



Broadband Regulation

Statement

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1. The local loop between the customer's premises and the local telephone exchange is at the point of being transformed from its traditional role to one in which customers enjoy high speed broadband, voice and television over internet and video-on-demand services over a single telephone line.
2. As the local access network operated by BT cannot be easily replicated by BT's competitors, in competition terms, the local loop represents a critical economic bottleneck.
3. Enabling all providers to benefit from equal access to that network offers the twin benefits of both greater and more sustainable competition and swifter rollout of new services as competing providers innovate to attract customers.
4. Ofcom believes that Local Loop Unbundling (LLU) - in which a provider takes either partial or full control of the customer's connection - is the most effective means of delivering more innovation, greater choice and lower prices in broadband.
5. Ofcom first laid out its plans for LLU in May 2004. Over the last 12 months there has been substantial progress in improving the commercial attractiveness of LLU including:
 - reductions in key prices such as a 70% reduction in shared loop prices (where one company – in most cases BT – provides voice services and another provides broadband);
 - the introduction of a bulk migration price of £20, to make it cheaper for companies to move their customers from one kind of wholesale service to LLU as market circumstances and technology advantages change;
 - most recently, BT's voluntary reduction in full loop prices (where a single company takes responsibility for all services) from £105 to £80, a development which means that the UK has some of the lowest LLU prices in Europe; and
 - improvements in the provisioning and service support systems and processes needed to deliver local loop unbundling, as a result of the work of the independent Telecommunications Adjudicator which was established by Ofcom in July 2004. The Adjudicator works closely with BT and LLU operators; by facilitating industry-led solutions to operational problems with LLU, which has led to significant improvements in system capacity and quality levels.
6. Taken together, these developments have led to a significant increase in the market's overall interest in LLU. A number of major new players

have entered the market, the number unbundled exchanges has increased to 650, which serve about 45% of the population and the number of unbundled lines have grown six fold since May 2004.

7. Even so, LLU remains relatively embryonic today with only about 70,000 unbundled loops to date, representing about 1% of the broadband market. It has been suggested that further improvements and clarity are needed before LLU is a fully viable platform upon which LLU operators can compete effectively.
8. Ofcom remains fully committed to actively addressing barriers that may hinder the development of LLU. BT's geographically targeted price reductions that were introduced on 1 April 2005, which saw a reduction of £1.10 in 561 of the largest exchanges that LLU operators are targeting, have been of particular concern to LLU operators, as those price reductions directly reduce margins for operators and so would diminish the business case for any future investment.
9. Ofcom believes that the uncertainty this created together with uncertainty about necessary future LLU system and process improvements, could have slowed investment in LLU during this critical period in the market's development.
10. The commitments made by BT on 23 June 2005 regarding IPStream and LLU pricing levels and LLU process improvements are therefore welcome. These commitments essentially provide reassurance about the future margin available to LLU operators in two stages.
11. Until 1.5 million lines have been unbundled, BT has committed not to reduce the connection or rental prices of its ADSL broadband products (IPStream/BT Central or DataStream), with the exception of the £10 reduction in the end user connection charges also announced on 23rd June. BT has also made commitments regarding the pricing of new IPStream/BT Central products, additional features and more bandwidth-intensive offerings. These commitments will have the effect of maintaining the margin available for typical scale LLU operators.
12. Upon reaching the 1.5 million line threshold, BT has committed to only reducing the rental price of the ADSL end user connection, and then by no more than 3% (on a nationally averaged basis) up until the earlier of 1 April 2007 or the completion of the Wholesale Broadband Access (WBA) Market Review.
13. These measures do not preclude future reductions in the price of IPStream/BT Central and DataStream. Instead, the effect of these measures are that any reductions in the price of IPStream/BT Central and DataStream will be matched by a reduction in regulated LLU or backhaul prices in order to ensure that a stable and sufficient margin is available for LLU operators.

14. Ofcom will work proactively with BT to ensure that these commitments are met.
15. Some LLU operators have suggested that Ofcom should intervene to protect the margin available to them, possibly through formal regulation such as an *ex-ante* margin rule. Given the commitments made by BT, Ofcom believes that such an intervention would be unnecessary and inappropriate. However, should formal regulation be necessary in the future to support the margin available for LLU operators then Ofcom will intervene swiftly and decisively.
16. In addition to BT's commitments, Ofcom has today announced the full detail of the new approach to regulation of telecoms following proposed undertakings from BT under the Enterprise Act. This specifies that a new division in BT ('Access Services'), which is operationally separate from the rest of BT, will deliver key wholesale products for LLU operators including; MPFs, co-location and backhaul on an equivalent of inputs basis in 2006. This levelling of the playing field should further address the medium term concerns of LLU operators.
17. Ofcom believes that the margin stability that BT's commitments provide, together with the reduced rental charge for fully unbundled loops and BT's stated plans about other LLU system and process improvements, should deliver a more solid basis for LLU operators. These measures will also help to ensure that ISPs who are not investing in LLU have a greater range of better priced wholesale services in the future.
18. Going forward Ofcom is also required to periodically review the WBA market to ensure that any regulation is consistent with the competitive conditions. The findings of the last WBA market review were published in May 2004. Given that LLU is expected to provide increasing competition to BT in this market Ofcom believes that it would be premature to embark on a review until there is more evidence of how LLU-based competition will evolve over the medium term.
19. Ofcom will begin this review when there is greater clarity about the development and impact of LLU. There are indications that, with the benefit of increased certainty, LLU take-up may accelerate during the second half of this year. Should this be the case, then Ofcom expects to start the review in late 2005. In addition to the development of LLU, the review will consult widely with stakeholders to address how this market will develop and how regulation might adapt. In particular it is likely to cover:
 - the development of LLU alongside cable in providing competition to BT and their role in wholesale broadband markets;
 - likely wholesale product evolution in a world of converged Next Generation Networks;

- the extent to which geographic variations in competitive conditions exist; and
 - the possible need to adopt different regulatory solutions in different geographies and the implications of this for ISPs and consumers.
20. Ofcom will push forward this important review rapidly to ensure that the appropriate regulatory framework is in place as the market develops. However, given the complexity of this review and the need for extensive consultation it is likely that this review could take about 12 months to complete. Depending on the prevailing conditions at the time this may include any specific regulation necessary to ensure the continuing development of LLU based competition.
21. In summary, Ofcom believes that, taken together:
- margin stability until 1.5 million lines have been unbundled;
 - a maximum IPStream reduction of 3% after this up until 1 April 2007 or the conclusion of the WBA Market Review;
 - plans to review the broadband market to ensure appropriate regulation on an ongoing basis; and
 - the commitment to deliver equivalence of input for LLU and backhaul products in 2006 combined with other earlier process improvements;

these measures create the foundation on which LLU operators can base their commercial plans and enable a more competitive broadband market to deliver more innovation, greater choice and lower prices for ISPs and consumers.