarily reflect the views of CityFibre, KCOM or Virgin Media, who will be submitting their own responses to Ofcom.
2. We welcome this opportunity to comment on Ofcom's proposals for Area 3. Our response is structured into the following sections:
  - A. Ofcom's approach to presenting this Openreach offer: Processes & Procedures necessary for a robust consultation;
  - B. Understanding the true level of risk for Openreach;
  - C. The real consumer impact – inconsistencies with Ofcom's affordability agenda and the disproportionate impact on vulnerable consumers exacerbated by the lack of an Equality impact assessment; and
  - D. The urgent need for a charge control on 80/20 as bandwidth demand increases.

## A – Ensuring Proper Scrutiny occurs of BT's Proposals

3. UKCTA has a number of concerns in relation to the process Ofcom has undertaken in proposing to adopt Openreach's offer. We are disappointed that the consultation is very brief and that industry has been given very little time to review and react to the proposals. This does not amount to effective consultation.
4. It is surprising that Ofcom has moved away from the proposed options set out in its January consultation on the WFTMR, choosing instead to do something completely different. Given this is a consultation to adopt an Openreach proposal in full; we would expect a range of options and alternatives to be included within a robust consultative assessment.
5. In reality, this is a significant change in approach by Ofcom, based on a very short letter from Openreach, which is backed up neither with further data nor evidence.

6. The "commitments" offered in Openreach's letter are not robust, yet Ofcom appears comfortable to accept them, and offer them generous concessions, likely to result in higher retail and wholesale pricing and at a cost to consumers.
7. Ofcom should have carried out far more scrutiny of these commitments before changing direction, setting out a range of counter proposals which take due account of the impact on consumers.
8. We are particularly concerned by the complete lack of cost-benefit analysis of the new proposals. Given the length of the market review period and the impact on consumers, it seems quite astonishing that a cost benefit analysis has not taken place. This lack of proper scrutiny and a rushed consultation risks leaving consumers at risk of unnecessarily high prices and many without the prospect of any additional network investment in their area.

## **B - The True Level of Risk for Openreach**

9. In May of this year UKCTA responded to Ofcom's main consultation in this market review. In the main consultation, Ofcom suggested Openreach could earn excess returns of between £615m and £2,475m through the period of the next review, with a central estimate of approximately £1.5bn excessive returns (i.e. returns over and above the regulated returns already earned).
10. In Area 3, by Ofcom's calculations, Openreach's excessive returns were limited to leased line/exchange backhaul services due to the proposal of a cost based charge control being imposed on all speeds of FTTC in Area 3.
11. However, Ofcom also proposed that Openreach could effectively increase the wholesale prices of FTTC products if they were to invest in fibre in Area 3. Ofcom proposed two options for how this system would work; the first method involved Openreach making a commitment prior to April 2021 to roll out Fibre in Area 3. The second method involved Openreach submitting actual fibre roll-out figures for Area 3 each year to Ofcom and Ofcom adjusting the charge control pricing depending on the extent of Openreach's fibre roll-out in Area 3.
12. In each of the options for Area 3 in their original consultation, Ofcom proposed to use a precise calculation based on the actual (or planned) number of premises Openreach rolled out fibre to, in order to adjust the wholesale FTTC and anchor FTTP price BT's retail divisions and other retail operators would subsequently pay.
13. It now appears that Openreach have, in a letter, suggested a third option for wholesale price regulation in Area 3. This option involves **no calculation, no modelling, no regulation of any wholesale FTTC prices for speeds above 40/10** and simply suggests that **wholesale prices in Area 3 should match**

**the level of wholesale prices in Area 2** and in return, Openreach **will at some stage over the next five years** rollout fibre to 3.2million homes in Area 3.

14. In their original consultation, Ofcom included a number of assumptions in their modelling of FTTC prices for Area 3 that we believed to have highly favoured Openreach and led to the calculation of higher wholesale prices than may otherwise have been calculated. For example, the calculations of Openreach's market share were low and assumed Openreach would lose significant market share over the review period (which increased the calculated unit costs), legacy copper assets were written off early and their costs included in FTTC wholesale prices, and the scrap value of copper included which would benefit Openreach was minimal.
15. In this further consultation relating to Area 3 Ofcom recognise the issues with some of their precise modelling in their initial consultation and take a more approximate 'in the round' approach to arrive at the conclusion that Openreach's proposal will most probably only lead to further excessive returns (over and above the £615m-£2,475m – central estimate £1.5bn already identified) of about £313m although they could be considerably higher.
16. In arriving at the 'most probable' £313m additional excessive returns figure, Ofcom use a number of high level modelling assumptions which appear pragmatically to favour a result of lower overall returns. For example, in the original consultation Ofcom present the cost per premise to rollout fibre, identifying that depending on where the fibre is being rolled out, the cost will vary considerably and in the most rural remote places the costs will increase considerably. However Ofcom then use an 'average cost per premise' figure in their excessive returns calculation instead of making the logical assumption that Openreach will roll-out fibre in Area 3 to the 3.2 million premises where it is most economically viable to do so.
17. Ofcom have given time and consideration to the advantages Openreach will gain if they accept Openreach's offer and allow Openreach to increase wholesale prices in Area 3. However, Ofcom have given no consideration to who will be paying the increased wholesale prices, effectively who will be losing as a result of Openreach gaining £313m or possibly more in excessive profits. The reality is that end retail consumers in Area 3, who currently in some cases receive very low quality slow broadband will be paying.
18. Ofcom's conservative modelling estimates suggest that retail consumers could be paying £30 more per year for their broadband. However, using more realistic modelling assumptions and more precise premise build out costs Openreach's excessive profits could be double the £313m Ofcom calculated and equate to retail consumers paying £60 per year or £5 more per month for

their broadband than they otherwise would have to under Ofcom's usual cost based charge control approach.

19. This amounts to a significant additional and entirely unnecessary burden on consumers, making broadband less affordable with no apparent benefit to fibre build.

### **C- Understanding the Consumer impact – Wholesale prices linked to Broadband affordability**

20. By accepting Openreach's offer there is likely to be a transfer of funds from rural to urban areas. That is, areas without FTTP to areas with FTTP. As set out in BT's initial list of places where it plans to roll out subsidised FTTP, most of these are urban, with areas including Horsham, Chester, Banbury, Hereford and Canterbury being supported as part of the 'rural' rollout. This means that genuinely rural areas will be paying more to support rollout in urban areas. ONS statistics show that urban areas are on average much wealthier than rural areas.
21. Openreach does not need subsidy to roll out in urban areas. Much of the increased price which will be paid by consumers in genuinely rural areas is in any case unnecessary. BT does not need subsidy for it to be economic to build an FTTP network in Horsham, which has a population of 140,000. Consumers will therefore be paying higher prices for no benefit, either for them or for other consumers.
22. Ofcom's proposals lead to a transfer from poorer to richer consumers. To the extent that Ofcom's subsidy does have any effect, there will be a transfer from customers taking FTTC (who are generally poorer) to those taking FTTP (who are generally richer). This is in addition to the effect of the transfer from rural to urban areas.
23. Ofcom's proposals will harm protected groups. Ofcom has not carried out any meaningful assessment of the impact on equality of its proposals. By creating a transfer from poorer to richer consumers, Ofcom will adversely affect ethnic groups with lower average incomes and disabled individuals, who are on average considerably lower income than other people. Ofcom has neither recognised this, nor sought to ameliorate the inequality impact of its proposals.

24. Those with worst broadband are likely to overpay by the most. Customers in Area 3 who get access to FTTP broadband first will not pay any excess to subsidise FTTP rollout. Conversely, customers in Area 3 who get access to FTTP at the end of the rollout will pay to subsidise all other consumers' fibre rollout. Those customers will therefore be doubly harmed, once by having poor quality broadband, and secondly by being compelled to overpay for that broadband, to subsidise others who receive better quality services.

#### **D- The need for Anchor Pricing on 80/20 to protect consumers**

25. In its earlier January proposals, Ofcom proposed a basket charge control in Area 3, with 55/10 and 80/20 FTTC products being subject to charge control. As Ofcom sets out at §3.34, it no longer proposes to charge control products with speeds in excess of 40/10. It explains (§§3.35-3.37) that this is for the same reasons which it set out in the January consultation for Area 2.
26. UKCTA does not agree that the 40/10 FTTC product will be an effective anchor on the price of 80/20 and faster speed variants over the course of the next charge control, or even that it is an effective constraint on 80/20 pricing at present. Customers' behaviour has changed significantly over the last year, particularly since the covid-related lockdown and increase in home working, and this has led to an increase in bandwidth used by customers for video streaming and video calls. For business customers, there is very little demand for the 40/10 product, with the 80/20 product seen as the minimum for business usage albeit with a preference for mid-range speeds (such as 220/20).
27. Recent results statements from CPs demonstrate that the market has shifted and that the majority of customers joining providers based on the Openreach network now take 80/20 rather than 40/10 or ADSL. This has risen sharply in recent months, with some CPs' take-up of 80/20 doubling in the past year. Effectively, ADSL is now an end of life product purchased by few customers, and 40/10 is also now moving towards becoming a legacy product, even before the regulatory period begins.
28. Ofcom's original proposal not to regulate 80/20, as set out in its January consultation, was taken on the basis of limited and rather outdated evidence. At §2.13, Ofcom set out that in the year ending March 2019, around two thirds of Openreach lines were at or below 40 Mbps download speeds, while the proportion of customers on 80 Mbps download speeds had declined by an undisclosed amount. However, even the trend that Ofcom presented in January was inconsistent with the 40 Mbps product remaining a viable constraint on 80 Mbps being an effective constraint throughout the period. Ofcom noted that speeds of 40/10 and below had fallen from 75% to 66% of Openreach's base in a single year. This would point towards less than half of Openreach's base being on 40/10 or slower even in the first year of the five-

year control period. However, as pointed out above, half of CPs' new customer acquisitions are now 80/20 speeds, and we expect this to be maintained, leading to rapid growth on customer numbers on faster speed variants.

29. UKCTA considers that this is substantially due to the impact of Covid-19, which has revolutionised working patterns and led to a massive increase in the use of bandwidth-hungry videoconferencing services, along with continued growth in HD video streaming. This has driven a permanent increase in consumers' bandwidth demands, by driving home the need for sufficient capacity to engage in multiple video streams simultaneously.
30. It is also important to note that spindown is unusual in the broadband market. Higher speed internet services are an 'experience good' – consumers' preferences for them are driven by having previously consumed them, after which lower speed services feel unacceptably outdated. UKCTA therefore expects few customers to move from higher to lower speeds in the upcoming regulatory period, meaning that 40/10 products will not impose a competitive constraint on 80/20 products.
31. Beyond current customer numbers, Ofcom has considered companies' forecasts. However, these are rather outdated already, due to the impact of Covid on demand for broadband. Ofcom should actively seek new forecasts from stakeholders, which UKCTA expects would show much greater demand for speeds above 40 Mbps.
32. Furthermore, even the forecasts which Ofcom did see only went as far as 2023/4, and in that year 63% of demand was expected to be for speeds in excess of 40 Mbps. There is consequently limited evidence that there will be an effective constraint even by the middle of the control period, particularly in light of consumers' reluctance to switch down in speeds.
33. Overall, the evidence that Ofcom relies on to make the case that it is appropriate to regulate only the 40/10 FTTC product is now outdated, and was in any case weak evidence in support of Ofcom's position. Ofcom should reassess the evidence in this area, which will lead it to conclude that it is appropriate to apply the charge control to 80/20 FTTC, rather than to 40/10 FTTC.
34. Given the range of retail prices offered in the market, any attempt to use a margin squeeze test to constrain 80/20 wholesale pricing is likely to be ineffective at preventing a substantial wholesale price rise. The test outcome is entirely dependent on BT's retail pricing strategy (even although it is a legally separate entity from Openreach). The only correct solution to safeguarding 80/20 pricing is through a charge control.

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