Review of the wholesale broadband access markets

Consultation on market definition, market power determinations and remedies

25 September 2013

Non-Confidential Version

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Introduction

EE Limited ("EE") notes that it is also responding to Ofcom's consultations in relation to the 2014 – 2017 fixed access market reviews ("FAMR") in addition to this response to Ofcom's consultation on the 2014-2017 Wholesale Broadband Access ("WBA") market review ("the WBA Consultation"). EE welcomes the opportunity to participate in this important consultation process, which will set the regulatory framework for the UK fixed telecommunications industry at a critical juncture in time during the transition towards meeting government and consumer demand for superfast services and infrastructure. EE requests that all of these responses are considered in a holistic manner, given the clear interaction between these different markets.

Those parts of this response marked with [✂] and highlighted in blue contain commercially sensitive confidential information, which should not be published without EE's prior written consent.

Policy context for the WBA review

In the past, infrastructure competition has been incentivised as a result of WBA wholesale costs being set at a comparatively high level in comparison to Local Loop Unbundling ("LLU") rental costs. This has resulted in the evolution of superfast broadband services, which through a combination of commercial and state-funded rollouts, will soon be available to 95% of the country.

EE's experience of retailing superfast fibre services over the last 12 months suggests that adoption will be significant, particularly in the Broadband Delivery UK ("BDUK") state-funded areas of Ofcom's proposed geographic Market A.

As per the analysis below, it can be seen that a price premium is generally attached to Asymmetric Digital Subscriber Line ("ADSL") standard broadband services ("SBB services") in today's Market 1. In addition these SBB services are heavily managed and limited to reduce the communications providers' exposure to BT's high bandwidth charges.

In Markets 2 and 3, SBB services are cheaper than in Market 1. However, a price premium over the Market 2/3 SBB prices is attached to fibre services in Market 2/3, reflecting the increased BT fibre rental charges over its SBB rental charges in Market 2/3. BT's fibre rental charges are the same in Market 1 as they are in Markets 2 and 3.[1]

This means that Market 1 customers have a choice: either to pay a premium price for a managed, constrained SBB service, or to pay the same (or similar) premium price for an unlimited, superfast fibre service.

		SBB	Fibre
EE	Market 1	£ 15 (20GB usage)	£15 (unlimited usage)
	Markets 2/3	£5 (unlimited usage)	£15 (unlimited usage)

[1] As BT has been the successful bidder for essentially all BDUK funded projects, EE expects BT to maintain consistent wholesale fibre pricing irrespective of whether its network roll-out is funded commercially or by BDUK.

Sky	Market 1	£17 (40GB usage)	£20 (unlimited usage)
	Markets 2/3	£7.50 (unlimited usage)	£20 (unlimited usage)

Prices shown are for broadband and weekend calls packages, exclusive of line rental and special offers. Source: Operator's websites, September 2013.

EE believes that the majority of Market 1 / Market A customers to whom this choice of broadband services and pricing is available will choose the fibre service. This is evidenced by a campaign run earlier in the year by EE, in which SBB customers in fibre-enabled areas were contacted and offered a fibre service at the price shown in the table above. In Market 1, [✂][✂]% of customers chose to upgrade to fibre:

Regrade offer	Conversion rate
Market 2/3 WBC to Fibre	[✂][✂]%
Market 2/3 low speed WBC to Fibre	[✂][✂]%
Market 1 to Fibre	[✂][✂]%

Source: EE campaign analysis, September 2013

EE therefore believes that the impact of fibre becoming available to a large proportion of current Market 1 premises during the charge control period will be highly significant, and must be considered in the definition of Market A. BDUK fibre will offer customers a choice of broadband providers[2], with pricing determined by the competitive market, and without the need for regulatory intervention. It is in conflict with Ofcom's obligations to ensure that regulation is "consistent and targeted only at cases in which action is needed"[3] for Ofcom to then regulate IPStream services in these same areas, when BT's SBB retail and wholesale prices will already be constrained by the market at or below the price levels for fibre services.

An important reason why Ofcom's regulatory principles involve a bias against intervention is the high risk of regulatory failure associated with any such intervention. Given the inherent difficulties in accurately and appropriately determining BT's costs of WBA supply in Market 1/A, there will always be a risk that such regulation may cause prices to be higher than would be the case if Ofcom refrained from intervention. Non-discrimination obligations also always contain the inherent risk that flexible pricing which may benefit consumers without harming competition will be prevented. These risks are especially high where there is a real prospect that fibre pricing by BT's competitors will drive down market pricing in the regulated areas. Whilst price caps and non-discrimination obligations may be expected to protect consumers from monopoly pricing in a true Significant Market Power ("SMP") situation, such restrictions are likely to involve inflexible pricing which creates *worse* outcomes

2 I.e. from the perspective of the number of principle operators ("POs"), open access to the BDUK funded fibre infrastructure changes the situation from being BT+0 or BT+1 to becoming BT+many.

3 Communications Act 2003, s 3(3).

for consumers when a market is competitive. Given that in any event Ofcom's proposed charge control is likely to result in price caps that are higher than BT's unregulated market driven pricing in Markets 2/3/B, EE considers that the current balance of risks of harming consumer interests are higher if Ofcom over-regulates in Market A than if it under-regulates. For these reasons EE considers that areas with BDUK-funded fibre should be included within Market B.

This then leaves Market A, composed of the 5% of premises that are in truly monopoly areas. That is to say, which are located in areas where the low population density and/or terrain mean that, even with the assistance of state aid funding, the roll-out of superfast fixed broadband infrastructure has not proven to be commercially viable. For the same reasons that fibre roll-out in these areas is not commercially viable, it is very likely that the economics of additional LLU roll-out in these areas will prove equally unattractive (at least within the time frame of the next WBA market review period). Accordingly, for the customers in these areas, to the extent that they have any choice of service provider other than BT Retail, it will only be using services delivered over BT Wholesale's IPStream service.

In these areas, EE therefore agrees with Ofcom's WBA Consultation proposals that the price of End User Access and bandwidth needs to be regulated by Ofcom (EE submits aggressively), in order to protect customers from monopoly price abuses by BT. In particular EE contends that:

- A shrinking IPStream customer base, using a shrinking IPStream infrastructure (due to BT's on-going WBC migration program) should result in static, or reduced, per end user access prices.
- There is room to significantly reduce the wholesale price of bandwidth in Market A, given the seemingly low cost of the upstream Openreach input products (and consistent with the Market 1 bandwidth costing information disclosed in BT's latest Regulatory Financial Statements ("RFS")). EE firmly believes that such price reductions would result in direct and tangible benefits to the quality of the offerings that retail providers can make to Market A customers.

The alternative of course would be for Ofcom to set no or a very loose charge control on WBA services in Market A, in the hope that high wholesale and retail prices would change the current economics and stimulate the roll-out of competing fixed infrastructure to BT's network. However given the high roll-out costs, very limited potential scale economies, and natural retail demand elasticities, this outcome would seem unlikely to occur. Accordingly, this approach is likely to create higher retail prices for the end-customers in these areas with no countervailing benefits.

Summary of key issues

- EE supports many of the proposals in the WBA Consultation. For the reasons set out in the WBA Consultation by Ofcom, EE agrees with the proposed simplification of the geographic markets to two; that geographic Market B should be regarded as being competitive with no remedies therefore imposed; and that a charge control and other SMP remedies should continue to be imposed in geographic Market A – which geographic market should be smaller in size than the current Market 1. Again for the reasons set out by Ofcom in the WBA Consultation, EE also agrees that the withdrawal of regulatory obligations in relation to current Market 1 exchanges that do not fall within Market A should be immediate.

- EE considers that the key failing in Ofcom's current analysis is the fact that its proposed geographic Market A includes a number of exchange areas in which BT is likely to face strong competition in the supply of WBA services over the BDUK funded fibre networks that will be rolled out so as to complete broadband coverage of 95% of UK premises by the end of the charge control period. EE considers it to be disproportionate and harmful to consumers for Ofcom to be proposing to apply SMP remedies in geographic areas where open access BDUK funded infrastructure will effectively remove any current barriers to competitive entry. Instead, EE believes that Market A should be defined to cover only those 5% of premises in which BT will truly face no current or likely competition.
- Whilst the impact may not be significant, applying Ofcom's important regulatory principle of ensuring all regulatory action is targeted only at situations in which action is needed[4], EE believes that a number of other adjustments should be made to Ofcom's geographic market definitions, as follows:
  - EE considers that Vodafone should continue to be regarded as a Principal Operator ("PO")[5]
  - EE considers that the threshold for considering whether or not Virgin Media is present at an exchange should be reduced from 65% to 40%[6]
  - EE considers that Ofcom should reconsider whether any exchanges should be removed from Market A based on rollout and committed roll-out as at 31 December 2014. EE considers that this approach will ensure that Ofcom's SMP remedies remain proportionate throughout the market review period, at the same time as still providing an appropriate degree of regulatory certainty. EE would not envisage this requiring Ofcom to update its proposed charge control pricing, although it would be open for Ofcom to do this if the change was very material[7].
  - EE believes that Ofcom should continue to distinguish between BT only and BT+1 exchanges. Given the short space of time in which there has been a second PO in the majority of BT+1 exchanges, EE considers that it is too early for Ofcom to conclude that there are any material barriers to competitive service share expansion in these exchanges. In larger[8] BT+1 exchanges, EE considers that Ofcom should also have regard to the potential for further competitive entry.

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4 See Communications Act 2003 section 3(3) and Ofcom's regulatory principles at http://www.ofcom.org.uk/about/what-is-ofcom/statutory-duties-and-regulatory-principles/

5 See further EE's response to Consultation question 4.2.

6 See further EE's response to Consultation question 4.1.

7 In such a case, there is likely to be a material change in circumstances that would suggest that Ofcom should in any event revisit the terms of the charge control, even if the definition of Market A was defined in a static fashion – hence EE's proposal would cause no greater degree of regulatory uncertainty or burden.

8 EE notes BT's suggestion that the demarcation line should be set depending on whether an exchange serves 3,000 premises or more. EE supports this proposal.

EE believes that at least the latter sub-set of BT+1 exchanges if not all BT+1 exchanges should be considered prospectively competitive and removed from Market A.

- EE has the following main comments in relation to the proposed Market A charge control:
  - EE believes that an explicit SMP obligation should be imposed on BT to supply at least an equivalent product to IPstream at the charge controlled IPstream price in any Market A exchange in which BT has withdrawn its IPstream products. To prevent gaming by BT, EE also considers that BT's WBC pricing should be regulated in Market A when it is supplied in conjunction with IPstream services;
  - EE believes that the volume forecasts in Ofcom's cost model for the WBA charge control are far too low, as a result of Market A being defined too widely, to include exchanges where material competition over BDUK fibre is likely (hence volume forecasts for the Market A exchanges being artificially depressed).[9]
  - EE does not consider that Ofcom should depart from the current approach and approach under BT's RFS of allocating 100% of DSLAM costs to end-user rental costs. EE is concerned that allocating 25% of these costs to bandwidth costs is unwarranted given falling forecast IPStream end user volumes (hence bandwidth usage) in Market A, and will distort prices to the detriment of BT's retail competitors.
  - Whilst EE accepts that there will be one-off annual fluctuations that need to be disregarded, EE remains of the view that Ofcom has set the efficiency targets for the WBA charge control too low, based on the very materially larger efficiency savings that appear to have been achieved historically by BT.
- EE supports Ofcom's other SMP remedy proposals, except for the following:
  - EE considers that Ofcom should align the notification periods to be given in relation to price changes for WBA services to those proposed to be required in relation to LLU services. In particular, EE considers that BT should be required to give 90 days notice of any WBA price increases. Otherwise, EE considers that the two sets of SMP conditions will unduly discriminate against providers who consume WBA services rather than purchasing LLU directly, in violation of Ofcom's obligations under the Communications Act.
  - EE does not consider that there is any justification for the removal of the current transparency obligation requiring BT to include information relating to network components and usage factors. EE is worried that doing this will cause competitive harm to WBA customers such as EE, by increasing BT's already significant bargaining power vis a vis such customers.

[9] This contrasts with Ofcom's proposals at §7.114 to include these exchanges in Market A, but to exclude fibre customers in its volume forecasts. It is EE's understanding that this approach increases the prices payable by the remaining customers forecast to be served by these exchanges, as BT is still allowed to recover the full amount of BT's fixed costs and common costs, but over an artificially depressed number of customers.

- EE disagrees with Ofcom's proposal not to impose a general remedy of cost orientation in the WBA market. Given the wide discretion that will be given to BT to set prices within the proposed basket charge control, and given the evidence of very significant cost savings achieved by BT in 2011-2012 under the ceilings set by the current charge control, EE considers that this remedy (together with the associated public reporting obligations) is both important and proportionate.

Response to WBA Consultation Questions

Question 3.1: Do you agree with Ofcom's proposed product market definitions? If not, please explain why.

EE is broadly in agreement with Ofcom's proposed product market definitions as set out in Section 3 of the WBA Consultation. In particular EE notes that it agrees that it is appropriate to include supply via Virtual Unbundled Local Access ("VULA"), LLU and cable in the wholesale market.

Question 4.1: Do you agree with Ofcom's view of the relevant criteria for assessing the geographic market boundaries? If not, please explain why.

Not entirely. Ofcom states at §4.45 of the WBA Consultation that it considers three criteria for assessing the geographic market boundaries:

- The number of operators present at the exchange that exert a material competitive constraint;
- Service shares at the exchange;
- The likelihood of further entry in the exchange.

EE has some concerns with these criteria, as follows.

The number of operators present at the exchange that exert a material competitive constraint

EE is concerned that Ofcom's analysis does not include the actual or potential competitive constraint likely to be exercised by **fibre based operators** during the course of the market review period (§4.48).

EE agrees with Ofcom that fibre rollout in exchanges already considered to be competitive (i.e. in Market B) is unlikely to significantly affect Ofcom's analysis of competitive conditions in Market B (§4.48).

However, EE considers that fibre based competition using upstream remedies and commercial access arrangements over networks rolled out using BDUK funding is likely to be highly relevant to the competitive constraint faced by BT in many **Market A** exchanges during the market review period[10]. In particular, EE notes Ofcom's estimate that within the first year of the market review over ¼ of Market A premises are likely to be covered by BDUK funded fibre networks, rising to up to ¾ of those premises by the end of 2017 (Table A12.8). These estimates are too large for Ofcom to simply ignore. The open access rules of

[10] Ofcom notes the relevance of this in the WBA Consultation – see §4.5; §4.32; §5.14; §5.28; §5.52.

the state aid funding to which the BDUK infrastructure is subject (§5.53) effectively remove any material entry barriers to competitive service provision over this infrastructure – i.e. the situation moves from being BT+0 or BT+1 to being BT+many.

Unless Ofcom's analysis factors in the clear competitive constraint on BT's SMP that the rollout of the BDUK infrastructure represents, EE considers that Ofcom's proposed Market A market definition and SMP remedies will fail to meet the statutory requirements of objective justification, non-discrimination and proportionality. Even more importantly, for the reasons set out at the beginning of this response, even though EE understands that Ofcom has consumer best interests at heart, EE considers that Ofcom will create a real risk of causing consumer harm as a result of regulatory failure.

EE accepts that fibre network topology is different to that of the current generation access ("CGA") network (§4.30; §5.29; §5.54). However Virgin's cable network topology is also different to that of the CGA network, and Ofcom has developed a methodology to deal with these differences without an apparent undue degree of difficulty[11]. EE considers that it is clearly both possible and necessary for Ofcom to consider the planned roll-out of BDUK funded networks, and to estimate the percentage of premises in each Market A exchange likely to be covered by this roll-out so as to arrive at an assessment of those Market A exchanges in which BDUK funded fibre is likely to facilitate material additional competitive entry.

EE does not accept Ofcom's suggestion that the roll-out locations for BDUK funded fibre are too uncertain for Ofcom to take into consideration (§4.32). Whilst some of the information may still be confidential to BT, the locations and timing for roll-out for many BDUK funded initiatives have already been determined. For example, EE notes that BT currently publishes a table mapping UK postcodes to cabinets that will be enabled for fibre, including details of the proposed BDUK rollouts, which is generally updated monthly by BT[12].

Indeed, Ofcom has already prepared detailed fibre volume forecast estimates in Annex 12 of the Consultation, directly contradicting Ofcom's assertions at §5.55 that the timing and location of fibre roll-out is too uncertain for Ofcom to predict. The competitive impact of all such BDUK projects must be factored into Ofcom's analysis. It is highly inappropriate for Ofcom to only propose to take the impact of this BDUK funded competition into account in setting the regulated price for Market A pricing but not in determining whether or not there is likely to be effective competition in any of the relevant Market A exchanges.

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11 EE also notes that this technology neutral approach is recommended in the ERG "Common Position on Geographic Aspects of Market Analysis (definition and remedies)" published in October 2008 (the "ERG Geographic Common Position"), which states that the geographic units chosen should ensure that "*the network structure of **all relevant operators and the services sold on the market** can be mapped onto the geographic units*" (pp.3, 11, emphasis added)

12 See https://www.btwholesale.com/pages/sc/downloads/broadband/Community/Broadband_Community/21CN_Broadband_Availability/PCP_Mapping_Report_August_2013_incl_BDUK.zip

EE appreciates that Ofcom's volume forecast analysis is not currently done on an exchange by exchange basis. However, increasing BDUK coverage information is becoming available from councils as well as BT[13] and EE expects that it should be possible for Ofcom to make reasonable exchange by exchange estimates, e.g. using its volume forecast averages in the absence of other specific available coverage information.

Wherever this analysis indicates that a material percentage[14] of premises within Market A exchange will be able to be served by BDUK funded fibre, then EE considers that the **exchange should be regarded as prospectively competitive and moved to Market B**.

In this manner, Ofcom will be able to ensure that its Market A SMP conditions are truly only targeted at geographic areas where regulatory intervention is necessary to ameliorate the effects of competitive market failure – which EE would expect to be in the area covering the circa 5% of the UK which will not be covered by either commercial roll-out or BDUK funded roll-out by the end of 2017.

Service shares at the exchange

EE is concerned that, by only measuring the service shares of POs which have installed physical infrastructure at an exchange, Ofcom is omitting to include fibre based competition which can be provided by the POs and other actual or potential competitors to BT using fibre based equipment located *elsewhere* (§4.30). EE's proposed solution for dealing with this deficiency in Ofcom's approach is set out above.

EE also agrees with BT that the 65% threshold set by Ofcom for determining whether Virgin is a PO at an exchange has been set too high. EE believes that this threshold should be set at coverage of circa 40% of premises in an exchange. Even if it is accepted that Virgin is unlikely to materially expand its network rollout in Market A (§4.40), there will by definition be only two or less other POs at any Market A exchange. This should comfortably allow Virgin to achieve service shares of circa 13.5% or above (i.e. 1/3 of the premises it covers), which is in line with the national service shares of the other POs as set out in Table 4.1 of the WBA Consultation. EE accepts that changing this threshold may not have a large impact on the proposed definitions of Market A and Market B (§4.41). However, to the extent that setting this threshold at a more reasonable level causes Ofcom to refrain from inappropriately regulating the supply of WBA services at *any* exchange, EE considers that this is necessary to ensure that Ofcom's SMP remedies comply with Ofcom's obligations under the Act to ensure that SMP conditions are in all cases both

13 See for example the coverage maps published by Northumberland council and Buckinghamshire and Hertfordshire councils: http://www.connectedcounties.org/stateaidconsult/; http://www.northamptonshire.gov.uk/en/councilservices/environ/economic/pages/superfast-broadband.aspx

14 EE suggests that this should be set at somewhere around **40%** of premises covered by 2017, the same percentage of coverage that EE recommends for determining that Virgin is a PO at an exchange (see further details in the response to this question below).

objectively justifiable and proportionate and that the risk of regulatory failure as a result of over-regulation is avoided.

The likelihood of further entry in the exchange

In essence, Ofcom's analysis appears to assume that further entry into an exchange during the course of the market review period is only likely if two or more POs (in addition to BT) have placed a firm order with BT to install LLU infrastructure at the exchange as at a cut-off date shortly before the making of Ofcom's final statement (§4.107) (which we assume will be some time towards the end of 2013). EE has three major concerns with this approach:

- It creates a high risk of inappropriate over-regulation by Ofcom, and hence of regulatory failure which will harm consumers. EE notes that this is a real rather than purely theoretical risk. By way of example, EE notes that very shortly before Ofcom's last WBA statement was due to be published, TalkTalk released its interim results, committing to a strategy of unbundling, and announcing 700 new exchanges. Ofcom discuss this within the statement, but was unwilling to change the WBA market definition as the actual exchanges TalkTalk planned to unbundle were uncommitted[15]. As it transpires, although these exchanges were "uncommitted" according to Ofcom's definitions, 700 were indeed rolled-out between Oct 2010 and Mar 2013.[16]
- It pays inadequate regard to the *size* of Market A exchanges.
- It does not factor in competition from non-LLU based communications providers ("CPs") – e.g. those using BDUK funded fibre networks to provide broadband services.

In relation to the first concern, EE accepts that having a definition of Market A which is constantly updated to remove an exchange as soon as a committed LLU order is placed with BT by a third PO may be administratively burdensome to implement, and create potential undesirable regulatory uncertainty. Without this – i.e. assuming that the likelihood of future entry will be assessed at one or more pre-specified static points in time – EE also accepts that there will be some potential left for gaming.

However, like both BT and TalkTalk, EE believes that more should be done by Ofcom to strike the right balance between these concerns and the objective of ensuring that Ofcom's regulations will remain proportionate *throughout* the market review period. By way of just one suggestion, EE recommends that the definition of Market A is updated for the 2nd and 3rd years of the SMP conditions imposed on BT so as to **<u>remove exchanges from Market A based on roll-out and committed roll-out measured as at 31 December 2014</u>**.

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15 Specifically, Ofcom stated that "*On 16 November 2010 Talk Talk announced plans to unbundle a further 700 exchanges. However, Talk Talk is still in the process of assessing these plans and has not provided us with a list of these 700 exchanges. We have not updated the data below with the information provided to us by Talk Talk even though it may be considered at this stage to be similar to the "Uncommitted" plans previously provided. We do not believe this has a material impact because we do not take account of these uncommitted plans in our assessment of the presence of POs by exchange*". See - Review of the wholesale broadband access markets, Statement, December 2010, §§A3.6 – 3.8

16 TTG unbundled exchanges: Oct 2010 – 2003 exchanges, Mar 2013 – 2724 exchanges.

EE believes that this approach would materially reduce the risk of inadvertent overregulation. There will of course potentially be some firm orders submitted only after the proposed secondary 31 December 2014 date. However the additional 9 month period will at least allow Ofcom to capture orders that are placed only a few days or weeks after the first cut-off date. EE considers that this is important to ensure that Ofcom's regulations remain proportionate in the 2nd and 3rd years of the SMP conditions and that regulation is targeted only at cases where it is needed. We note in this regard that EE's proposal is similar to TalkTalk's suggestion that Ofcom should consider all internally identified roll-out to be undertaken within 12 months after Ofcom's cut-off date (§4.65), except that EE's proposal also deals with Ofcom's concerns that operators may not enter all exchanges initially planned (§4.66 to §4.67).

EE also believes that this arrangement would meet requirements for regulatory certainty, stability and clarity. The relevant date for the update to the definition of Market A would be known well in advance by the industry. The proposed timing should also enable Ofcom to give CPs at least 60 days notice of the changes to the definition before it comes into effect (which is not a materially different period of notice to that which will be given to them in relation to the starting definition of Market A to apply as from 1 April 2014 (cf Ofcom's views at §4.109)). Lastly, regulatory certainty would be encouraged and administrative burden minimised due to the limited focus on the potential removal of small percentage of exchanges from Market A, rather than a complete re-assessment of the relevant market definitions and exchange designations, which would continue to be done only once every 3 years.

EE disagrees with Ofcom's concerns that adopting such an approach would require Ofcom to revise the SMP conditions that Ofcom proposes to issue at the start of the 2014 to 2017 market review period and/or conduct a new market review (§4.109). Currently, "Market A" is proposed to be defined as "the area covered by the BT exchanges set out at Appendix 1 to Schedule 1 of this Notification". EE does not see why this definition could not be amended to state along the following lines:

"the area covered by:

(i) For the first year of the SMP conditions, the BT exchanges set out at Appendix 1 to Schedule 1 of this Notification; and

(ii) For the second and third years of the SMP conditions, the BT exchanges set out in the revised version of Appendix 1 to Schedule 1 of this Notification to be published by Ofcom on [31 January 2015] in accordance with the process described in [paragraphs xx to xx of the WBA Statement]"

EE does not consider that this amendment would be likely to cause Ofcom to need to revisit the level of the charge control in Market A, unless there was a very material reduction in the number of Market A exchanges. In such a case, there is likely to be a material change in circumstances that would suggest that Ofcom should in any event revisit the terms of the charge control, even if the definition of Market A was defined in a static fashion – hence EE's proposal would cause no greater degree of regulatory uncertainty or burden.

EE also considers that this approach would be consistent with the ERG Geographic Common Position (§4.110), as Ofcom would be clearly specifying in advance the basis on which Ofcom would segment exchanges into the two separate geographic markets (i.e. "*clear and unambiguous criteria according to which the geographic units are grouped*" as recommended by the ERG)[17], as well as the two specific points in time at which Ofcom would assess the degree of actual and committed PO presence at the exchanges, and this approach would remain unchanged for the duration of the market review period.

In relation to the second concern, in line with EE's response to Ofcom's WBA Call for Inputs, EE remains of the view that the size of Market A exchanges and the coverage of the exchange footprint by one other PO are highly relevant to the question of the likelihood of further entry. In this respect, EE supports BT's submissions that a BT+1 exchange should be regarded as prospectively competitive and thus designated as being in Market B if the exchange covers 3,000 premises or more (§4.93).

In relation to the third concern regarding Ofcom's analysis giving inadequate weight to the fibre based competition which will inevitably emerge during the market review period, EE repeats its comments above.

Question 4.2: Do you agree with Ofcom's proposed set of Principal Operators (POs)? If not, please explain why.

No. EE agrees with Ofcom that the defining feature of a Principal Operator (PO) should be whether or not that operator is likely to exert a substantial competitive constraint on other operators (§4.53). EE further agrees that Ofcom's analysis of this question should be done on a forward looking basis over the full period covered by the market review (§4.54). In this respect EE agrees with Ofcom's designation of BT, Sky, TalkTalk and Virgin Media as well as O2 as a PO.

However, EE disagrees with Ofcom's proposed exclusion of Vodafone as a PO. Like O2 before the acquisition of its fixed business by Sky, Vodafone is a large vertically integrated company, present in several telecommunications markets where it is a well-established player (§4.58). Vodafone has rolled out LLU infrastructure in exchanges covering 60% of the UK, covering more area than the accepted PO Virgin Media and a very similar percentage to the accepted previous PO O2. In the absence of any barriers to expansion of Vodafone's service share in the areas in which it has rolled out its network, EE considers that Vodafone's presence at those exchanges represents a material competitive constraint on price rises by the other operators serving those exchanges, notwithstanding that Vodafone's present service share may be lower than 10% and notwithstanding the absence of any current intention by Vodafone to significantly expand its retail broadband operations based on the current market pricing of the operators at those exchanges (cf §4.59). To the extent that classifying Vodafone as a PO would cause Ofcom to refrain from inappropriately regulating the supply of WBA services at even one exchange currently classified as falling within Market A (see §101), then EE considers that this is necessary to ensure that Ofcom's overall set of SMP conditions are

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[17] See ERG Geographic Common Position, p. 16.

objectively justifiable and proportionate, in compliance with Ofcom's legal obligations.

Question 4.3: Do you agree with Ofcom's geographic market definitions? If not, please explain why.

With one exception, EE agrees with Ofcom's new Market A and Market B geographic market definitions. The exception is that EE considers that Ofcom should continue to distinguish between BT-only and BT+1PO exchanges.

Whilst BT's service share in BT+1 exchanges may currently be high, EE considers that the statistics in Figure 4.7 of the Consultation, which show that in only 10% of these exchanges has the additional PO been established for a period of 3 years or more and that in over 70% of these exchanges competitive entry has only been in place for a year or less, make it clear that it is far too early for Ofcom to conclude that there are any material barriers to competitive service share expansion in these exchanges which would bring BT's service share down to below an SMP level.

In relation to BT+2 exchanges, Ofcom has given regard to the fact that after both PO entrants have been active for a period of 4 or more years, BT's service share falls to an average non-dominant level of between 30 to 40%. Ofcom has, EE considers rightly, thus placed less reliance on the fact that after only a period of 2 years BT's service share in these exchanges is on average around the higher 50 to 60% level (see §§4.79-4.81, Figure 4.5). EE considers that Ofcom's focus on levels of competition in BT+1 exchanges after only 2 to 3 years[18] (§4.88; §4.94; §4.104) is inconsistent with Ofcom's approach for BT+2 exchanges. Given Ofcom's definition of a PO, EE considers that Ofcom's comments about POs at BT+2 exchanges being large vertically integrated companies with highly developed sales networks representing a significant competitive force (§4.81) are equally valid in relation to POs at BT+1 exchanges.

Prima facie, EE remains of the view that Ofcom is wrong to conclude that BT is inherently likely to be able to enjoy a position of SMP in all BT+1 exchanges for the duration of the 2014 to 2017 market review period. Were BT to seek to increase its prices in those exchanges, EE believes that the PO present at the exchange would have both the ability and the incentive to take service share from BT, thus constraining BT's conduct. EE remains of the view that this is true both at the retail and wholesale levels.[19]

Furthermore, EE believes that Ofcom should have regard to the fact that in certain BT+1 exchanges, BT is likely to face additional competitive constraints from potential future entry by means of:

18 EE also notes that this category of BT=1 exchanges may be statistically unreliable, as it only represents 10% or less of such exchanges (see Figure 4.7)

19 EE considers that Ofcom's concerns regarding barriers to wholesale switching (§4.97) are disproven by recent switches by BT Wholesale customers to alternative providers – e.g. by the Post Office to TalkTalk and as a result of Sky's acquisition of O2's broadband customer base, moving these customers onto Sky's own LLU network.

- Fibre based competitors in all BT+1 exchanges with premises served by BDUK funded fibre (noted by Ofcom but wrongly discounted at §4.92 and §§5.52-5.55); and
- Additional LLU entry in those exchanges large enough to support this – namely as BT has suggested, all of those BT+1 exchanges that serve 3,000 or more premises (§4.93, cf Ofcom's inappropriately generic comments about the economies of scale and density available at Market A exchanges at §5.34).

At a minimum therefore, EE considers that all BT+1 exchanges meeting the above additional criteria, if not all BT+1 exchanges, should be designated as falling within competitive Market B.

The only other comment EE has on Ofcom's proposed geographic market definitions is in relation to Ofcom's proposed treatment of the 29 exchanges which currently do not have any active broadband connections (§4.106). To the extent that these exchanges are covered by Virgin Media; that any PO other than BT has installed or committed to install LLU infrastructure at these exchanges and/or to the extent that these exchanges are likely to be covered by BDUK funded fibre during the course of the market review period, then EE considers that these exchanges should be treated in exactly the same fashion as exchanges which currently do have active broadband connections.

Question 4.4: Do you agree with Ofcom's proposals to update the geographic market boundaries? If not, please explain why.

Subject to the comments above in response to Questions 4.1 to 4.3, yes.

Question 5.1: Do you agree with Ofcom's proposal that BT holds SMP in Market A? If not, please explain why.

Yes, subject to the comments above in response to Questions 4.1 to 4.3 in relation to:

- The removal from Market A of certain exchanges which are, or are likely to become, effectively competitive during the market review period to 2017; and
- The ongoing reservations that EE has in relation to Ofcom's conclusions on countervailing buyer power (see footnote [12] above).

Question 5.2: Do you agree with Ofcom's proposal that no operator has SMP in Market B? If not, please explain why.

Yes. EE welcomes this proposal from Ofcom, which is in line with EE's response to Ofcom's WBA Call for Inputs.

Question 5.3: Do you agree with Ofcom's proposal that KCOM holds SMP in the Hull Area? If not, please explain why.

EE has no comments on this question at this stage.

Question 6.1: Do you agree with the general access, non-discrimination and transparency obligations we propose to impose on BT in relation to the market for WBA in Market A? If not, please explain why.

Subject to the following comments, yes:

a) EE disagrees with the reasoning given by Ofcom for proposing to disregard the recommendation BP28 in the BEREC Common Position on WBA, advising national regulatory authorities ("NRAs") to impose SMP obligations in order to ensure speedy and efficient wholesale switching processes:

- The fact that "*switching between wholesale suppliers has so far not been significant in the UK*" (§6.117) should not be regarded as any justification for inaction by Ofcom. It is precisely *because* of inappropriately high barriers to switching that low levels of wholesale switching away from the SMP operator may be seen in a market.
- EE takes objection to Ofcom's suggestion that switching in Market A and Hull is unimportant because these geographic markets together only represent a small proportion of premises (§6.117). Clearly having the ability to switch to one or more competing providers of broadband services is an important benefit to all UK consumers, regardless of where in the UK they happen to be located. In Market A and Hull where BT and KCOM continue to dominate the markets, it is *especially important* for Ofcom to ensure that there are no inappropriately or artificially high barriers to switching by wholesale WBA customers, so as to create the maximum possibility for competitive pressure to reduce BT and KCOM's SMP in these markets and thus maximise consumer choice.

b) EE is concerned about Ofcom's proposal at §6.144 to remove the current transparency obligation requiring BT to include information relating to network components and usage factors. EE is worried that this may make it difficult for WBA customers to distinguish between the two types of WBA ancillary charges referred to at §7.68 of the Consultation (those passed through directly and those subject to a mark-up above Openreach charges), given the different regulatory approach adopted by Ofcom in these two cases. Generally EE does not consider that anything has changed to make this information any less important to assist CPs in monitoring for potential anti-competitive behaviour and providing transparency than Ofcom determined in the last market review.

c) EE considers that Ofcom should adopt a consistent position in relation to BT's obligation to notify changes to its WBA terms and conditions in Market A to the approach Ofcom is proposing under its concurrent Fixed Access Market Reviews. Specifically, EE considers that, instead of only requiring BT to give 28 day's notice of such changes in all cases (§6.156), this should only be the case where BT is notifying new terms and conditions or a price decrease. Where BT is proposing to **increase** its WBA charges, EE considers that competitors to BT who rely on these WBA input products should be given 90 day's notice of the proposed increase. EE considers that this requirement is equally important, fair and proportionate as it is in relation to the supply WLA and WFAEL services –

where Ofcom is proposing to continue to require BT to give 90 day's notice[20]. EE also considers that this consistent approach is important to ensure that communications providers which consume BT's regulated WBA services in Market A are not discriminated against by Ofcom's SMP conditions as compared to those communications providers which consume BT regulated upstream WLA services in Market A, in compliance with Ofcom's legal obligations under the Act. EE considers that this is likely to be quite important to communications providers reliant on BT's WBA services in the next market review period, as the charge controls currently proposed by Ofcom make it quite likely that these communications providers will see price increases for some WBA services, which they will need to try to recover through their retail pricing.

d) In relation to Ofcom's proposed SMP obligations regarding transparency as to quality of service (§§6.170 to 6.181), EE recommends that Ofcom revisits its conclusions once the quality of service regime under Ofcom's Fixed Access Market Review has been settled, so as to ensure consistency of approach where appropriate.

e) EE disagrees with Ofcom's proposal not to impose a general remedy of cost-orientation. EE's comments on this issue are set out below in response to Question 7.18.

Question 6.2: Do you agree with our proposal not to require a period of notice for the withdrawal of existing regulatory obligations in respect of the exchanges that move from Market 1 or Market 2 (which are currently subject to regulation) to Market B (which we are proposing not to be subject to regulation)? If not, please explain why.

Yes, EE is very supportive of this proposal. EE does not believe that there is any justification which would make it necessary or proportionate for Ofcom to continue to imposing SMP regulation in relation to the exchanges to be moved to Market B beyond the beginning of the new market review period on 1 April 2014.

Question 6.3: Do you agree with the general access and non-discrimination remedies Ofcom proposes to impose on KCOM in relation to the market for WBA in the Hull Area? If not, please explain why.

EE has no comments on this question at this stage.

Question 6.4: Do you agree with Ofcom's approach to price remedies in the Hull Area? If not, please explain why.

EE has no comments on this question at this stage.

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20 EE notes that BT is currently subject to only a 28 day notification requirement in the WBA market. In the context of a first time charge control during which prices may generally expected to come *down* over the charge control period, this is not such a concern. However based on the X values on which Ofcom is currently consulting price *increases* under the 2014-2017 charge control are a very real possibility, increasing the importance of allowing operators adequate time to adjust their retail pricing so as to be able to cover the increased input costs.

Question 6.5: Are there other remedies that, if imposed by Ofcom, would promote entry into the market in the Hull Area by other providers?

EE has no comments on this question at this stage.

Question 7.1: Do you agree that an Inflation-X type of control is the appropriate form of charge control?

Yes. Ofcom has previously applied an inflation minus X type of charge control in the WBA market and also applies this approach in the upstream WLA market. EE is supportive of this established approach.

The only reservation that EE has with the proposed reliance on an inflation-X charge control is where this approach may cause a margin squeeze situation in Market A. As Ofcom notes in the Consultation, BT's main retail offering is currently priced nationally (§4.22). Under Ofcom's proposed CPI-X charge control for WBA services in Market A, there is still a wide range of X values under consideration (§7.5). Many of the X values under consideration would see relevant WBA wholesale prices in Market A rise above their current levels, and even above CPI. If there is no corresponding increase in the prices of the retail broadband services supplied by BT in Market A, this situation may make it impossible for any other retail broadband provider consuming WBA input products to compete in Market A – which would seem to defeat the purpose of Ofcom's SMP price control regulation in that market.

In order to avoid this risk, EE considers that it may be prudent for Ofcom to introduce a "safety-net" retail-minus price cap, which would only apply in the event that the margin between BT's retail pricing in Market A and the CPI-X price cap was too small to allow WBA based competitors to compete with BT Retail in Market A. This approach would be consistent with the BEREC recommendations in BP42 and BP43 regarding protection against margin squeezes in the WBA market referred to at §7.165 of the Consultation.

Question 7.2: Do you agree that CPI is the most appropriate inflation index?

In terms of the choice between using RPI or CPI for setting the charge controls, EE agrees with Ofcom's proposed criteria in paragraph A12.93 of the WBA Consultation with one important caveat. EE does not have firm views on which index is more appropriate, but considers that it is vitally important that Ofcom ensures its decision is consistent across the whole of the charge control (and indeed between charge controls).

In terms of the criteria used to make the choice of index, Ofcom's second criterion is cost causation, expressed as the extent to which the regulated firm's costs move with the index in question. At the very least, EE considers that this should consider the extent to which the industry's costs move with the index in question. As noted in paragraph A12.84 of the WBA Consultation, the purpose of using an inflation index in setting charge controls is "to protect the regulated firm and customers from forecast error" (emphasis added). Therefore Ofcom's focus only on the extent to which each price index reflects inflationary changes in the cost base of only the regulated company is misplaced.

Further, EE considers this is better expressed differently. The purpose of using an inflation index is to ensure that the relative "tightness" of the charge control remains constant in real terms and that wider inflationary changes do not make an individual charge control more or less tight solely because of changes in the value of money. As such, the price index used should reflect the wider value of money (i.e. a general industry wide price index) rather than specifically the costs of individual regulated companies or customers.

Under either expression of this criterion, potentially both the CPI and RPI are valid indices. EE's understands Ofcom's reasons for proposing a move from RPI to CPI, given the emerging view that CPI provides a more robust measure of inflationary pressures on the wider economy. The only concern about such a move is one of consistency. EE considers that if such a change is deemed necessary it should be expressed as a wider policy intention which would apply across all of the price controls in the electronic communications sector. It is important that different indices do not create any opportunities for arbitrage or competitive distortions. Further, as noted above in the discussion relating to the valuation of post-1997 duct assets, it is important that no distortions are introduced as between inflation factors applied to costs compared to those applied to charges. EE therefore urges Ofcom to include in its assessment the need to ensure that no such distortions arise (and set out in its reasoning for a move to CPI why this is the case).

Question 7.3: Do you agree that an upstream input CPI-X approach still remains the most appropriate form of control?

Yes.

Question 7.4: Do you agree that a charge control duration of three years is appropriate?

Yes.

Question 7.5: Do you agree that IPstream Connect and the relevant ancillary services are the appropriate services to charge control?

No. EE remains of the view, as expressed in response to Ofcom's WBA Call for Inputs, that Ofcom's charge control regulation in Market A should be technology neutral and capture *all* WBA products offered by BT in Market A.

Whilst it may be correct that IPstream Connect is *currently* the most widely used product in Market A, Ofcom cannot ignore its own analysis as set out in Annex 12 as to the likely changes to this situation over the course of the charge control period. [✂] [✂]

In this respect, EE welcomes Ofcom's clarification that, where BT withdraws IPstream Connect Max ad Max Premium from a Market A exchange, Ofcom will require BT to provide an equivalent (or better) product to IPstream at a price that complies with the IPstream charge control (§7.64). BT has made it clear that it plans to progressively withdraw its IPstream services and EE considers that it is therefore very likely that WBA customers will need to rely on this regulatory protection. EE is concerned however that this obligation does not currently appear to be reflected in the draft legal instruments in Annex 6 to the WBA Consultation. In the interests of legal certainty for all concerned stakeholders, EE would expect to see this legal obligation clearly reflected in BT's SMP conditions.

EE also remains of the view that Ofcom should regulate the price of BT's WBC and WBC FTTx services in Market A even when these services are provided in conjunction with BT's slower speed IPstream Connect services. An important reason for this is that if the obligation only applies if/when BT removes the supply of IPstream Connect services at an exchange, this will create clear gaming incentives for BT to leave this service in place merely to avoid regulation of its WBC and WBC FTTX services. Fundamentally, EE remains concerned that the large speed difference between IPstream and WBC FTTx services severely restricts the indirect regulatory constraint represented by a charge control on the much slower IPstream Connect services. This leaves only the bare minimum protection of an obligation for BT to offer fair and reasonable terms and conditions (§7.64). For the same reasons set out by Ofcom at §§7.156 to 7.162 of the WBA Consultation, EE considers that this level of regulatory protection is inadequate to promote competition and the best interests of consumers.

Question 7.6: Do you agree that all the services should be placed in one single basket and sub-caps applied to certain services?

EE has no major concerns with Ofcom's proposals to place all of the services in a single basket, provided that the sub-caps are set at the appropriate level to prevent BT from being able to distort competition and/or extract excess profits (e.g. through gaming using prior year weightings).

Question 7.7: Do you agree that the cease charge should continue to be set to £0 and excluded from the main basket?

Yes, for the reasons set out by Ofcom at §§7.91 to 7.93.

Question 7.8: Do you agree with our adjustments to BT's base year costs?

Not entirely. EE has the following comments regarding Ofcom's proposed adjustments to BT's base year costs:

- EE understands the principles behind Ofcom's proposals to adjust BT's levels of mean capital employed and depreciation charges so that these reflect levels that would be seen in a hypothetical ongoing network ("HON") (§A11.11). However EE agrees with Ofcom's concerns expressed at §A11.16 that in so doing, Ofcom should be careful that the upflifted costs of a HON assumed by Ofcom in its model are as realistic as possible a reflection of the actual ongoing costs of running such a network. As Ofcom notes, the figures are showing that BT would be able to run such a hypothetical network at a significantly lower cost than previously assumed. It is reasonable to assume that such a "steady state" network would have significantly longer asset lives than are seen in practice (and than are assumed in BT's accounting treatment). This is because a significant proportion of asset depreciation can be considered as arising from technological obsolescence which drives a need to update individual network elements to introduce new technologies. However, this real world driver of asset lives is essentially assumed away when considering a HON and Ofcom should therefore assume that such a network would be cheaper to run.

- As noted above, EE's other major concern with Ofcom's proposed HON adjustments is the apparent *lack* of any adjustment proposed by Ofcom to the forecast level of fixed and common costs (i.e. costs which are not purely incremental) to reflect Ofcom's forecast loss of volumes to fibre based services. EE considers that this approach is inconsistent with how an efficient owner of an HON should behave – e.g. EE would expect BT to be able to reduce some labour and equipment costs at an exchange serving materially less customers in the timeframes relevant to a charge control period, and at some point it may become economically rational to close an exchange[21].
- EE strongly agrees that it would be inconsistent with Ofcom's anchor product pricing approach to allocate any costs associated with stranded assets or 21CN transitional costs (§A11.22). Generally EE considers that Ofcom should exercise great care before making any adjustments for restatements, given the high risks of inconsistent / inappropriate cost allocation.
- EE considers that Ofcom's proposed change in approach from the current charge control so as to allocate 25% of DSLAM costs to bandwidth (§§A11.25-28) is inappropriate and liable to cause unintended pricing distortions. Ofcom appears to suggest at §A11.28 that this allocation does not have a material impact, given that it does not change the overall level of base costs (merely their allocation between rental and bandwidth). As can be seen in Figure 7.7, this re-allocation does have a very significant impact in that it reduces the X value under Ofcom's central case by one third, from -6% to -4%. In the light of this impact, and also the greater commercial incentives BT may have to increase its bandwidth charges over end-user rental charges identified by Ofcom in the WBA Consultation, EE considers that Ofcom should refrain from departing from BT's RFS in allocating 100% of DSLAM costs to end-user rentals. Further, EE considers that if, contrary to this, Ofcom continues to consider such an adjustment is necessary then greater scrutiny is applied to the 25% figure. This appears to have been derived by taking the historic number of additional DSLAMs which BT contends are bandwidth related (footnote 104). However, it is unclear to what extent such DSLAMs are solely in relation to additional bandwidth requirements and the extent to which they are in fact providing additional lines as well. Furthermore, to the extent that Ofcom continues to forecast total bandwidth consumption and the number of Market A IPstream customers to fall by the end of the charge control period, EE would expect this to result in a **reduced** need for DSLAMs, rather than being the driver for any increased DSLAM installation. EE is therefore concerned that if such a high proportion of DSLAM costs is allocated to the bandwidth cost stack, BT will be able to over-recover its true costs
- EE agrees that the 2012 RFS data should be adjusted to reflect the new boundaries of Market A (§7.122). However this is subject to the further removal of prospectively competitive exchanges from the definition of

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21 In contrast, the markedly different X values under Ofcom's high, medium and low volume forecast assumptions set out in Figure 7.7 suggest that Ofcom has anticipated BT incurring essentially an identical pool of costs, just spread over a smaller number of end-users.

Market A as proposed by EE above in this response. There is also insufficient information provided in the WBA Consultation for EE to be able to comment fully on the cost impact of the change from Market 1 to Market A (§§A11.30-A11.32). For example, the BT-only exchanges assumed in BT's redefined Market 1 s 135 information response referred to at footnote 105 are likely to be smaller on average than the total average size of BT-only and BT+1 exchanges that Ofcom is proposing to include in Market A, but it is not clear whether Ofcom has taken this into consideration when relying upon BT's estimates.

Question 7.9: Do you agree to our proposed simplified modelling approach and the use of anchor pricing?

Simplified modelling

EE has no major objections to the use of a simplified model on the assumption that Ofcom's assertion that the creation of a more detailed model would be "an exercise in spurious accuracy" (§7.106) is correct (i.e. that the assumptions that have the greatest impact on the outcome are those that it is least possible to render more accurate by more detailed modelling work - §7.105).

Anchor pricing

EE also has no major objections to Ofcom's proposals to use an anchor pricing approach rather than a modern equivalent asset ("MEA") approach. However, EE does have some significant concerns about the way in which Ofcom is proposing to *apply* the anchor pricing approach, in particular in relation to customers in Market A which are likely to be provisioned over fibre.

EE notes that in practice the majority of these concerns fall way if the scope of Market A is reduced as EE has suggested above so as to remove from Market A those exchanges where coverage by BDUK funded fibre is expected to be significant. However, even in this case EE's concerns on principle will remain.

A detailed description of the principles of anchor product regulation was set out in Ofcom's 2007 consultation on "*Future broadband: policy approach to next generation access*".[22] Ofcom relevantly noted as follows:

> *"The attraction of… anchor product regulation… is that both would promote efficient and timely investment* ***by leaving the risk and reward related to the capabilities of next generation access with the investor"*** (§A7.1, emphasis added)
>
> *"Price – one of the aims of anchor product regulation is to ensure that,* ***in the migration to next generation access networks, no customers are made worse off"*** (§A7.9, emphasis added)

Ofcom's comments in relation to the use of anchor pricing in the 2011 WBA charge control are also relevant[23]. In particular, the following:

[22] Annex 7 of "Future broadband - Policy approach to next generation access", September 2007, http://stakeholders.ofcom.org.uk/binaries/consultations/nga/summary/future_broadband_nga.pdf

[23] http://stakeholders.ofcom.org.uk/binaries/consultations/823069/statement/statement.pdf ; http://stakeholders.ofcom.org.uk/binaries/consultations/823069/summary/condoc.pdf

"….we use the anchor pricing approach because of its incentive properties and because it helps address uncertainty over migration volumes and costs (WBA 2011 charge control consultation, §3.46)

"It should also be clear that the control will apply irrespective of whether the anchor product is actually supplied over the existing network or over 21CN, should that be rolled out in Market 1. This is so that ***customers for current generation products can be confident that they will always be able to obtain a service at least as good as their current offer, at a price no higher than they would have paid if new technology had not been rolled out****."* (WBA 2011 charge control Statement, §3.87, emphasis added)

"The adoption of a new platform has the potential to offer significant cost savings and we want the charge control to give the right incentives for BT to undertake such an investment (where this benefits consumers in the long run). At the same time the migration of services to a new platform poses some challenges as the speed of migration and associated costs are uncertain.

The anchor pricing approach largely avoids these practical difficulties. It means that the risk associated with introducing new technology is borne by the regulated entity. For example, if the new technology is successful and results in lower costs, then the regulated entity can retain the benefits of such cost savings, until prices are gradually moved to reflect the new technology. Conversely, if the new technology is unsuccessful, consumers are protected from higher prices.

We consider that ***it is more appropriate that this risk is borne by the regulated entity than by consumers. The regulated entity is far better placed than Ofcom to take decisions on major technology changes****"* (WBA 2011 charge control consultation, §§3.51-3.53, emphasis added)

"We draw a distinction between gradual ("business-as-usual") technical progress and the kind of "paradigm shift" technology change represented, for example, by BT's move from its legacy network to its 21CN. The former can straightforwardly be taken into account within an RPI-X charge control and is reflected by the assumed rate of real unit cost reduction. ***We apply our anchor pricing approach to major technology changes****"* (WBA 2011 charge control consultation, §§3.56, emphasis added)

"…we assume that the capital costs (i.e. depreciation and return of capital employed) and operating costs of the network ***are at the efficient levels that would be expected if the network were in an ongoing environment****….*

In practice, this means that we will need to adjust BT's reported costs in order to build forecasts of efficient ongoing WBA costs… (i.e. assuming that BT had not started building its 21CN). This adjustment is referred to as a "hypothetical ongoing network" (HON) adjustment…" (WBA 2011 charge control consultation, §§3.59-3.60, emphasis added)

Ofcom's proposal to subtract from its volume forecasts any subscribers who are served by fibre in Market A (§7.114) represents what EE considers to be a major and inappropriate departure from the above established principles of anchor product pricing as historically applied by Ofcom generally and in the WBA market, for the following reasons:

- It makes the WBA charge control pricing subject to the uncertainties associated with forecasting migration to fibre, whereas anchor pricing is intended to remove this uncertainty;
- Rather than transferring *both* the risk and reward of investing in fibre to BT (which logically must include the risks and benefits associated with BT choosing to bid for BDUK funded projects), Ofcom's approach materially mitigates BT's risk (by requiring WBA users to pay for assumed volume losses to fibre) whilst leaving BT with 100% of the potential rewards of its fibre investments (in the form of cost efficiencies including the use of the BDUK funding and the ability to charge unregulated WBC FTTx pricing);
- It departs from the principle of modelling an efficient hypothetical ongoing network – as it assumes the current level of Market A 20CN costs is essentially maintained, in spite of assumed materially lower volumes of services over which those costs are allocated, due to the forecast migration to fibre. Clearly there are significant cost savings that can be achieved through things like energy and space savings from equipment reduction in the face of a falling IPStream customer base, which do not appear to be reflected in Ofcom's proposed charge control;
- It breaches the fundamental tenet of anchor pricing that consumers of the legacy anchor product should be protected by paying prices no higher than they would have paid if new technology had not been rolled out – i.e. all assumed volume losses to fibre in Ofcom's model increases the cost to WBA users in Market 1 as compared to a situation where BT made no investment in rolling out BDUK funded fibre in Market A and there was consequently no such volume loss (see the contrasting X values in Figure 7.7 depending on the volume forecast assumptions); and
- It is inconsistent with the principle that anchor pricing is designed to deal with precisely the major technological change represented by a shift from delivery of broadband services over DSL to fibre in Market A.

In the light of the foregoing, EE submits that **all** of BT's current and future forecast customers within the boundaries of the current Market A exchanges should be assumed to be supplied via BT's IPstream ADSL technology (§7.114), irrespective of whether BT ultimately chooses to serve those customers using ADSL2+, fibre or any other form of fixed broadband technology within the WBA market (and also irrespective of the physical location of the technology used to serve customers in premises covered by the Market A exchanges).

Consistent with Ofcom's approach in calculating BT's service shares for the purposes of determining BT's SMP in Market A, this should include all current and forecast BT Retail customers, plus retail customers served using BT

Wholesale's WBA products (IPstream Connect, WBC and WBC FTTX), which EE assumes will produce service shares similar to those currently enjoyed by BT in Market A, of circa 91.8% (see Table 5.2). To the extent that Ofcom anticipates BT's service shares being materially lower than this as a result of the purchase of upstream inputs such as VULA by other CPs (§7.114), then as discussed above EE considers that this should be a reason for Ofcom to **consider the affected exchange areas prospectively competitive and to remove the exchanges from Market A entirely**. It is logically inconsistent and completely unfair to consumers of BT's regulated WBA Market A services for Ofcom to do as it has done and to allocate 100% of the fixed and common costs associated with DSL service supply from these exchanges at the same time as assuming a material negative volume impact on BT's service shares as a result of migration to fibre (§7.117).

Question 7.10: Do you agree with our volume assumption analysis?

No. For the reasons set out above, EE considers that it is inappropriate for Ofcom's model to reduce end-user volume forecasts by the number of customers expected to migrate to fibre services (§§7.1307.31). Where the impact of competition over BDUK funded fibre is expected to be material, EE considers that the relevant exchange should be removed entirely from Market A.

Question 7.11: Do you agree with our asset and cost volume elasticities assumption analysis?

EE does not have any specific comments on the asset and cost volume elasticities being assumed by Ofcom. As a wholesale customer rather than a network operator in these markets, EE does not have access to the relevant information to be able to provide a detailed view. However, EE does note that the nature of additional bandwidth costs would mean that it would expect there to be significant economies of scale in relation to these costs. The 0.65 elasticity used for both cost and asset volume elasticities may therefore be relatively high and warrant further investigation.

Question 7.12: Do you agree to the use of the "rest of BT" rate for the cost of capital assumption?

Yes.

Question 7.13: Do you agree to our proposed operating cost efficiency improvements of between 3.5% to 5%?

Table A12.18 discloses BT cost reductions in Market 1 for all relevant FAC unit costs for the WBA service of up to 59%, and in no case of less than 19%.[24]

[24] BT's 2013 RFS figures are different again, but it is unclear whether the cause of these changes is related to efficiencies or one-off adjustments. Whilst bandwidth costs have gone up slightly from 2011/12, they are still materially lower than 2010/11 costs. Rental costs appear to have increased materially from 2011/12, but it is unclear whether or not there is some element of reallocation of costs between different services. It is also somewhat concerning from an Equivalence of Inputs perspective that BT's internal Market 1 bandwidth costs appear to be materially lower than its external Market 1 bandwidth costs. See

These figures dwarf the 3.5% efficiency target set in the 2011 WBA charge control.

Clearly, for the purposes of setting achievable BT efficiency targets going forwards, Ofcom needs to ignore the impact of any non-representative changes (§A12.69). Nevertheless, even halving the lowest percentage of cost reductions achieved by BT would result in an achievable efficiency target of circa 10% - more than double Ofcom's proposed target of 5%. On this basis, EE considers that Ofcom's proposed efficiency target has been set materially too low.

For the reasons set out in §A12.74 of the Consultation, it would not seem that the efficiency savings that Openreach may or may not be able to make in relation to the supply of other charge controlled services are necessarily good indicators of the cost savings that BT can make in the supply of WBA services in Market A (cf Table A12.17). EE therefore considers that Ofcom should place strong weight on BT's historic actual Market 1 performance, once the impact of non-representative changes has been taken into consideration.

EE also considers that the level of efficiency target set for BT should be motivated by an overall policy objective when setting anchor product based charge controls of maximising benefits to end-users from the investment in delivery of services using more efficient technologies by the regulated firm. In this respect, we believe that it is vitally important that BT is given challenging efficiency targets, as these are markets where it by definition has a complete monopoly and competition is not providing any efficiency incentive. It is also important that BT is not able to use profits from these uncompetitive markets to cross subsidise other markets – all of which points to a need for a robust efficiency assumption.

Question 7.14: Do you agree with our proposal not to make one off adjustments to WBA prices at the start of the control?

Yes.

Question 7.15: Do you agree that the range of plausible X values is -10% to 0%?

No. The range of plausible X values obviously depends on the input assumptions that Ofcom uses (§7.141). EE's comments on these assumptions, including those on the assumptions regarding efficiency, DSLAM cost allocation and volumes that Ofcom claims to be "particularly uncertain" (§7.141) have been set out in response to the questions above. EE considers that the range of X values being considered by Ofcom should be revised in accordance with EE's comments on those assumptions.

Question 7.16: Do you agree with our base case range of X values and the assumptions underlying this range?

No. Ofcom's base case range of -7% to -1% and its central case of -4% has been based on a number of assumptions with which EE disagrees. EE

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http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2013/CurrentCostFinancialStatements2013.pdf (page 112).

considers that the range of X values being considered by Ofcom in its base case range should be revised in accordance with EE’s comments on those assumptions, which are set out in response to the questions above.

Question 7.17: Do you agree with the proposed levels of the sub-caps?

EE agrees with Ofcom’s assumptions that growth in bandwidth per user is likely to exceed growth in the number of IPStream Connect users (§7.83). EE also agrees that, logically within a basket charge control, BT has an incentive to apply price reductions to services that are falling in volume and to apply price increases to those that are likely to increase in volume (§7.83).

However it also needs to be kept in mind that rental charges are an *unavoidable* cost faced by BT’s rivals in respect of every retail customer. Factually, it is also relevant that BT has chosen to increase its rental charges by a material level of 15% in the final year of the current WBA charge control (§7.84), even though its end-user volumes have remained broadly flat throughout the charge control period (§A12.25).

Whilst EE wholeheartedly agrees that it is very important for Ofcom to set an appropriately tight sub-cap on BT’s bandwidth charges, EE therefore considers that great care should be taken before Ofcom assumes that BT will have a strong incentive to reduce rental prices absent an appropriately restrictive sub-cap.

Question 7.18: Do you agree with our proposals on cost accounting?

Whilst Ofcom has not specifically asked a question on this issue, EE notes its concerns with Ofcom’s proposal not to impose a general remedy of cost-orientation in this market review. EE considers that, given the overwhelming market power held by BT in Market A and the strong incentives it has to extract monopoly profits where it can, a service-by-service cost orientation obligation is a proportionate and important complement to sub-caps on certain key services within Ofcom’s proposed basked price control. In particular in this regard EE notes the wide discretion that is proposed to be given to BT to set prices within the proposed basket charge control, and the evidence of very significant cost savings of in excess of 19% achieved by BT in 2011-2012 under the ceilings set by the current charge control (see Table A12.18).

[✂] [✂]