Promoting competition and investment in fibre networks: WFTMR 2021-26

Pricing wholesale local access services in Geographic Area 3 with a BT Commitment to deploy a fibre network

Virgin Media response

October 2020

Non-confidential Response

SUMMARY

Virgin Media welcomes the opportunity to respond to this further Wholesale Fixed Telecoms Market Review ('**WFTMR**') consultation ('**the consultation**').

We continue to support Ofcom's objectives for the WFTMR, the intended outcomes and, broadly, the mechanisms Ofcom intends to achieve these. In particular, we agree with the changes Ofcom proposes to make in this consultation, as a result of BT's commitments.

Ofcom's proposal to adopt a 'forecast RAB' approach in Area 3 is consistent with its signalled approach in the January 2020 consultation, contingent on BT making a material voluntary build commitment. This change simplifies the regulatory remedies to be applied across the UK and avoids the previous approach of drawing a bright-line distinction between geographic markets; where competing infrastructure investment is encouraged on one side and effectively deterred on the other. In our view the approach proposed in this consultation achieves a good balance between protecting consumers and encouraging network investment across UK geographies, which will benefit consumers across future market review periods.

Since the January 2020 consultation, the country has experienced the impact of COVID-19, which has impacted the lives and livelihoods of all consumers materially. It has also provided a test to the resilience, capacity and capability of the UK's telecoms infrastructure, as well as reinforced and enhanced the value that households place on connectivity. Adoption of home working, e-learning and telehealth have accelerated to levels that commentators would not have predicted 12 months ago. Connectivity has acted as a lifeline for social interaction, entertainment and purchasing households' basic needs to an unprecedented extent.

This period has reaffirmed our confidence that the UK's network infrastructure is robust and effective. It has also strengthened our view that Ofcom should not shy away from incentivising further investment and ensuring the value of this investment is commensurate with the critical role it will continue to play for the economy and society during the forthcoming charge control periods.

1. AREA 2

We continue to support Ofcom's proposals in Area 2. It is key that both Openreach and competing networks are incentivised to invest and that pricing remedies imposed on Openreach are set at a level to enable efficient alternative networks to have the ability to compete and achieve economies of scale over time. Failing to achieve these outcomes will not be in the long- or short-term interest of consumers in this geographic market.

40/10 anchor

We continue to support Ofcom's proposal for a 40/10 anchor product; in our view this is the appropriate service for at least the forthcoming charge control period. As an anchor, this remains many times faster than 'decent' connection speeds as defined for the USO and it is capable of being utilised for bandwidth intensive services by multiple concurrent users for all but perhaps the highest intensity customers.

COVID-19 has demonstrated that this bandwidth tier is entirely adequate as a service offering even under unprecedented circumstances of increased homeworking and multiple members of households making use of their broadband services concurrently.

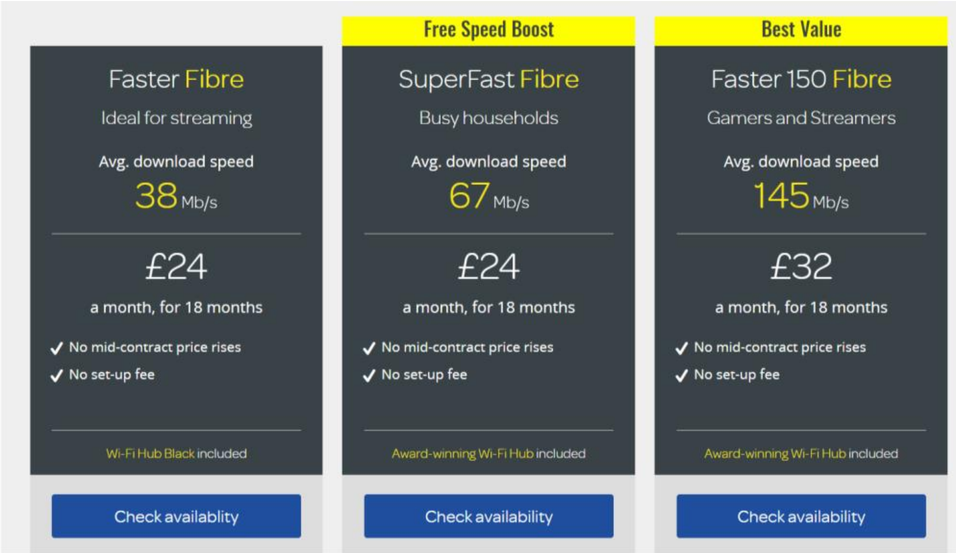
While we do not believe there is any evidence to suggest that affordability is, or will be a problem in this market, consumers are nonetheless sensitive to price. Providers need to ensure that their customers remain willing to pay for the services that they offer. Setting the anchor product at a level far beyond households' projected bandwidth needs would restrict the ability of providers to experiment with innovative and value propositions, ultimately to the detriment of consumers.

Furthermore, we do not believe that there is a demand factor that would justify the use of a higher speed anchor. It is apparent from commercial propositions in the market, and proactive migration campaigns announced by competitors, that Openreach's discount scheme has continued to create a commercial incentive to accelerate the pace at which customers migrate to higher speeds, rather than there being a clear trend from consumers needing or desiring higher bandwidths.

For example, at the time of this response, TalkTalk offered its GEA 80Mbps services for the same headline price as its GEA 40Mbps package. In this context, an increase in the mix of households taking the 80Mbps GEA product is not a signal of a ratchet effect to higher bandwidth demand, it is

TalkTalk responding to commercial incentives set by Openreach and consumers responding with monotonic preferences.

Figure 1: TalkTalk[1]



We agree with Ofcom's logic about the relative risks of removing price controls on higher bandwidth services in Area 3. Openreach is constrained by its existing discounting regime, Ofcom's updated proposals would seem to further reinforce incentives for Openreach to adopt a nationwide, rather than geographically disaggregated approach with its retail CPs. Furthermore, existing general remedies on network access appear adequate to address any lingering concerns about BT's scope to undertake a margin squeeze.

It is also clear that the perceived and actual competitive threat to Openreach at the wholesale level has grown since Ofcom's original consultation on this topic, with additional investors sponsoring more ambitious rollout plans from altnets and some consolidation already emerging (notably, CityFibre's acquisition of FibreNation's operations).

As a result, 40/10 remains the appropriate anchor for at least this charge control period. Evidence would suggest migration to higher bandwidths is likely to be supplier-led rather than customer-driven and this anchor will be entirely substitutable for higher bandwidths given most households' likely needs during at least the review period. Furthermore, countervailing pressures on Openreach from its wholesale competitors, as well as its own contractual arrangements for GEA discounts, further reduce the prospect of excessive prices, whether in Area 2 or 3.

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[1] https://www.talktalk.co.uk/shop/, (Retrieved 14/09/2020)

2. AREA 3 – DISCOUNTS

In our response to the main WFTMR consultation, we highlighted our concerns about Ofcom's original proposal to not constrain Openreach's ability to offer geographically targeted discounts in Area 3 to the same extent as in Area 2.

This was due to our overarching concern that Ofcom's task of distinguishing between Area 2 and 3 is challenging and prone to error. If Ofcom designates an area as being unlikely to experience network investment this may, nonetheless, lead some altnets to target these areas to achieve a first-mover advantage, even if it results in marginally higher costs than a comparable location in Area 2.

As a result, the impact of regulatory error and unintended consequences could be material if starkly different remedies were applied in areas that are otherwise relatively indistinguishable to an investor. Given this risk (and that Openreach's incentive to pursue foreclosure strategies is not dependent on geography) we encouraged Ofcom to take the precaution of limiting geographically targeted discounting of FTTP services in Area 3, to avoid the risk Openreach might use any flexibility to thwart competitive entry. As a result, we welcome Ofcom's revised proposals on this topic. This change is a step towards avoiding a 'cliff edge' of remedies applying in one, marginal, location but not in a similar location that is less challenging from a commercial investment perspective.

3. POST-2026

We welcome Ofcom setting out its anticipated approach to future charge control periods and the factors that it would expect to consider in those reviews. This clarity is helpful for all stakeholders, particularly given these network investments are long-term capital allocation decisions.

While Ofcom's commentary was clearly not intended to be comprehensive or exhaustive, any reference to considering the 'fair bet' of non-Openreach investors was nevertheless conspicuously absent from the broad framework that Ofcom sets out.

Openreach's ongoing and forthcoming investment in gigabit-capable network rollout has been developed and expanded over the course of some years, no doubt with extensive engagement with Ofcom, Government and its investors.

When set against previous market reviews, Ofcom's proposals in the WFTMR (including in this consultation) do reflect a 'step-change' in providing incentives for network investment. If this change is ultimately delivered in the Final Statement, it may trigger further investment.. For the desired effect of the 'step-change' to be sustainable, Ofcom must provide investors other than Openreach with the confidence that the new, investment friendly approach to regulation will prevail beyond the forthcoming review period. This is important given the typically long payback periods and risky nature of investments of this type.

In our view, therefore, Ofcom should provide similar reassurance to non-Openreach investors that Ofcom's framework for charge controls will endure over an appropriate period of time and in a form that underpins the long-term viability of investing. Put simply, competitors should be assured the rug will not be pulled from under them once Openreach's rollout nears completion and instead the 'strategic shift' to incentivising investment for <u>all</u> providers will be sustained.

4. CONSULTATION QUESTION RESPONSES

Question 3.1: Do you agree with our approach to assessing the BT Commitment and proposals for pricing WLA services in Geographic Area 3?

Yes, we broadly support Ofcom's revised proposals. We continue to consider the 40/10 wholesale product to be the appropriate anchor for at least the forthcoming charge control period. We also welcome the changes Ofcom has made to more closely align its WLA service pricing remedies in Areas 2 and 3, in recognition of BT's commitment as well as feedback from stakeholders that competing Area 3 investment, to some degree, is likely.

Equally, we support Ofcom's proposal to implement proportionate and necessary restrictions on Openreach's ability to introduce geographically targeted discounts to its WLA services in Area 3, as we advocated in response to Ofcom's January consultation. Ofcom's revised proposals recognise competitive build will occur in Area 3 and Openreach should not have mechanisms in place to deter or punish this investment in a targeted way.

Question 4.1: Do you agree with our proposals for basket design and implementation of a forecast-RAB?

Virgin Media has no material comments on these proposals at this time.

Question 5.1: Do you agree with our proposals for reporting requirements?

Yes, we broadly support Ofcom's revised proposals on reporting requirements. We support the removal of various reporting requirements where these obligations as no longer relevant or necessary. Equally, we support the reporting requirements Ofcom proposes to retain as these will support Ofcom and other stakeholders in monitoring BT's commitments.