

Strategic Review of Digital Communications

Response by KCOM

8th October 2015

Introduction and summary

1. Ofcom's strategic review comes at a time when the opportunities for investment in fixed access network infrastructure are greater than they have been since the late 1990s. The continued growth in demand for bandwidth, in conjunction with maturing technologies, is creating an environment in which investors and businesses like KCOM are gaining the confidence to commit to long term investments upgrading the fixed access network. This implies a realistic prospect for end-to-end competition that was entirely absent when Ofcom last conducted a strategic review of the sector.
2. KCOM is rolling out fibre to the premises (FTTP) to all the homes and businesses in the Hull area¹. FTTP services are now available to over 30% of homes and over 40% of businesses. We are actively expanding this footprint, with plans to reach approximately 60% of homes by the end of 2016, and we expect to be complete by 2020. This is the largest single deployment of FTTP in the UK, and creates a future proof platform for consumers and businesses in Hull that delivers 1Gbps services today, and offers an easy upgrade path to 10Gbps services and beyond.
3. We are taking this opportunity to invest, but it represents a significant investment for a business the size of KCOM – proportionately greater than any other in the UK – and therefore the financial risk will need constant and carefully monitoring. The new network will ultimately cover all the homes and business in the original licenced area², including those in the rural East Riding of Yorkshire, and this will be achieved without any public subsidy.
4. The business case is very finely balanced. Even small changes in the external environment, and changes to regulation in particular, are likely to have a significant effect on the financial viability of our investment. For example, we would like to accelerate the

¹ We used fibre to the cabinet for a small number of premises, and may keep these existing deployments for some time before upgrading to FTTP.

² This area includes Kington upon Hull and some of the surrounding East Riding of Yorkshire. See figure 4 below for a map of the area.

roll-out, and would be more confident about doing so if there were more certainty over the likely regulation of fibre services and the treatment of legacy services in the transition to a more efficient network architecture. However, a major disruption, such as that caused by structural separation of BT with its potential implications, could damage our confidence and force us to look at a more cautious investment programme.

5. Other operators are also investing in new access network infrastructure, both in Hull and around the UK. Should these investments flourish, then end-to-end competition can play a much greater role in making sure that digital communications markets continue to work for consumers, citizens and businesses. We consider that end-to-end competition has the potential to be effective in many locations around the UK. Although we accept that it is not a realistic option everywhere, Ofcom ought to consider that the current regulatory framework is already encouraging access investment and therefore requires limited changes.
6. In this context, the structural separation of BT and increased passive access and/or regulated wholesale access would not encourage is not a good idea. It would inevitably lead to a significant amount of disruption to the entire industry; would create a considerable amount of uncertainty; and would undoubtedly damage the prospects for investment by all the current access network owners due to the inevitable remedies on passive and wholesale access costs that will follow. In addition to this detrimental effect on investment, we do not believe that structural separation is a good solution to any of the most pressing competition problems currently faced in the UK. At best, it addresses concerns about vertical leverage of market power. It does not tackle the underlying problem of the existence of market power in access markets. In fact, by damaging the prospects for access network investment it reduces the chances of developing the effective end-to-end competition that would reduce BT's market power.
7. One of the most significant problems faced by KCOM (outside the Hull area) is the ongoing poor performance from Openreach, and we support Ofcom's interventions in this area to date. Structural separation will not address these issues, and once again, by damaging the prospects for end-to-end competition, it may actually make them worse, requiring perpetual intrusive ex ante regulation.
8. As a final comment, whatever the ultimate choice of strategy, we urge Ofcom to ensure that each and every regulatory intervention is proportionate to a clearly identified problem. KCOM operates in a unique set of conditions in the Hull area: foremost because of the limited scale of the market, but also because of the demographics and the historic development of the market. A regulatory solution, or strategy for that matter, which is appropriate for the rest of the UK cannot be assumed to be appropriate or proportionate in Hull.

Structure of the response

9. This response is structured in four sections following the policy areas identified by Ofcom:

- Investment and innovation;
- Sustainable competition;
- Empowering consumers; and
- Targeting regulation.

10. A common theme running throughout these sections is that we believe Ofcom should build on current market developments by prioritising the creation of an environment conducive to access network infrastructure investment.

Investment and innovation*KCOM investment*

11. KCOM is rolling out a fibre to the premises network in the Hull and East Yorkshire area. The new network currently passes over 50,000 homes and around 6,000 business addresses, meaning that almost 30% of the population and over 40% of businesses in this region now have access to ultrafast broadband services. We plan to reach over 95,000 homes by March 2017, and complete coverage of all homes in the area by 2020.

12. The new services have been extremely popular, with take-up of 38% of homes passed in residential markets. It is also proving popular with business customers, especially small businesses who are now able to get a reliable 250Mbps connection from as little as £30 per month³. Around half of the businesses passed by the network now take a Lightstream service.

13. KCOM opted to invest in fibre to the premises based on a GPON architecture for a number of reasons:

- a. It delivers a better user experience – especially in terms of meeting expectations. Unlike xDSL, FTTP does not suffer from distance dependent connection speeds. Therefore, a customer who buys a 100Mbps service will be able to connect at 100Mbps⁴.

³ The Office Light 250 package is currently £30 per month excluding VAT on a 24 month contract. This offers 250Mbps download and 125Mbps upload speed, with a monthly download allowance of 150GB.

⁴ Although, as with any internet connection the throughput achieved by an end user will depend on a range of other factors, notably the number of other users in shared parts of the KCOM network, and on the internet.

- b. The technology is relatively mature, and being deployed at scale around the world. This contrasts with G.Fast, which has yet to be proven in real world deployments, and only delivers very high speeds over very short copper loops (less than 100metres) which means that it only really makes sense as a fibre to the distribution point technology.
 - c. A GPON network offers a good balance between cost (of both deployment and operation) and performance relative to point to point fibre networks.
 - d. It is easily upgraded with 10G-PON equipment already available, and even faster speeds being developed by vendors⁵.
14. Our relatively small scale allows us to deploy fibre in a very efficient manner – building the new network on a bespoke basis to suit each road. Similarly, we are developing more efficient techniques for making the final connections into customer premises. This has resulted in one of the lowest cost per home passed, and per home connected, in the world.
15. Despite all of this, the financial case for the investment is very finely balanced, and requires payback over a long period of time. Although we are currently marketing our Lightstream services as a premium product relative to current generation broadband, the difference in price is quite small. For example, the entry level 50Mbps Lightstream package is only £5 more than the basic broadband service, and comes with a much higher usage cap⁶.
16. The investment is entirely privately funded. Although the area covered by our network includes sparsely populated rural towns in the East Riding of Yorkshire (see figure 4 below for more detail), we are planning to build out to all homes and offices in the area. Unlike the harder to reach areas in the rest of the UK, we are receiving no public funding for building this network. However, we would note that the business connections voucher scheme has proved very popular in the region, and would welcome the continuation of this scheme.
17. In part, the business case is about building a more efficient network architecture for the future. Realising the full benefits of this new architecture will mean retiring older services and platforms, and removing legacy equipment. Ultimately, it should allow KCOM to

⁵ For example, Huawei recently ran a successful lab trial of 100G-PON: <http://pr.huawei.com/en/news/hw-379230-pon.htm>

⁶ Lightstream Home is currently priced at £36.99 per month including line rental, free UK evening and weekend calls, and 120 minutes to UK mobiles. This gives the customer a 50Mbps fibre service with a usage allowance of 70GB. Our basic ADSL2+ broadband package, Home, costs £31.99 per month and includes line rental and the same bundle of voice minutes, and has a usage allowance of 35GB. We also offer Home Starter ADSL2+ packages with a 10GB usage allowance, which costs £23.99 with the equivalent calls bundle.

reduce the number of local exchanges in the Hull area and remove copper cables, and to deliver voice and data services more efficiently as a result.

18. Although these developments are some way off, they are vital to our business case for FTTP. The precise timing of these changes is uncertain, and will depend in part on the take-up of new services. However, it is clear that they must happen at some point in the not too distant future, and we would expect to be starting this process of network transformation within the next five years. To support the adoption of more efficient network architectures, it is vital that Ofcom provides clarity on the regulatory treatment of both legacy and new services during this transition. We discuss this and other recommendations in more detail from paragraph 23 below.

Other investment in Hull

19. Within the last three years, two new entrants have started building fixed access networks in Hull:
 - a. MS3 is building a fibre network across Hull and East Yorkshire, targeting business customers and selling a fibre network across. Its first customer went live in March 2013.
 - b. City Fibre has started building its own network in Hull on the back of a contract to supply MBNL with backhaul services in the East Yorkshire region.
20. In turn, these investments are supporting growth in alternative fixed wireless suppliers such as Connexin and Pure Broadband. Both providers now offer wireless services across most of the original licenced area, i.e. the area in and around Hull in which BT does not have copper access network infrastructure.
21. These developments in Hull are indicative of the opportunity for network investment given current market conditions. Demand for bandwidth continues to grow, driven by OTT TV and video services in the residential market, the ever increasing use of smartphones, and changes in the way businesses communicate with customers.
22. Equally, around the rest of the UK we find further evidence of a desire to invest, perhaps most notably from Virgin Media's plans to extend its coverage – the first time there has been any material cable network roll-out in 15 years.

Supporting and encouraging network investment

23. It is important for Ofcom to support and encourage these market developments. As discussed further below, investment in fixed access networks creates the possibility of end-to-end competition, and consequently the prospect of a much reduced need for detailed ex ante regulatory intervention.

24. Our view is that the most important way in which Ofcom can support these investments is by delivering a stable regulatory regime. Investment in primary infrastructure, such as our FTTP roll out, requires a long term payback period. The financial risks are significant given the fast pace of technological and demand developments. It is even more important, therefore, that regulation does not add any material degree of risk.
25. Certainly as far as the KCOM investment is concerned, the business case for FTTP is finely balanced. Changes in the external environment, including changes driven by regulation, could very easily tip the scales and mean that continued investment is no longer viable. Given the competitive nature of markets in the UK, and the long term payback period, the same is likely to be true for many of the other network investments taking place or being planned around the UK.
26. Overall, our view is that the current regulatory regime is performing reasonably well, and can be improved by changes in implementation rather than a fundamental shift in approach. Although markets have changed significantly in the last ten years, and the next decade may bring even more change, the analytical tools used in market reviews and the underlying competition law principles remain fit for purpose. Ofcom does not identify any problems, competition or otherwise, that cannot be assessed and addressed within the existing framework.
27. There are a number of specific ways in which Ofcom could reduce regulatory uncertainty and help support fixed access network investments:

Give end to end competition a chance

28. First and foremost, to use the opportunity provided by the strategic review to signal support for such investments. We understand the reasons for the decision in the last strategic review to rely on regulated access. At the time the prospects for investment in fixed access networks were largely non-existent. The prospects today are far better. Whilst we accept that new network build will not solve all the competition problems in UK communications markets, it should at least be given the chance to solve some of them.

Increase the market review period to five years

29. Secondly, given the relatively long planning timelines required by these investments, it would make sense to move to a longer market review period. Certainly, a full and comprehensive review every three years, with the possibility of a complete overhaul of previous decisions, creates an unnecessary level of uncertainty. It may, of course be necessary to update certain parameters of a regulatory intervention to account for market developments within a five year period, but it should be possible to agree and commit to the fundamental aspects on an intervention for at least five years.

Ensure regulation is always proportionate to local conditions

30. An issue of particular importance to KCOM and its business in Hull is that regulation must always be proportionate to the problem identified. All too often, regulation is designed to address problems at a national level, and with BT in mind. These obligations are then applied, perhaps with minor modifications, to KCOM in Hull. As discussed in detail from paragraph 63 below, this does not always lead to appropriate, proportionate regulation. This creates regulatory uncertainty for KCOM because regulation is being designed to cater for conditions which do not necessarily exist in Hull.

Remove obstacles to the adoption of an efficient network architecture

31. To help KCOM and others plan and manage the transition to new technologies, and to create the confidence that these plans will not be disrupted by regulation, we encourage Ofcom to set out a clear policy explaining its position in relation to legacy services. There are two key issues:

- a. first, whether consumers using legacy services should receive some form of protection to ensure that their service continues to be made available; and
- b. secondly, what will happen to existing technology specific requirements, such as those set out in universal service obligations, or access obligations stemming from the narrowband market review.

32. We would urge Ofcom to resist the temptation to intervene to protect customers from these developments. Although the customer might not have requested a change in service, it is vital that network operators have the flexibility to adopt new, and more efficient, technology which will improve services for the vast majority of consumers. Regulation designed to protect consumers using legacy services would reduce flexibility and ultimately would lead to increased costs without any real benefit to the consumer.

33. KCOM takes its responsibility to its customers very seriously. We consider that it is our responsibility to engage with customers well in advance of the removal of any legacy products or services, and to help customers migrate to a modern equivalent service. We operate at a scale whereby we can address customer concerns on a case by case basis.

34. Similarly, greater clarity is needed in relation to the regulatory treatment of fibre based services. For example, the requirement for battery backup. Whilst we understand the need for service continuity, a more comprehensive and all-encompassing approach which includes customer premise equipment and customer owned equipment. It makes very little sense to require, at considerable expense, battery backup of just a single part of a networked service. Either the requirement for battery backup should be removed, or significantly extended to include all the equipment necessary for effective communications.

35. Overall, we consider that the right approach is for Ofcom to develop a regulatory policy for all fibre networks without regard to the current circumstances. That is, ignoring the fact that there are various universal service obligations relating to PSTN services, the fact that the PSTN is powered, and so on, to think about the regulation that would best support and protect consumers of services provided on an all fibre network.

Sustainable competition

36. The question of sustainable competition highlights two points we would like to emphasise in this response:
- a. Hull is not a representative sample of the rest of the UK. For a variety of reasons, both regulatory strategy and specific implementations of that strategy may need to be different in Hull.
 - b. Secondly, there is a realistic prospect of end-to-end competition in Hull. As per the first point, this is not true of the UK as a whole, but the conclusion may well also hold for some specific areas in the rest of the UK.
37. We discuss the first point in detail in the final section of the response, and therefore focus on the prospects for competition in Hull in our discussion below.

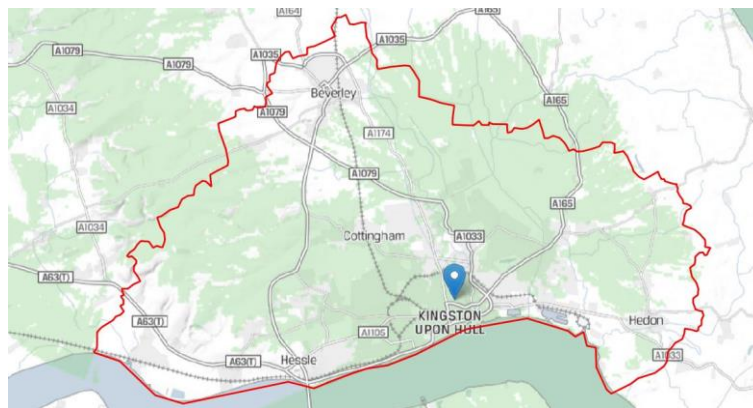
End-to-end competition in Hull

38. As noted above, a number of new entrants are starting to offer services in the Hull area based on investment in fixed network infrastructure. Although these networks are primarily focussed on business customers, they are supporting mobile and wireless operators selling to the residential market. Equally, City Fibre is supporting residential services through a trial in York in partnership with TalkTalk and Sky, and we assume similar services could be rolled out in Hull should the trial prove successful.
39. There is clearly a long way to go, but these nascent developments hint at the potential for end-to-end infrastructure competition in Hull. This is likely to come first to business connectivity markets. Although the residential market represents a greater challenge, other CPs will continue to assess this option.
40. In relation to the residential market, mobile services are increasingly important to the competitive landscape in Hull. There are significant levels of social and economic deprivation in Hull – particularly in the City itself. Given this demographic, there has long been a higher proportion of mobile only households in Hull compared to the rest of the UK. Despite the growing demand and uptake of broadband services in recent years, the

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number of households in Hull who do not buy any fixed line service through the KCOM network has increased from around 10% in 2007 up to almost 18% this year.

41. In terms of substitutability, mobile services are clearly used and viewed as an alternative to fixed voice in almost all scenarios. Increasingly, with the roll out of 4G networks, mobile services represent a very close technological substitute to fixed broadband services. Future enhancements such as 4G+ (LTE-A), which require relatively small incremental investments over the initial 4G roll-out, can create services with bandwidth well in excess of those offered using VDSL.
42. However, fixed broadband services currently tend to offer far more generous usage allowances than mobile broadband equivalents. On this basis, fixed and mobile broadband services may not represent effective substitutes for all customers, but this is likely to change as mobile operators offer more competitive packages, for example by including access to data heavy applications such as Netflix.
43. Another potential concern is coverage of the mobile networks. The MNOs were initially quite slow to roll out 4G services, and Three has yet to upgrade from 3G in the Hull area. However, the remaining operators now offer good indoor 4G coverage in most parts of the city and East Riding as can be seen in the following charts. These are based on data from Ofcom's mobile coverage checker service. The original licenced area is shown in red in each diagram.



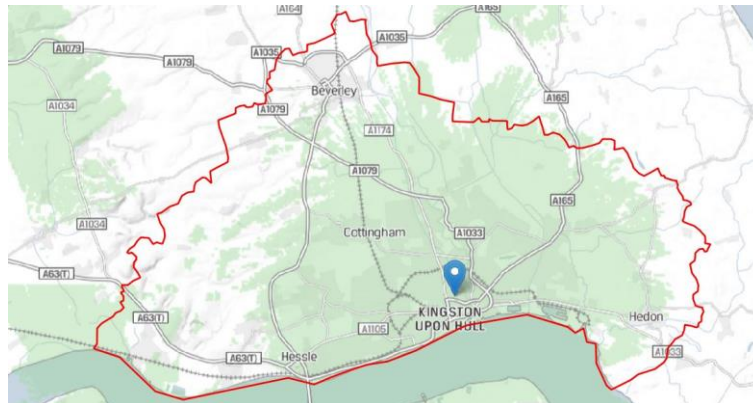


Figure 2: O2 4G indoor coverage



Figure 3: Vodafone 4G indoor coverage

44. We view 4G services as a competitor to our broadband packages in Hull. We will continue to ensure that we offer good value for money by maintaining a difference in terms of usage allowances, and by investing in FTTP to create a better service.
45. On a forward looking basis, and referring to the original licenced area in and around Hull, it would seem appropriate for mobile services to be included as an effective substitute for fixed voice services in the narrowband market reviews. Equally, we consider that mobile services should be taken into account in the delivery of universal service for voice communications.
46. There is an increasing degree of overlap between mobile and fixed in relation to broadband services. We recommend that Ofcom conduct market definitions at a local level given the differences in consumer behaviour and market conditions more generally in Hull. In addition, and as with voice services, mobile clearly has a significant role to play in the delivery of universal broadband availability.

New models of competition

47. Increasingly, we see residential services being bought and sold in bundles. We expect that this will continue over the next decade as bundles generally offer the consumer better value for money. To date, however, these bundles have been based largely on traditional electronic communications services – fixed and mobile telephony, broadband, and TV.
48. As Ofcom has noted, various operators are now beginning to experiment with bundles which include subscriptions to OTT services. At this stage, it is unclear whether this will become the norm, or whether consumers would rather purchase these services separately. Clearly, this will depend to a large degree on the relative benefits of buying the services through the bundle. For example, BT TV customers can buy Netflix through BT with the potentially significant benefit that watching the service will not contribute towards data usage allowances – in contrast to a customer who buys the service independently.
49. As a relatively small operator, we note that there is a risk of being unable to negotiate deals with the suppliers of OTT services to allow us to create competitive bundles. Similarly, we are not in a position to negotiate bespoke deals for TV content. As such, we support Ofcom's ongoing work in Pay TV, and believe that its approach and the analytical tools developed in this field could potentially be applied to assess premium OTT services.
50. We consider that the ability to offer mobile services as part of a bundle will gain in importance over the next decade. KCOM currently offers mobile services through its relationship with O2. We note with some concern the two proposed mergers in the sector. The wholesale mobile market in the UK has been relatively competitive to date. There is clearly a risk associated with a reduction from 4 to 3 operators that the wholesale market will become materially less competitive, and that operators will be less interested in supplying to resellers and MVNOs. Equally, we have concerns that the proposed BT EE merger could affect the willingness of EE to sell wholesale access to fixed network operators who are in competition with BT.
51. Should these proposed mergers go ahead, then we consider that it may be necessary to intervene to ensure the wholesale market remains competitive, and that fixed operators can continue to negotiate resale and MVNO agreements. Specifically, it may be appropriate to require the merged entities to offer wholesale access to the mobile network, and at prices to enable competition with the MNOs in downstream markets.

Structural separation

52. Of all the topics and potential outcomes discussed by Ofcom, the possibility of structural separation of BT has the most far reaching consequences for the industry as a whole. Our view is that structural separation would not address any of the major issues currently faced

by the industry. It would not be a proportionate response in the circumstances, and therefore should not be pursued as an option in this review.

53. It is an obvious, and important question to ask. In the last strategic review, Ofcom found that the net benefits of that approach were outweighed by a less intrusive, less disruptive, and more flexible functional separation.
54. There are a number potential benefits of structural separation, but the only certainty is that it removes the incentive and ability to discriminate by leveraging market power into the markets in which the separated downstream division operates. All of the other benefits identified by Ofcom are rather more speculative. For example, there is really very little reason to believe that a structurally separated network company would deliver better quality of service. The most important incentives remain the same: the network company controls a set of bottleneck assets and faces very little competition.
55. However, it is also important to note that there is some end to end infrastructure competition. Most notably from Virgin Media, but also from a range of smaller new entrants. For the first time in almost generation, there is both the appetite and opportunity to invest in fixed network infrastructure. A move to structurally separate BT would tend to undermine this investment, and therefore undermine the development of the only form of competition which might ultimately remove the need for access regulation.
56. Equally, it is important to note that the creation of a network operator which is dominant, but crucially not a monopolist, would not remove the concerns regarding cost allocation nor completely remove the issues associated with discrimination. Due to the presence of competition, the network company would still have incentives to use its position of economic strength to adversely affect competition through leverage across geographic boundaries, and by manipulating costs allocations.
57. The most significant issue we face at present with Openreach is their continued poor performance. In particular, we note that although some of the average measures of performance are improving, we continue to experience a 'long tail' of interactions where performance remains at unacceptable levels. In particular, once an Ethernet delivery has missed its original target, then gauging by performance we have received, Openreach has only very weak incentives to fix the problem. The 'deemed consent' arrangements in the Openreach contract contribute to this problem, and we consider that the removal of this option for Openreach to avoid SLG payments would help maintain appropriate incentives.
58. These types of problem can only be addressed either through the incentives created by genuine competitive pressure, or through carefully designed regulatory interventions. Structural separation would not directly affect Openreach's incentives with regard to performance. We consider that the industry and consumers will benefit more in both the

short term, and the long run, if Ofcom were to focus its attention on the design of appropriate regulation to correct BT's incentives to encourage good performance for all customers, and to raise both the average and the minimum standard of performance.

Empowering consumers

59. KCOM continues to support Ofcom's work in relation to consumer issues. Participation is a particular concern in Hull. We believe that more could be done to encourage and promote participation, but we are sometimes hampered by potential conflicts with regulation.
60. Separately, we support Ofcom's work to ensure that consumers are better able to access and assess information to allow them to make informed decisions. We note two examples of practices in fixed broadband markets that have been driven by competition and are not helpful to consumers:
- a. First, the often misleading headline speeds of xDSL broadband services. Customers of our Lightstream FTTP services have reported that getting the advertised speed is one of the most satisfying aspects of the service. With BT planning to use G.Fast, this issue looks set to continue. G.Fast offers potentially very high bandwidths of perhaps 500Mbps over extremely short and high quality copper loops, but this speed drops off very quickly as loop length increases.
 - b. Secondly, broadband service pricing in the rest of the UK is generally misleading as it does not include the mandatory purchase of voice line rental. The problem is being exacerbated as line rental prices increase. In Hull, KC advertises broadband prices which include line rental. However, we then suffer from adverse comparisons to offers that customers see elsewhere around the country. This mistake may be easily corrected, but the initial negative perception often remains.
61. In relation to broadband speeds, we work closely with our customers - both proactively and reactively - to try to identify and fix problems. A significant issue that we face is that the underlying cause of the poor performance is often within the customer premises. For example; poor internal wiring; old or incompatible devices; electromagnetic interference from TV STBs, lights, microwaves, etc; inappropriate routers. We believe that most of these problems will be removed or significantly reduced once customers move to fibre based services. However, until these new services are available to all customers, we need a better way to communicate with customers to identify and address common in-house problems.
62. This potentially gives rise to problems in delivering USO bandwidth targets: in circumstances where the access platform ought to deliver a 10Mbps service, but the customer is experiencing much less, it is not clear whether the USO can be deemed to

have been met. It can be very time consuming and expensive for the network supplier to determine the underlying cause if this is in the customer's house. Clearly, our limited resources would be better spent investing in new networks and improving services across board rather than investigating specific cases in order to demonstrate that a regulatory obligation has been met. Therefore, we encourage Ofcom to give some thought to the implementation of any universal service obligation for minimum broadband speeds.

Targeting regulation

63. Regardless of strategy, regulatory interventions must always to be proportionate to the problem they are designed to address. This means they must be appropriate to local conditions. Understandably, regulation is usually designed to address problems associated with BT's market power and conditions in the rest of the UK, but then also applied to KCOM in Hull.
64. In some cases this approach will be appropriate. However, Hull is not a representative sample of the rest of the UK, and KCOM is vastly different to BT. Therefore, in many cases the resulting regulation will not be appropriate or proportionate to the circumstances in Hull.
65. We discuss a number of examples in the following subsections. These indicate that regulation could be better targeted in Hull, and that Ofcom should not presume that regulation designed for the rest of the UK will be appropriate in Hull. First, however, we set out why Hull is different.

Hull in comparison to the rest of the UK

66. There are a number of differences between the Hull licenced area and the rest of the UK, and these drive the need for different regulatory approaches. Most importantly, the market is very small compared to the rest of the UK. The original licenced area is shown in Figure 4 below, and covers all of the Kingston upon Hull unitary authority along with parts of the surrounding East Riding of Yorkshire.

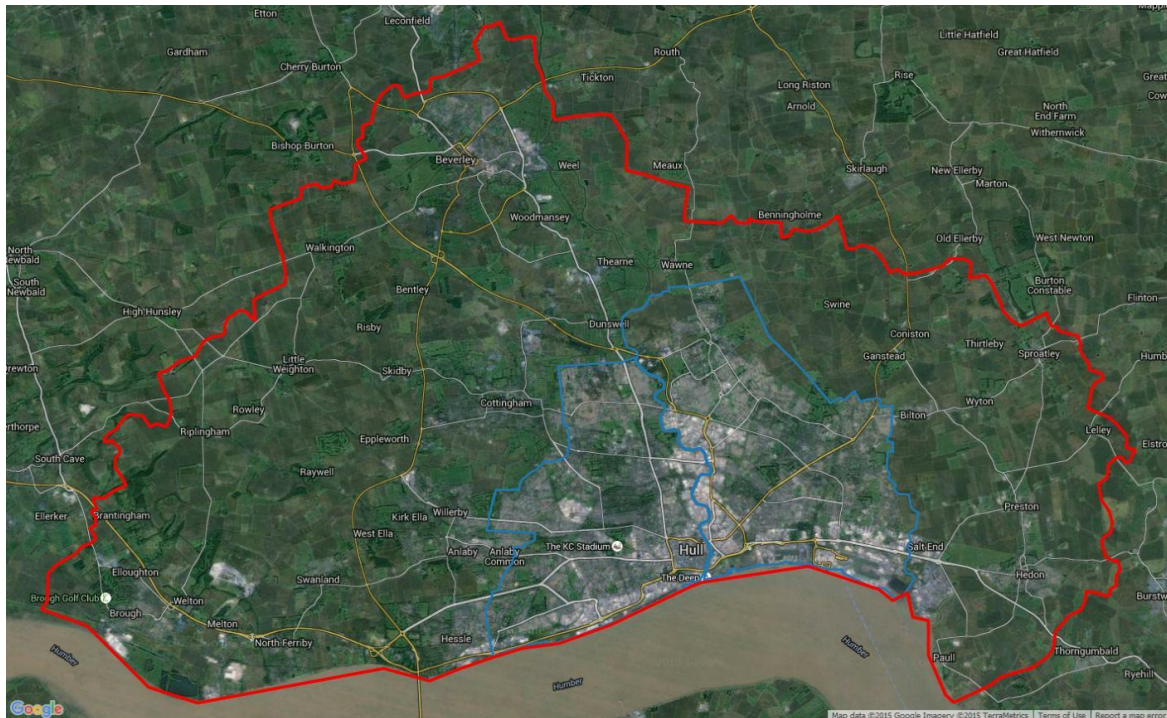


Figure 4: the original Hull licenced area (red) and the Kingston Upon Hull local authority boundary (blue)

67. As is clear from Figure 4, a large proportion of the original licenced area is rural, with a number of small villages dotted around the East Riding area. However, similar to the rest of the UK, the majority of the population live in the larger towns and the city.
68. The population served by KCOM in this area is approximately 390,000⁷, spread over roughly 168,000 homes. This represents less than 1% of the UK as a whole.
69. The population density in the city of Hull is high, but this is also one of the most deprived areas in the country. There are significantly higher levels of deprivation compared to the rest of the country. As shown in figure 5 below, according to the latest Multiple Deprivation statistics published by the Department for Local Government and Communities⁸, 30% of the population live in one of the most deprived 10% of areas in England.

⁷ Based on mid-2012 estimates, the population in the Kingston upon Hull area was 257,000. The remaining third live in the East Riding.

⁸ English indices of deprivation 2015, <https://www.gov.uk/government/statistics/english-indices-of-deprivation-2015>

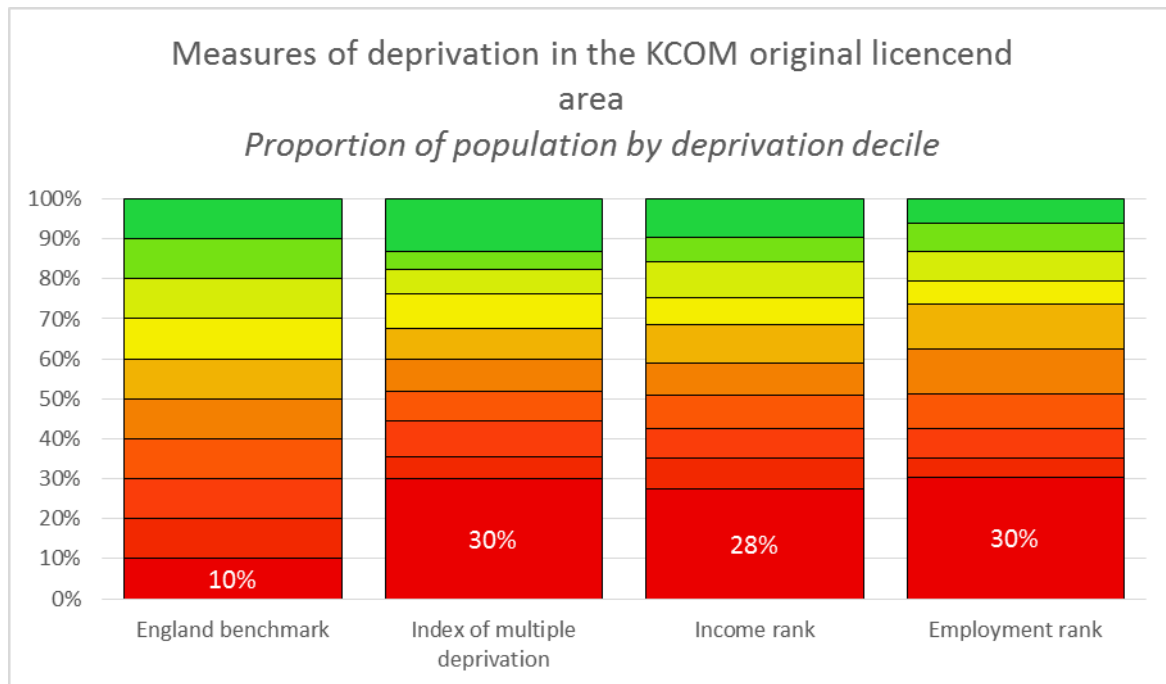


Figure 5: Indicators of deprivation in the original licenced area

70. The distribution is even more heavily skewed in the city of Hull, in which 45% of the population live one of the most deprived 10% of areas in England. However, this is balanced to some degree by the relatively more affluent areas in the East Riding.

71. In terms of the market for business services, there are approximately 10,000 VAT registered businesses in the area and around 14,000 addressable business premises. One indicator of the magnitude of demand for business communications services is the amount of office space in the area. As shown in the table below, the original licenced area has an average amount of office space for a large city, but certainly does not stand out as having a high density of offices. Cambridge, for example, has almost the same amount of office space but with around a quarter of the population.

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City / Local Authority Area	Office space (thousand m ²)	Population (mid 2012)	Relative office density (m ² per head population)
Original licenced area	532	390,000	1.4
<i>Kingston upon Hull</i>	390	256,717	1.5
Nottingham	824	308,313	2.7
Bradford	789	524,619	1.5
Reading	622	157,027	4.0
Milton Keynes	620	251,980	2.5
Leicester	555	331,502	1.7
Coventry	541	323,132	1.7
Swindon	522	211,934	2.5
Cambridge	479	125,155	3.8
Stockport	417	283,897	1.5
Norwich	414	133,904	3.1
Doncaster	249	300,302	0.8

Table 1: Office space in English towns and cities⁹

Wholesale access obligations

72. The prospects for competition in Hull are different relative to the rest of the UK. Economies of scale operate at almost every level in the telecoms value chain. As a result, the small size of the market in Hull limits the viability of many business cases.
73. Given the differences between KCOM's network and BT's, and differences in the way that these networks are run, the wholesale access products offered by each operator will never be identical. Of particular importance are any differences in processes: from ordering, through to provisioning and in-life management of customer services. Technical differences in products are usually relatively easy to overcome, but dealing with different processes becomes much more difficult when operating at scale.
74. A great deal of work has been done since the last strategic review through the OTA and OTA2 to develop an interface and a set of robust processes to allow CPs to use Openreach products and services efficiently at an industrialised scale. This has involved considerable development work from both BT and CPs.
75. A similar, albeit smaller, development effort would be required to use KCOM wholesale access services. It is very difficult for a national CP to justify these incremental costs, and

⁹ The data is based on the Commercial and Industrial Floorspace and Rateable Value Statistics (2005 Revaluation), 2008, and population figures from Office of National Statistics.

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the additional management time and effort, given the limited target market in Hull. Consider the problem from the perspective of a national CP: do you focus your attention on the 99.4% of the population addressable through BT, or the 0.6% which can be accessed by KCOM?

76. Ultimately, with the prospect of having to develop and maintain a new product, a different interface, and different processes, no national CP has ever used the regulated wholesale access services offered in Hull. A good example of this issue was the introduction of CPS. KCOM developed the product at great expense, which has then never been used by a national CP.
77. It should be noted that these costs and issues do not apply to competition based on end-to-end infrastructure. Where a CP builds their own network they can use the same products and processes in Hull as they would in any other part of the country.
78. More recently, Ofcom has moved away from requiring specific forms of wholesale access, and requiring that KCOM provide access on reasonable request. We consider that this approach should be adopted more broadly across the markets in Hull. This would not only reduce our costs, a benefit that will be passed through to consumers, but would also give us more flexibility to respond to the specific needs of our wholesale customers.

Regulatory accounts

79. KCOM is required to maintain a system of accounting separation and produce annual audited regulatory accounts. We incur a not insignificant cost in producing these accounts. Until recently, these accounts were used to produce our fixed narrowband termination and origination rates. However, even this is no longer required.
80. BT's regulatory accounts are used in setting charge controls in almost every market review, and in support of other competition investigations. As far as we are aware, and in stark contrast, the KCOM accounts are of no interest to industry, and are not even used by Ofcom. In recent market reviews where KCOM's wholesale pricing has been considered, Ofcom has benchmarked to BT's costs and prices rather than using the costs produced in our regulatory accounts.
81. It would therefore appear that the continued requirement for KCOM to produce regulatory accounts is disproportionate.

About KCOM

KCOM Group PLC delivers communications services to a range of businesses and consumers throughout the UK under a number of different brands. In Hull and East Yorkshire, as the incumbent provider KC delivers a range of communications services to business, consumers and other CPs. Nationally, Eclipse Internet delivers a portfolio of internet based communications services with a focus on the SME market.