30th January 2016

Dear Sirs,

I congratulate Ofcom on a comprehensive Narrowband Market Review document. The document looks at both the retail and wholesale markets and contains a large amount of objective supporting data, but sadly consults only on a narrow range of questions concerned wholly with SMP and wholesale market remedies. I believe that in the absence of other action by Ofcom, this approach risks failing to drive the UK telecommunications market forward for the benefit of the UK's digital economy as a whole.

Regulating Wholesale Communications Markets for Consumer Benefit

- I contend that the purpose of regulating a wholesale market should be to promote fair competition *to ensure consumer benefit*, rather than to assign oligopolistic profits amongst a relatively small number of major wholesale market participants[1].
- The effectiveness of wholesale market regulation should therefore be seen in the light of trends in consumer benefit (that is, *in the retail market*).
- Figure 1.2 of the consultation shows that retail prices for line rental have increased whilst wholesale prices have reduced. Indeed, there is a case for arguing that Figure 1.2 under-estimates increases in line rental costs in the retail market as supplementary services such as CLIP[2] and call reject have increasingly been removed from line rental bundles and added as separate monthly items.
- Figure 1.2 demonstrates therefore that over the period 2010-2016 consumer benefit has been increasingly compromised.

Identification of Failure of Market to Pass Consumer Benefit Test

I believe the Narrowband Market review identifies in many places *why* market failure has allowed an approximate doubling in gross profit margins on retail line rental business to take place, yet unfortunately falls short in identifying potential remedies. You state (paragraph 1.8) that

> *There have been significant increases in retail line rental prices, which have a particular impact on those consumers who take fixed voice-only services.*

These increases are felt by <u>all</u> retail customers, and not just by those who take voice-only services. In particular split purchasers (paragraph 4.98) are affected[3]. It is not only consumers that are affected however. In terms of competition between CPs, the increasing price of retail line rental suits the 'oligopoly' suppliers identified in Figure 1.2 because the opportunity for differentiation from small or niche data-only ISPs is reduced - unless they offered a bundle, overall costs to consumers would increase unless these market participants had reduced their broadband prices by the amount of the line rental increases over the period.

[1] The market review has identified an apparent lack of competition in the market as a whole (see e.g. paragraph 1.10)
[2] Calling Line Identity Presentation
[3] In addition, the effect of the ASA ruling (paragraph 1.10) appears to have decreased price transparency for this group.

Your data appears to show that:

- Fixed call volumes are falling and there is an element of mobile call substitution, (Figure 3.2 p31, Figure 4.4 p75). The proportion of fixed call volumes to mobiles is particularly low[4] and a high proportion of calls "([✂]%)" are 'in-bundle' (i.e. at zero marginal cost to the subscriber).
- Despite falling call volume over the period 2004 -2015, the demand for fixed access lines has remained static or risen slightly as you note in paragraph 1.18.
- Paragraph 4.13 identifies the principal reason for this. Survey responses showed that three times as many people have their line principally for broadband access rather than principally for making fixed calls.

You have therefore determined that the price inelasticity in the demand for fixed lines for voice services is related to the requirement to have a fixed voice service in order to get a broadband line.

In summary: the market review has determined that over the period 2010 – 2016 the average CP gross margin on analogue voice line rental has increased from ~30% to ~60%, and that that the demand is inelastic despite the majority of subscribers not needing a service that is bundled. In the light of this it is hard to see how you conclude that paragraph 1.49)

> *… we think that retail outcomes have been good for those buying bundles of voice and broadband….*

You have identified only one CP Service (Virgin Media's Fibre Optic Broadband, paragraph 4.61) which meets this stated demand, and this service is not available in areas not covered by Virgin Media's infrastructure.

Potential Regulatory Solution to Consumer Benefit Failures

A potential regulatory solution for the consumer benefit failures and the apparent lack of competition within the market[5] would appear to be the LRIC decremental approach favoured by Ofcom (Figure 14.1). Instead of applying this in the wholesale market and hoping that the competition as it is between oligopoly suppliers would affect the retail market, this approach could be applied more directly to the retail market itself.

In applying the decremental approach to retail fixed lines without analogue voice service the outline approach would be:

- Set a maximum gross margin on retail analogue lines (with voice service) relative to wholesale prices, with returns for oligopoly CPs set at similar levels to existing LRIC models.

[4] Contrary to your assertion in 4.146 that the calls are of 'different types', I believe Figure 4.4. provides at least circumstantial evidence that (price driven) substitution is taking place. Calls to mobiles are generally included in mobile service bundles, but not in fixed service bundles, and a large proportion of such calls are from mobiles. No data is presented to break down the fixed calls into direct and indirect access types, where the price of indirect fixed international calls often undercuts direct calls by a factor of 10-40.

[5] Identified by Ofcom Market review, paragraph 1.10

- Then set the price of analogue lines without fixed voice services at a cost relative to the cost of network excluding the PSTN.

I maintain that the benefits of this approach would be:

- An Immediate and significant reduction in costs for line rental for the benefit of all consumers but particularly the vulnerable groups identified by the market review and split purchasers[6].
- Fairer and more transparent competition as market participants transferred fixed costs to broadband services. Subscribers to voice only services would not be affected as they would be protected by the regulated price cap on lines. Competition in the broadband market would come from within the oligopoly suppliers themselves but also potentially from smaller niche ISPs whose services might become increasingly attractive to subscribers (through split purchasing). A more dynamic market with a greater number of participants might result, although such an outcome would not be necessary for the measures to pass the consumer benefit test.
- To encourage the acceleration of the development of the UK telecommunications market as a whole by bringing the ‘longer term’ forward. The expected ‘longer term’ developments were identified by Ofcom in paragraph 1.4 of the market review

  ..in the longer term we anticipate traditional voice telephony being replaced by voice services carried over broadband, and that this will be facilitated by the ability to purchase broadband without traditional voice services.

Yours faithfully,

[6] There would be a limited opportunity for oligopoly CPs to drive revenue from calls because of the opportunity identified in the market review for call by call substitution by retail subscribers (of fixed calls by indirect access services or mobile calls.)