

**TELEFÓNICA O2 UK LIMITED RESPONSE TO:**

**“REVIEW OF THE WHOLESALE BROADBAND ACCESS MARKET”**

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## **TELEFÓNICA O2 UK LIMITED RESPONSE – OFCOM REVIEW OF THE WHOLESALE BROADBAND ACCESS MARKET**

### **Introduction**

1. Telefónica O2 UK Limited (O2)<sup>1</sup> welcomes the opportunity to respond to Ofcom's Review of the Wholesale Broadband Access Market (the WBA Market Review).
2. O2 is a leading communications company for consumers and businesses in the UK, with 21.355 million mobile customers and over 632,400 fixed broadband<sup>2</sup> customers as at 31 March 2010.
3. In October 2007 O2 launched its fixed broadband service using the Be broadband network (Be was acquired in 2006). Based on local loop unbundling (LLU) and using ADSL2+, O2 has been able to differentiate itself in the market by making it easy and straightforward for customers to connect to broadband<sup>3</sup>. O2 uses wholesale broadband access products in areas where we have not deployed our own network.

### **Ofcom's strategic approach to broadband**

4. In our response to Ofcom's previous WBA Market Review<sup>4</sup>, we emphasised that, in our view, it is essential for Ofcom to ensure that it maintains a strategic approach to broadband, that it must not deal with Market Reviews as "stove pipes" but recognise that together, the various elements of the regulatory framework (the WLA market remedies, the WBA market remedies,

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<sup>1</sup> Telefónica O2 UK Limited (O2) is part of Telefónica Europe plc which is a business division of Telefónica S.A. and which owns O2 in the UK, Ireland, Slovakia, Germany and the Czech Republic, and has 53.9 million customers (at March 2010). Telefónica is the world's largest integrated telecommunications operator, and the largest in Europe in terms of market capitalisation. Its activities are centred mainly on fixed and mobile telephony, with broadband as the key tool for the development of both.

<sup>2</sup> And on 1 October 2009, O2 UK entered the business fixed telephony market with the launch of its full communications service to small and large businesses.

<sup>3</sup> And hence, for the most part, our focus is on the sister Wholesale Local Access Market Review.

<sup>4</sup> <http://www.ofcom.org.uk/consult/condocs/wbamr07/statement/statement.pdf>

BT Undertakings<sup>5</sup>, BT's voluntary WBA pricing commitments and moreover the underlying regulatory principles flowing from Ofcom's Strategic Review (Telecommunications) must form a cohesive overall regulatory ecosystem for broadband. We remain of this view.

5. Accordingly, we support Ofcom's intent in the WBA Market Review 2010 to ensure that *"taken together, our proposals in the two markets are intended to ensure consumers in the UK continue to have access to a wide choice of products from a range of suppliers."* [1.2] and its re-iteration as to the importance of WLA (and LLU in particular) not only in relation to sustainable competition<sup>6</sup> but also as an enabler for part de-regulation in the WBA market. Furthermore, we note that Ofcom's analysis also considers the potential effects the various remedy options might have for LLU in some circumstances.<sup>7</sup> We support Ofcom's approach here to ensure the WBA remedies do not undermine the objective of the remedies established in the WLA market – i.e. to support competition at the deepest level where competition is likely to be effective and sustainable.

#### **Ofcom's approach in the WBA Market Review 2010**

6. We note that Ofcom's approach largely follows that which was established in the previous WBA Market Review<sup>8</sup>, segmenting the market into sub-national

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<sup>5</sup> Incidentally, we note that Ofcom makes no particular reference to the BT Undertakings in relation to WBA products. For the sake of completeness and clarity we would suggest Ofcom provides some commentary here as to the role the Undertakings have for WBA (for example, as it does in the WLA Market Review).

<sup>6</sup> *"[to encourage] the effective and sustainable competition, based on investment by competitors in their own infrastructure, that we believe provides the greatest benefits to consumers to develop."* [1.14]

<sup>7</sup> For example, avoiding side effects of driving anti-competitive low prices or excessive prices [5.51] or possibly constraining the levels of returns (for LLU) through a charge control [5.64].

<sup>8</sup> We note that the main changes to the approach taken in the previous Market Review are broadly as follows: Market 1<sup>8</sup>: The introduction of a charge control<sup>8</sup>. Ofcom proposes this remedy (along with a general access, non-discrimination and transparency remedy) because *"once BT's voluntary commitment to not price above a ceiling cap expires<sup>8</sup>, we are concerned that BT could set excessive prices which would ultimately be passed on to consumers"*. [1.26]; Market 2<sup>8</sup>: The introduction of cost orientation and cost accounting (for transparency) requirements. Ofcom does not impose a charge control because of the risk of a negative impact on current and future LLU investment prospects in the market; and, Market 3<sup>8</sup>: As before, Ofcom does not impose regulation in this market as it considers no entity has SMP in the market. But we note that Ofcom proposes to no longer maintain that exchanges must be above a certain scale (at least 10K end user lines) before it can fall within Market 3 (4 or more POs [3.261]).

markets between which Ofcom identifies appreciable differences in competitive conditions.

7. As the European Commission identified at the time of the last review<sup>9</sup>, Ofcom was the first national telecoms regulator in the EU to identify different broadband markets in different geographic areas within a country and to propose lifting regulation in those geographic areas where effective competition was present.

#### **Assessment of the effects of the WBA Review 2006/7**

8. Ofcom provides some assessment of BT's market share and financial performance in the market at section 4 of the WBA Market Review. In relation to Market 3, Ofcom observes "*Since the last review BT has continued to lose market share, falling from 38% in February 2008 to around 28%.*" Assessment of BT's position in the wholesale market is of course important for the SMP analysis.
9. Indeed, at the time of the last WBA Market Review, Ofcom explained that it would carefully monitor the development of competition. In this respect, we believe analysis of the market is important, not only in relation to establishing the existence (if any) of SMP but also to inform Ofcom's overall strategic approach to broadband (as above).

#### **Analysis of BT's financial performance**

10. Ofcom notes that whilst BT has introduced some disaggregated financial reporting by each of the sub-national geographic markets, there remains a significant amount of revenue and costs which are not geographically allocated [4.37] and that:

*"in the absence of an agreed allocation methodology, an analysis of returns by market will inevitably produce a range of estimates for each market... However, we consider that reasonable allocations of revenue*

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<sup>9</sup> [http://ec.europa.eu/unitedkingdom/press/press\\_releases/2008/pr0803\\_en.htm](http://ec.europa.eu/unitedkingdom/press/press_releases/2008/pr0803_en.htm)

*and cost suggest that ROCE in all three markets may now be above the cost of capital, reflecting the returns being made in the market as a whole [10].” [4.39]*

11. We note that Ofcom considers that it has sufficient information (BT has also provided confidential information to Ofcom) to assess possession of market power in the markets. We would also suggest that there needs to be sufficient transparency and clarity over allocation methodologies to enable Ofcom to set (and consult on) the price control regime in Market 1 (later this year) and moreover to ensure that costs are revenues are correctly attributed to each market (for example, to demonstrate that allocations are not being disproportionately allocated to Market 1 or 2 where SMP is present). Lack of transparency in relation to BT's cost base and allocation methodology (including assessment thereof), has been one of the concerns voiced in relation to Ofcom's review of Openreach pricing (see *The Carphone Warehouse Group Plc v Office of Communications (Local Loop Unbundling)*)<sup>11</sup>.

#### **Market Developments – Number of Principal Operators**

12. Ofcom's market assessment is based on the number of Principal Operators (POs) that provide broadband services (or are forecast to provide services) over their own access networks (BT or Virgin Media) or have deployed LLU in more than 10% of the UK. Ofcom considers that the principal LLU operators are: TalkTalk, Sky, Orange, O2 and Cable & Wireless Access. [3.253]
13. Since publication of Ofcom's WBA Market Review document, Orange has announced that it will pass its fixed infrastructure back to BT<sup>12</sup>.

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<sup>10</sup> Although, of course, since Ofcom has concluded there is not a national market, there is in effect no “market as a whole” per se.

<sup>11</sup> <http://www.catribunal.org.uk/237-4154/1111-3-3-09-The-Carphone-Warehouse-Group-Plc.html>

<sup>12</sup> [http://business.timesonline.co.uk/tol/business/industry\\_sectors/telecoms/article7099128.ece](http://business.timesonline.co.uk/tol/business/industry_sectors/telecoms/article7099128.ece)

14. We assume, therefore, that Ofcom will need to recalibrate its assessment in relevant exchange areas, to take account of the exit of Orange as an LLU Principal Operator.

**Concluding remarks**

15. We agree with Ofcom that this is an important Market Review and that, as Ofcom notes:

*“Together, the decisions taken (following consultation) in the WLA and WBA market reviews will affect how competition and investment in broadband services will develop in this important stage for NGA networks.” [2.13]*

16. We would be pleased to discuss our comments with Ofcom.

**Telefónica O2 UK Limited**

**June 2010**