Ofcom Strategic Review of Digital Communications

TalkTalk comments on Ofcom Terms of Reference

June 2015

NON-CONFIDENTIAL VERSION

1 Summary

1.1 This is TalkTalk's response to Ofcom's Strategic Review of Digital Communications: Terms of Reference which was published on 12 March 2015. Our key views are summarised below.

1.2 Ofcom's regulatory strategy for the next decade should be aimed at delivering an ambitious vision to provide 1 Gigabit ultrafast broadband to the vast majority of UK consumers and businesses and to deliver a step change in mobile coverage and speed at affordable prices over the next 10 years. This will drive high uptake, enhance digital skills and allow Britain to lead the digital world and deliver significant economic and social benefits. As Ofcom rightly identifies the key enablers of this vision are effective competition and efficient investment.

1.3 We think that the industry structure that can deliver this vision will be founded on a retail market where providers without their own access networks can compete effectively with those who do and consumers have a choice of a minimum of four scale providers of quad services. At the network level Ofcom's strategy should nurture the opportunity for extensive infrastructure competition to roll-out new fixed line UFBB networks. The UK's ambition will not delivered by an oligopoly of 2 or 3 vertically integrated behemoths.

1.4 The UK is in a poor position today to achieve this vision: competition is actually regressing; SFBB uptake is low; investment is weak; and, service quality is poor.

1.5 The UK initially performed well following the Ofcom's 2005 strategic review which introduced functional separation and equivalence. However, this model is ill-suited for the future. We see the best strategic solution to deliver improved competition and investment is to structurally separate Openreach. This will: provide a genuinely level retail playing field and revitalise retail SFBB and UFBB competition; allow significant de-regulation of Openreach and BT Retail giving them both more commercial flexibility; rejuvenate Openreach as a focussed and well capitalised business rather than being an ever smaller part of BT Group; drive more infrastructure investment as network competition is enhanced, risk is reduced and Openreach is allowed more freedom; and, service quality will be improved.

1.6 Ofcom does not have the powers to force separation itself but it can make a reference to the CMA for a market investigation reference ("MIR"). The criteria to warrant making a MIR are fully met. Accordingly Ofcom should commence a consultation on whether to make a reference as expeditiously as possible.

1.7 The alternative of continuing the vertically integrated model will – even with substantially more complex and more intrusive regulation – be unable to deliver the competition and investment that the UK needs.

1.8 Our response is laid out as follows:

- In section 2 we discuss what we think the vision should be for the UK digital communication sector both in terms of what consumers will need and the industry structure that can best deliver it
- Section 3 discusses the current situation and whether there are barriers to achieving this vision
- In section 4 we outline our view of the potential solutions for meeting this vision – the options we discuss are: continuation of status quo; structural separation; and regulatory improvements under the vertical integration model
- Lastly, in section 5 we discuss opportunities for de-regulation

2 Vision

2.1 Below we set out our vision for the market from consumers' perspectives (both business and residential) – the role that digital communications will play in our economy and what consumers will demand in the next decade. We then discuss the key enablers and underlying industry structure that is needed to deliver this vision.

2.1 Consumer vision

2.2 Britain should be ambitious about the scale of its digital potential over the next decade.

2.3 We have much to be proud of in the UK. In some parts of the digital communications market (notably standard broadband) we have a vibrantly competitive market with wide choice, low prices and innovative services. We are also high users of digital services with the world's biggest online retail trade surplus with great strengths in digitally enabled industries. However, there are some areas for significant potential improvement notably: we have 10m people without basic digital skills; network service quality and mobile coverage is poor; take-up of superfast broadband is slow; and, ultrafast investment is almost non-existent.

2.4 We think with the right reforms we can achieve far more.

2.5 Consumers should have genuine choice of world leading and innovative access services that will allow all UK consumers almost boundless connectivity to use the services they want:

- In fixed, we should strive for a Britain where ultrafast 1 Gigabit technology (such as FTTP) is available to the vast majority of homes and businesses. This would make connectivity effectively limitless as is electricity today which will enable the next wave of data-intensive services.
- In mobile, we should aim for 'always there': dependable, ubiquitous and high speed mobile connectivity in the vast majority of places where consumers need it

2.6 These fixed and mobile services will need to reflect that reliable communications will become ever more essential and consumers expectations and demands will be commensurately far higher than today.

2.7 To ensure that consumers are properly empowered there must also be good transparency of offers and easy migrations to allow them to select accurately and move easily to the best package for them.

2.8 We should also strive for significantly improved and universal digital skills

2.9 This is an exciting vision for a Britain leading the way in the digital world that will deliver significant economic and social benefits, enable the government to reduce the cost of public services and allow the digital sector to drive overall economic growth. It builds on our current strengths in digital through ensuring that the UK has the necessary communications infrastructure and services to lead the world.

2.2 Enablers

2.10 This vision can only be achieved if both of two enablers are met:

- efficient investment is forthcoming – the required level of investment, particularly in fixed, is likely to be far higher than we have seen over the last decade. Without efficient investment, consumers will suffer from low coverage, low speeds, low quality and a lack of capacity
- competition is effective with vibrant competition along as much of the value chain as possible. Without effective competition consumers will pay excessive prices for services, quality will deteriorate (e.g. customer service, fault levels) and uptake will be retarded.

2.11 Competition at the infrastructure level is also the surest way to drive efficient infrastructure investment. The greatest incentive for an incumbent such as BT to invest will always be the threat of competition punishing delay and lack of risk-taking since they will lose market share. An operator with no competitive pressure is able to delay investment to allow it to earn higher returns since, for instance, demand will increase over time. This was well articulated by Margrethe Vestager who said recently [1]:

> *"Incumbent operators argue that if they cannot merge with their rivals in the same country they will be unable to increase their investment. I've heard this claim quite often, but I have not seen evidence that this is the case. Instead, there is ample evidence that excessive consolidation may lead not only to less competition and more expensive bills for consumers, but that it also reduces the incentives in national markets to innovate. In fact, infrastructure investment can be stimulated by competition. In 2009 a new player, Free Mobile, entered the French telecoms market. Following that entry, the overall level of telecoms investment in France grew, and remains at higher levels than at the moment of Free's entry."*

2.12 We agree with Ofcom's focus in its strategic review on efficient investment and effective competition[2].

2.3 Industry vision

2.13 We describe below the industry structure and future market ecology that is most likely to deliver this vision – first we describe the ecology at the retail level and then at the infrastructure level. Lastly, we describe the type of industry structure that we should avoid.

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[1] http://ec.europa.eu/commission/2014-2019/vestager/announcements/state-union-antitrust-eu-2015-2016_en

[2] Ofcom explained that its third objective was de-regulation. We see de-regulation as a natural consequence of more effective competition rather than an objective by itself. We discuss this in section 6

At the retail level

2.14 We think the key characteristics of a vibrant retail market are:

2.15 First, a minimum of *four*[3] scale retail providers of quad play services[4] (i.e. voice, broadband, TV and mobile). This reflects the industry prediction that most (though not all[5]) customers will in 10 years be purchasing their communications as a quad bundle from a single provider. These customers need a choice of players.

2.16 Second, the ability for retail providers and new entrants without their own fixed or mobile network to compete in the retail quad play market on a level playing field. This is essential since vibrant innovation and competition will only happen with an effective reseller market (i.e. retailers without their own network). The importance of resellers is most evident in the SME market where non-network based retailers serve about 30% of the market and are a critical engine of innovation.

At the network level

2.17 We need widespread roll-out of 'ultrafast' broadband (UFBB) networks (such as FTTH).

- For these investments to be efficient and timely they should be contestable ideally in all geographies of the UK. Without the threat of competitors gaining a first mover advantage Openreach's incentive will be to delay investment and sweat its copper/ FTTC assets. 'Investment races' will ensure the fastest and most efficient UFBB investment as can be seen in Spain and Portugal. We think that there is a realistic prospect for significant competition for infrastructure investment (as shown by TalkTalk's FTTH roll-out in York with Sky and CFH). This opportunity must be promoted by Ofcom's future regulation.
- In some regions these new UFBB networks will likely be, once built, 'natural monopolies' (or an enduring economic bottleneck) i.e. the network owner may hold market power. This means that regulation[6] (either behavioural or structural) may be necessary to ensure effective retail competition on these networks. Ofcom has both the powers and ability to impose this regulation if necessary.

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[3] We think the minimum number of operators should be four for a number of reasons. It is unlikely that any individual player will have a share over 40% (which is a typical minimum level for a dominance finding). The fixed market (for standard broadband) has been competitive with four scale players. Ofcom in its decision on 4G spectrum concluded that it should aim for four mobile operators. See Assessment of future mobile competition and award of 800 MHz and 2.6 GHz, Jul 2012 §1.10

[4] We think that four scale players at the retail level will not result in material scale inefficiencies given that at the retail level the minimum economic scale is low

[5] We recognise the need to meet the needs of customers who do not buy services in a quad bundle e.g. but fixed separately from mobile. We think that in general a market that serves quad play needs will for the most part also serve the needs of customers who do not purchase products in bundles

[6] Regulation may need to differ geographically. Regulation will need to prevent exploitative behavior and, if the monopoly provider is vertically integrated, exclusionary behavior as well

An ecology to be avoided

2.18 Some commentators are promoting a future industry structure dominated by vertically integrated operators i.e. large retail providers that operate their own extensive fixed and mobile networks and do not wholesale at competitive levels. Given the density economies particularly on the fixed network there could only realistically be 2 or 3 such operators. Such an ecology would not meet consumers' need for choice, investment, innovation and competition – the small number of operators safe from the threat of entry would become unresponsive oligopolists who would invest slowly. We are already seeing the start of this trend in the low levels of recent investment.

3 Barriers

3.1 We see a number of barriers to this exciting market vision being met. The current levels of investment and competition are sub-optimal. Further, the signs are that, absent material regulatory change, these problems will get worse, investment will fall further behind the efficient level and competition will further regress in the coming years.

3.2 Ofcom's 2005 strategic review introduced equivalence of inputs and functional separation to address the then rampant non-price discrimination and also ushered in significant LLU price reductions. This resulted initially in large improvements in competition and investment for standard broadband. However, recently competition has been regressing and investment in SFBB and UFBB has been slow. We provide below some evidence of the problems.

3.3 Competition in the retail market has been regressing over the last 3-5 years

- BT has gained an abnormally and unjustifiably high share of SFBB customers[7] – it currently accounts for 73% of Openreach SFBB connections versus 40% for all connections. The trend is not towards a more normal and competitive market structure – in the most recent quarter BT Retail's share of Openreach SFBB net adds actually increased (from 56% to 58%)
- In part as a result of its high SFBB share BT has grown its overall broadband market share by about 1.2 percentage points per year principally driven by its high SFBB share – BT's share of broadband has risen from 26.0% in 2009 to 31.9% in 2014 Q3[8], an increase of a fifth. BT's increasing share is despite it having the highest complaint levels in the market. BT is moving closer to having a dominant position in retail broadband.
- In the SME market BT's retail share is around 10 times that of the next largest provider (about 50% versus 5% for the next largest player). Such a market structure is unlikely to deliver good outcomes for business customers.
- There is little market entry, and the market is becoming increasingly concentrated and overly 'stable'. There has been no significant new entrants in the last five years[9] and there has been consolidation of existing major providers (e.g. Sky acquired O2 broadband base and BT potentially acquiring EE base and before 2010 TalkTalk acquisitions of AOL and Tiscali). Following the BT acquisition of EE, the four leading providers will control about 95% of retail broadband connections.
- Uptake of SFBB, particularly over the Openreach network, has been much lower than it could have been due to excessive wholesale prices – 5 years after SFBB by Openreach was launched uptake is just 22% and for rivals to BT Retail

[7] In our view the only plausible explanation of BT's abnormally high share is that BT is margin squeezing (caused by the anchor tenant relationship BT Retail has with Openreach)

[8] source: Ofcom Telecommunications Market Data Tables

[9] we cannot think of any new entrant in the last 7 years who has (organically) developed a customer base of more than 100,000 customers (which is about 0.4% market share)

it is just 10%. The low uptake by rivals is due to an excessive wholesale price which is about twice the underlying cost[10]

- Competition has been hindered by excessive wholesale prices across all regulated products. For instance:
  - Frontier analysis for Vodafone has shown that BT's returns have been £5.5bn in excess of their cost of capital (over the last 8 years)
  - In *addition* to this, BT have inflated the costs (and so prices) of regulated products by £262m a year by manipulating the cost attribution across BT Group[11]
  - BT game price baskets by increasing relative prices on products BT Retail buys less of (as Ofcom identifies has occurred with different types of EAD circuits[12]). The effect is to inflate the wholesale prices of products rivals purchase
- As well as hampering competition, excessive wholesale prices also lead to inflated and inefficient retail prices

3.4 Investment and innovation in fixed networks has been inadequate.

- BT's overall spend on its access network has been roughly flat despite the much trumpeted new expenditure on NGA[13]. The spend on the non-NGA network (i.e. copper and leased lines) that standard broadband and SFBB services depend on has reduced by about 30-40%[14] and more in real terms.
- The majority (or at least a very large part) of BT's NGA investment has come from tax-payers[15].
- BT's NGA investment has also strategically avoided business parks and some business areas[16] presumably to avoid cannibalisation of BT's high price and high margin leased line business.

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[10] WIK estimated that the cost per line in 2014 is £4.04 per line per month. This is far less than the average price, which is currently around £8.00. See "*Estimating the cost of GEA: 2013 restatement and 2014 update*" can be found at: http://stakeholders.ofcom.org.uk/binaries/consultations/VULA-margin/responses/TalkTalk_Group_-_Annex_-_Wik_Consult_-_Estimating_the_cost_of_GEA.pdf.

[11] see Review of BT's cost attribution methodologies, Consultation, June 2015. The £262m includes £36m of errors. The vast majority of material errors found were in BT's favour. We do not consider that this is a coincidence. Notably in 2013 BT attempted to put through a number of reattributions which would have worsened the excess. Ofcom rejected these – see: Fixed access market reviews, Statement, June 2014 §A22.1*ff*

[12] Business Connectivity Market Review, May 2015 §10.18*ff*

[13] From BT's statutory accounts: FY2007: £1108m, 2008: £1073m, 2009: £951m, 2010: £907m, 2011: £1087m, 2012: £1075m, 2013: £1144m, 2014: £1049m, 2015: £1082m

[14] Openreach says its NGA capex is £300-400m per year. This implies that non-NGA spend has declined from ~£1bn by £300-400m I.e. By 30-40%. See Frontier report for Sky which provides a more robust analysis of BT's capex

[15] BT has invested about £1.4bn in the commercial roll-out (£300-400m a year over 4 years – see footnote 15). The total BDUK investment in 'non-commercial' areas is £1.7bn (both central funds and local authorities). The BT investment in non-commercial areas is unknown.

- Openreach is unresponsive to customers' needs. In particular, product innovation by Openreach has been slow and discriminatory. For example:
  - Openreach failed to develop a single jumper MPF ("SJ-MPF") product despite the potential for such a product to deliver significant cost savings for MPF customers (if it had been developed early enough) – notably BT itself does not use MPF and so would not have benefitted. Other beneficial innovations such as allowing CPs to change a customers' master socket and install their own VDSL modems have been delayed;
  - Product development requests by rest of BT are more than twice as successful as those from non-BT CPs[17] and BT's successful requests are delivered more quickly.

3.5 Service quality has been extremely poor. For instance,

- In early 2013: repair completion to SLA was just for 51.2% for WLR and 40.3% for MPF; and provision lead times reached 25.4 days for WLR and 21.3 for MPF[18]. Repair levels still remain below target
- Ethernet provisioning performance has substantially worsened (and remains poor). Leads times are long and there are frequent changes in delivery dates as outlined in Ofcom's recent BCMR[19]. [✂ CONFIDENTIAL ✂].
- There have been numerous and missed recovery plans
- Low service quality not only directly harms consumers but it also weakens competition as consumers are less willing to switch provider to get better terms

3.6 The deterioration in service quality has, we believe, been a result of reduction in investment by BT. Copper network capex was effectively diverted to Global Services[20] resulting in a cancellation of their maintenance programme to proactively prevent faults. As described above non-NGA capex fell by 30-40%. In Ethernet a major contribution to low service quality was inadequate resources – despite a 59% increase in volume, BT only provided 24% extra headcount[21]. Similarly in copper, Openreach did not ensure enough resources to maintain an adequate service level.

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[16] For example regarding low/late SFBB availability in London's Tech City: http://www.ispreview.co.uk/index.php/2014/07/londons-tech-city-still-suffering-lack-superfast-broadband.html

[17] 54% delivered/in development for BT and 24% for non-BT CPs. Source: Openreach Statement of Requirement tracker

[18] FAMR Statement Volume 1 June 2014 §11.28

[19] BCMR Consultation May 2015 §13.40*ff*

[20] the reduction in copper network capex in 2011/12 and 2012/13 coincided with low BT Global Services operating cash flow

[21] see BCMR Consultation May 2015 Table 13.8

4 Potential solutions

4.1 We discuss below three main strategic options for future regulation of the fixed sector.

- Continuation of the status quo / BAU
- Structural separation of Openreach
- Continued vertical integration with improvements to regulation

4.2 We focus on how well these options deliver effective competition, efficient investment (particularly in UFBB) and good quality.

4.1 Continuation of status quo / BAU

4.3 Though the current regulatory model has seen some past success, we do not think that the current regulatory model is sustainable and will not meet Ofcom's competition and investment objectives.

4.4 Ofcom's current model of regulation is founded on functional separation and equivalence to address the discrimination caused by BT's vertical integration. Combined with a *stringent* charge control on wholesale LLU products this bold, novel and since copied model allowed local loop unbundling to flourish. This propelled the UK forward in the (standard) broadband market:

- There was heavy investment by rival operators in local loop unbundling with TalkTalk and Sky having now each unbundled about 3,000 exchanges covering around 95% of the UK population. TalkTalk in particular innovated in technology deploying MSANs and an all IP network in scale based on ADSL2+ technology. This investment in own infrastructure allowed product differentiation, innovation and greater pressure on costs
- Prices of broadband fell rapidly – when TalkTalk initially launched it offered broadband for no additional charge (above line rental). At the time broadband cost an additional £10-£30. UK prices for standard broadband remain amongst the lowest in the world
- Uptake increased rapidly and the UK rose up the league table of broadband uptake
- Competition increased substantially allowing downstream de-regulation in wholesale broadband (in 90% of UK) and narrowband markets

4.5 It is, we believe, widely accepted that the Ofcom model has been successful for standard broadband in many respects.

4.6 However, the current model has not ensured acceptable service levels (see above) and Ofcom has been forced to introduce detailed 'minimum service standard' regulation to force BT to improve its service levels. The low quality problems[22] result in part from, we believe, BT's ownership of Openreach which weakens incentives for improvement (since, for example, SLGs are not paid for 40% of missed SLAs[23]) and results in funds being diverted from Openreach.

4.7 For superfast broadband ("SFBB") investments Ofcom opted in 2010 to adopt a different regulatory model. Whilst functional separation and equivalence applied to VULA (the SFBB wholesale product) no wholesale charge control was imposed. This lack of price/margin regulation has not delivered the twin objectives of investment and competition for SFBB. Whilst under this regime there has been adequate FTTC roll-out (although much of it funded by tax payers) competition has severely regressed and uptake has been low (as we explain at §3.3 above).

4.8 Though the regulatory regime is now (from April 2015) changing with the introduction of VULA margin regulation it is not clear if this will usher in sufficiently vibrant and effective competition or drive down the excessive wholesale prices. According to Ofcom's own calculations[24] BT's current wholesale/retail prices – which have led to such a regression in competition – are compliant with the new regulation. Thus it is not clear how well this new regulation will reverse the declining level of competition and re-establish the level of competition prior to SFBB being used to distort the market. [✂ CONFIDENTIAL ✂]. Also because of commercial confidentiality it is difficult to provide a high level of transparency that allows competitors a high level of confidence that BT is not abusing.

4.9 Even if the margin regulation was more effective (than it appears it will be) we still see other more systemic problems with the current model:

- BT Retail clearly has a special status and relationship with Openreach that no other operator has – this 'drives a coach and horses' through the objective of ensuring all retail operators compete on a level playing field and distorts retail competition
- Under the current regulatory model it is not clear whether or how Openreach could create anchor tenant type contracts with non-BT operators to level the playing field (and anyway given vertical integration Openreach would have no incentive to do so)
- Even if BT were not margin squeezing competition will be distorted since BT Retail faces different underlying costs to rivals
- Wholesale prices remain excessive and it is not clear there is any mechanism for addressing this

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[22] It might be considered that BT's ownership of Openreach combined with equivalence of input would create a mechanism for Openreach to 'pull up their socks' through pressure from BT Group management. However, the very poor performance suggests that this mechanism does not work. Also in some cases BT Retail uses a different wholesale product to rivals which weakens the incentive

[23] Under a functional separation model SLGs due to BT Retail are not in practice paid since they are merely an internal transfer

[24] see Approach to the VULA Margin: statement March 2015 §1.13

- [✂ CONFIDENTIAL ✂] [25]

4.10 Thus, under the amended regulatory model (functional separation, equivalence and in time margin regulation) the prospects for competition in UFBB (as well as SFBB) are not good. Further, as we have seen, the current model does not create good incentives for high service quality. Thus the current model is ill-equipped to deliver effective competition and efficient investment.

4.2 Structural separation

4.11 We think that structural separation of Openreach would deliver the twin objectives of investment and competition far more effectively that the current model. We describe below its key effects and advantages. We then discuss the arguments BT have raised against structural separation.

4.12 Furthermore, we think that now is the opportune moment for Ofcom to consider the case for structural separation and make a reference to the CMA.

- there is a investment lull – though some further FTTC investment is planned it is fully committed and cannot be reversed. Further, neither BT nor Openreach are about to make major investments that would be jeopardised by a referral
- separation may become more difficult after the integration of EE
- It would be difficult for Ofcom to make a referral in the next 5 years if it did not make a referral as part of this strategic review
- This is the right timing to ensure that the UK has the right future structure as significant new investment is needed over the next 10 years

4.2.1 *Genuinely level playing field*

4.13 Structural separation will provide a genuinely level playing field since Openreach will (unlike today) have no incentive to discriminate in favour of BT Retail[26] and against its rivals. This will remove retail market distortions and result in more vibrant competition. For example:

- All operators will have opportunity to be anchor customers. According to BT itself, BT Retail acts as an anchor customer for Openreach's FTTC network – BT Retail is "*a guaranteed customer or 'anchor tenant' to fill [the network]*" (see §4.23 below). This suggests there is an implicit contract between Openreach and BT Retail whereby BT Retail commits to driving volume and presumably in return enjoys some favourable commercial terms such as a volume discount[27]. However, no rival has been allowed the same commercial arrangement and

[25] [✂ CONFIDENTIAL ✂]

[26] we use BT Retail to mean all divisions of BT that are downstream of Openreach e.g. BT Wholesale, BT Consumer, BT Business and BT Global Services (in the UK)

[27] assuming BT Retail is acting rationally if it were to make any form of guarantee to Openreach then it would expect favourable terms in return (compared to operators who do not make such a guarantee)

there is no equivalence. Under structural separation, Openreach incentive would be to treat all operators equally and it would try and secure multiple anchor tenant type of arrangements with more than just one operator to reduce risk. This approach would also expand the market

- Structural separation will also critically mean that BT Retail will, unlike today, pay exactly the same wholesale charge as its rivals. Currently under equivalence/functional separation BT does not pay wholesale charges – rather the charges merely represent an internal BT accounting transfer. This results in several benefits:
  - there will be no incentive or indeed possibility for BT Retail to margin squeeze its competitors;
  - it will remove competitive distortions in the retail market since the cost that BT Retail faces will be exactly the same as rivals' – currently even where charge controls apply the incremental cost that BT Retail faces is LRIC whereas the incremental cost rivals face is LRIC plus a common cost allocation[28]. On VULA where no charge control applies the difference between wholesale charges and LRIC costs that BT faces is very large[29]
  - divergences between wholesale charges and *actual* incremental costs will not distort competition if BT is structurally separated[30]
- It is notable that BT itself accepts that retail competition is distorted. BT highlight that under vertical integration BT Retail's incentives are based on making the network investment pay-back rather than based on the wholesale charge it notionally 'pays' (whereas rivals incentives are based on wholesale charges). For instance BT has said[31]:

  > *Since its launch in 2010, the focus of BT's retail fibre strategy has consistently been weighted towards upgrading its existing copper broadband base rather than acquiring customers from other providers. This pro-competitive initiative reflected BT's broader strategy of providing its customers with the highest quality broadband experience while making its multi-billion pound [NGA] investment in the fibre network a commercial success.*
  >
  > *BT therefore decided that its retail operations should prioritise the sale of retail fibre broadband in order to make its enormous investment commercially viable.*

- Structural separation will ensure that all operators are treated equally in product developments and process improvements. As we describe above at §3.4, product innovation and development by Openreach has been slow and discriminatory.

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[28] charge controls are based on FAC costs which, effectively are LRIC plus an allocation of common costs

[29] wholesale VULA charges are about £8 whereas the LRIC cost that BT Retail faces is probably less than £1

[30] Currently if BT's incentives are based on actual costs whereas rivals incentives are based on charges. There are a number of reasons as to why these may diverge e.g. errors in cost calculation, mis-forecasting volumes and efficiency improvements

[31] BT Group plc's response to Ofcom's VULA Margin Consultation 19 June 2014 §4.11 and §4.12

- With structural separation, BT will not be able to over-attribute costs from non-regulated products to Openreach regulated products since they will be different companies. Thus the risk of excessive wholesale prices will reduce – excessive wholesale prices not only weaken and distort competition but they also lead to excessive retail prices
- Under structural separation, Openreach will have no incentive to inflate the prices of products in baskets that rivals use as they do now
- Openreach may have an opportunity to distort downstream competition in relation to switch off its copper network – for instance, [✂ CONFIDENTIAL ✂]. Structural separation will ensure that this distortion will not occur

4.14 These effects mean that structural separation will reduce competitive distortions and ensure far more vibrant retail competition as rivals compete on a truly equal footing.

4.2.2 *Allow significant de-regulation*

4.15 Structural separation will allow significant de-regulation of Openreach and other parts of BT – in particular, it can allow the lifting of regulation designed to prevent discrimination resulting from the vertical integration of a network monopoly with the largest downstream operator. This deregulation will allow Openreach and other parts of BT much more commercial freedom. For instance:

- complex margin squeeze regulation could be removed giving Openreach and BT Retail more freedom – for instance, BT Retail would not be constrained by regulation of how it prices bundles that include SFBB. It is notable that BT have appealed[32] the VULA margin decision on the grounds that it restricts its ability to compete in providing payTV services[33]
- strict equivalence requirements could be removed allowing Openreach to act more commercially and develop bespoke products and service wraps for different retail operators thereby stimulating innovation and investment[34]
- Openreach could be allowed greater price freedom for instance: greater price flexibility within baskets; and, freedom to develop innovative risk-sharing arrangements with different retail operators (e.g. co-investments, minimum revenue guarantees and volume discounts)
- if structural separation was imposed then Ofcom could delay the introduction of wholesale price caps on VULA[35] since excessive wholesale prices would not

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[32] http://www.catribunal.org.uk/237-8833/1238-3-3-15-British-Telecommunications-PLC.html

[33] Ofcom is correct in its approach to including bundles that include payTV and their costs in the VULA margin regulation. To do otherwise would render the regulation ineffective. Thus the 'restriction' is wholly necessary and appropriate

[34] equivalence of input requirements chill innovation since it requires Openreach to provide the same product to all customers at the same time. This means Openreach cannot develop a product only for one customer (or earlier for one customer) and thus wholesale customers incentive to request developments is dulled since they cannot gain any first mover advantage. See BCMR Consultation May 2015 A23.80, A23.86 and A23.110

[35] relative to the counterfactual where BT is vertically integrated

contribute to a margin squeeze and Openreach would have stronger incentives to reduce wholesale prices

- regulatory accounting obligations on the rest of BT could be removed and regulatory accounting rules on Openreach could be relaxed[36] since there would less concern that BT would manipulate the regulatory accounts to discriminate against competitors by allocating costs from non-regulated activities onto regulated Openreach products[37]
- simplifications of charge controls. Currently Ofcom needs to dedicate substantial resources to accurately setting charge controls since any deviation between wholesale charges and actual costs distort competition. If BT were structurally separated these distortions could not occur; the sole concern in setting charges would be the potential for Openreach to exercise market power through setting excessive prices. This will reduce the risk of distortions, reduce the resources required by Ofcom and reduce the likelihood of litigation

4.16 More generally the simpler regulation will improve confidence in the effectiveness of the regulatory regime reducing risk for all players.

4.17 As well as deregulation benefitting the market it will also reduce the burden on Ofcom allowing it to reduce resources allocated to regulating the fixed communications markets.

4.2.3 *Openreach would be rejuvenated*

4.18 Separation is likely to lead to Openreach being rejuvenated as a dedicated and focussed business rather than as a small part of a large behemoth more interested and engaged in retail activities. Today Openreach only accounts for a quarter of BT's overall activity (measured by cost) and post EE merger Openreach will be just one sixth.

4.19 Separation will deliver a number of specific benefits:

- sharper incentives for management to deliver more investment and better quality. Today Openreach management have mixed incentives as they always have 'one eye' to the need to support their downstream businesses
- Openreach will have full control of its own budgets
- the performance of Openreach will be more transparent to investors and other stakeholders
- Openreach will be a smaller more nimble organisation with policies optimised for its business rather than the whole of BT Group

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[36] another side benefit of separation would be that Openreach's cost of capital could be set more accurately since it could be directly observed rather than being estimated by an arbitrary disaggregation of the BT Group cost of capital and/or benchmarking versus other utilities

[37] This will also ensure wholesale charges are set closer to the efficient level (i.e. LRIC)

- Openreach will have independent access to capital markets which will help ensure it gets the efficient level of capital and it will not have to fight for capital or attention against more alluring retail investments

4.2.4 *More network investment*

4.20 Structural separation will create stronger network investment incentives for UFBB (for all players) and make UFBB investment more viable which will ensure faster and more efficient investment. This will happen through a number of mechanisms:

- The potential for BT's competitors to invest in infrastructure themselves will improve through a number of mechanisms
  - The more level playing field will allow them a larger base of SFBB customers which will make UFBB infrastructure investment more viable (as with TalkTalk's FTTH roll-out in York with Sky and CFH)
  - A structurally separated BT will mean that BT Retail is no longer a captive Openreach customer and so BT Retail could become a wholesale customer of rivals' UFBB networks. This means that rival UFBB networks could attract a larger customer base (again making UFBB investments more viable)
- This competition for investment will have several beneficial impacts:
  - it will encourage Openreach to invest faster, as there will be 'investment races' in various parts of the country. This dynamic has occurred in other areas where BT has responded to rivals build announcements by accelerations of their own roll-out (or other actions to delay rivals build)[38].
  - In particular, Openreach cannot be 'lazy' and rely on the guarantee that BT Retail will always purchase network access from Openreach, even though Openreach is offering an inferior product/price
  - it will improve Openreach's service quality as Openreach have to compete for customers

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[38] BT said they couldn't reach the rural villages of Dolphinholme and Glasson Dock, but as soon as B4RN announced they would roll out, BT changed their mind.
http://www.blackpoolgazette.co.uk/news/business/local-business/wyre-mp-blasts-bt-over-rural-broadband-lag-1-6836960

In Devon and Somerset the Council was trying to run a competitive process, but BT said they wouldn't bid unless it was exclusive. http://www.ispreview.co.uk/index.php/2015/02/bt-criticised-approach-devon-somerset-broadband-contract.html

In Birmingham BT launched legal action to prevent the Council building a 100Mbps network.

http://www.computing.co.uk/ctg/news/2294168/bt-will-challenge-york-broadband-project-in-eu-courts-says-cityfibre/page/1

In York BT threatened to litigate to slow rivals progress.
http://www.computing.co.uk/ctg/news/2294168/bt-will-challenge-york-broadband-project-in-eu-courts-says-cityfibre#

  - it will ensure that any tax-payer subsidies are genuinely competed for thereby ensuring value for money

- Openreach will be able (and willing) to de-risk its investment through novel commercial arrangements with multiple retail operators thereby improving viability of its UFBB investments. Where businesses make large investments they often seek to de-risk these[39] through arrangements that provide commitments such as *ex ante* volume commitments, revenue guarantees, co-investments or long contract durations. These types of arrangements are used extensively in other industries – for example in airports, ports, shopping malls, semi-conductor design, semi-conductor fabrication. Under the current regulatory model BT Group has no incentive to allow such arrangements (except with BT Retail)
- The viability of investment for Openreach will improve due to a number of other factors[40]:
  - volumes will be higher as all retail operators will push UFBB thereby lowering unit costs
  - Openreach will be able to access funds directly and not be constrained by funds being siphoned off for other parts of BT Group
  - It is possible that under structural separation wholesale price caps could be less stringent (than would be necessary under vertical integration) improving the viability of investments
  - Investments won't be delayed by BT in order to pressure Ofcom and government for regulatory forbearance
- Under structural separation investment risk will be reduced through two mechanisms
  - The greater long term certainty that a structural solution provides will reduce regulatory risk for all parties and so stimulate investment by Openreach and rivals in UFBB
  - Hold-up risk will be generally reduced under structural separation since there will be stronger downstream competition. Hold-up risk diminishes if downstream competition is high
- [✂ CONFIDENTIAL ✂][41]
- There is likely to be an increase in total funds available for UFBB in the UK since investment will not be so dependent on the balance sheet of just BT to fund roll-out. This is important since the funds required for UFBB are likely to be significantly higher than past expenditures[42].

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[39] in particular they seek to reduce the possibility of hold-up whereby, once the investment is sunk, retail operators seek to renegotiate prices downwards

[40] in areas where rivals are not competing with Openreach

[41] [✂ CONFIDENTIAL ✂]

[42] the total capex required for 95%+ FTTH is probably £10-20bn whereas the costs for similar FTTC coverage is probably £3-5bn

4.2.5 *Improved service quality*

4.21 We think that under structural separation service quality is likely to improve. This will happen through a number of mechanisms:

- Openreach will no longer have the perverse and harmful incentive whereby lower quality competitively advantages BT Retail. BT Retail benefits from low quality in two ways: low service quality protects BT's high market share by deterring migrations; and, when quality is poor there tends to be a 'flight to brand' where consumers and businesses tend to favour the perceived 'safe' brand of BT
- The level of SLGs paid out by Openreach under structural separation will be higher creating stronger and more efficient incentives to improve quality. Under a functional separation model SLGs due to BT Retail are not in practice paid since they are merely an internal accounting transfer
- If BT Retail is no longer a captive Openreach customer, Openreach will have a stronger incentive to improve service quality
- The reduced equivalence obligations will allow Openreach to innovate a greater range of quality options which should improve the viability of improved service quality. For instance, Openreach could develop bespoke approaches for particular operators or adopt risk-sharing arrangements
- A separate Openreach will have independent access to capital (and thus be less likely to have capital diverted); have a sharper focus on delivering higher quality; and, will be more open to public scrutiny

4.2.6 *BT's counter arguments*

4.22 At various points, BT has raised some questions regarding the effect of separation on investment and the practicality of separating Openreach. We discuss our view on these below.

4.23 The most repeated point from BT is that it/Openreach can only justify investments in SFBB (and UFBB) if it remains vertically integrated. It said recently[43]:

> *The decision [to invest in FTTC] was only possible because BT had both an infrastructure arm to build the network and a guaranteed customer or 'anchor tenant' to fill it - the retail arm of BT.*

4.24 Essentially BT is suggesting that without guarantees provided by BT Retail then there is a hold-up risk which would render Openreach's investment unviable. We think this argument is fundamentally wrong for a number of reasons.

4.25 First, in other industries it is not necessary to have vertical integration to avoid hold-up risk. For instance: "*does Heathrow need to be vertically integrated with BA to*

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43 http://www.btplc.com/Sharesandperformance/Industryanalysts/Newsletter/Issue37/Feature/index.htm

justify runway investment?" The answer to that is no[44]. Examples from other industries clearly show that vertical integration is not necessary to address hold-up risk which can be effectively addressed through contractual mechanisms. In any case, in telecoms where there is strong downstream competition then hold-up risk is diminished. These issues are extensively explored in the CRA report submitted by Sky as part of its submissions. We broadly agree with their observations.

4.26 Second, even were Openreach to rely on BT Retail as the anchor customer it would effectively marginalise other potential anchor customers who could de-risk the investment. Openreach's investment viability would be improved if it were able to rely on multiple anchor customers, rather than just BT Retail.

4.27 BT's argument reveals a number of other issues

- it is clear that BT Retail is treated differently to rivals and there is no level playing field – no rival has had the opportunity to become an anchor tenant like BT Retail apparently is
- BT is only considering its own investment incentives and is disregarding the investment incentives of rivals. UFBB investment can be contestable and therefore the investment of rivals must be considered. Ofcom needs to consider not just Openreach's investment incentives but also those of rivals
- BT's behaviour seems to show that it sees BT Retail as tied to Openreach and BT Retail would not purchase from rivals' UFBB networks. This type of behaviour will deter rival UFBB investment since it will reduce the market available to rivals

4.28 We believe that the real reason why BT demands it remains vertically integrated is that vertical integration allows it to weaken competition, gain supra-profits and use Openreach as a 'cash-cow' to fund its retail investments. The threat that structural separation will reduce investment has no sound economic efficiency basis – rather it is a crude form of blackmail.

4.29 BT also seem to be suggesting that the mere step of a CMA reference happening would put Openreach investment on hold. This is a deeply cynical argument. There is no logical reason for Openreach to delay investing in UFBB just because a CMA review is ongoing since investment (provided it is efficient) would be just as viable and would increase the sale value of Openreach. This argument is also crude blackmail.

4.30 BT has raised several questions regarding the practicality of separation. In our view the steps required for structural separation are straightforward presenting no risk or no material disruption because a lot of the relatively more difficult steps have

[44] Similarly, no competition authority would let BA purchase Heathrow

already been completed given the way BT and Openreach is currently organised[45]. For instance:

- The major steps have already been completed:
  - The 'trades' between Openreach and Rest of BT (RoBT) have already been productised and equivalent products introduced (for all the major flows) and separate systems have already been implemented to manage this
  - Openreach already has a separate senior management team and workforce to RoBT
  - there are established Chinese Walls to (attempt to) limit inappropriate influence and information sharing between Openreach and RoBT
  - Openreach already has a separate and established brand

  Notably, none of these more difficult steps were that disruptive when Openreach was originally created
- The additional steps required for structural separation are limited and relatively straightforward:
  - any current central / shared services with RoBT such as finance, HR policy, strategy, regulatory and legal could be easily separated
  - creating Openreach as a separate legal entity from BT and listed separately on the London Stock Exchange is a well established and straightforward corporate process. This process will take into account any liabilities and assets to be transferred or retained between Openreach and RoBT and it is also accepted by HMRC meaning there will be no adverse tax consequences. TalkTalk showed how smoothly and quickly this process can be carried out when it demerged from Carphone Warehouse in 2010.
  - The executive directors of this new entity (being the CEO and CFO) are already working for Openreach. There is no need for the new entity to have any more executive directors as demonstrated by BT Group plc which itself only has two executive directors. The only new appointments required to satisfy corporate governance rules are an independent Chairman and two independent non-executive directors (noting there is no need to have any more non-executive directors when there are only two executive directors). There should be no shortage of suitable candidates for these roles.
- There is no material risk that the new operating model will not work for RoBT – all other CPs (except BT) trade with an entity that they do not own. There is no reason as to why RoBT cannot trade effectively with Openreach if Openreach is separate

[45] Prior to separation it may be appropriate to slightly alter some of the boundaries between Openreach and RoBT in order to ensure a sensible division – for instance, exchange ownership, arrangements in Northern Ireland (where Openreach does not operate today)

- Openreach could be easily financed. It is a strong and stable business with assets of £13bn[46], revenue of £5.0bn, EBITDA of £2.6bn and operating cash flows of £1.5bn. It currently has a lower risk and cost of capital that the RoBT and its underlying assets and monopoly position mean that it could secure debt and equity relatively easily. Its size would probably place it in the FTSE 50[47]
- The defined benefits pension scheme could continue. There is no reason as to why Openreach could not bear its share of the scheme liabilities as well as assuming a share of the assets. Other companies have successfully split defined benefits schemes in the past.

4.3 Continued vertical integration

4.31 If structural separation is not pursued then it might be possible to improve the existing regulatory model to address (albeit only partially) some of the discrimination problems caused by a vertically integrated BT (i.e. behavioural remedies rather than structural). We discuss some of these improvements below.

4.32 A major problem with the current approach is that for new investments it allows a margin squeeze and the resulting competitive distortions. There are a number of options for addressing this[48].

- The most effective option in removing distortions would be to set a wholesale price caps (ideally based on LRIC cost) from the launch of new UFBB services (and do the same for SFBB). This would ensure that BT Retail and its rivals both faced the same long run costs (if prices were set at LRIC)
- The second-best option would be to rely on margin squeeze regulation but with significant improvements:
  - VULA margin regulation would need to be applied from the launch of UFBB products
  - The VULA margin (for SFBB and UFBB) would need to be significantly recalibrated so that it delivers a margin that genuinely allows effective competition – as we explained at §4.8 above under the current VULA margin regulation BT existing wholesale/retail prices are compliant even though they do not allow effective competition

[46] revenue, EBITDA and OCF from BT statutory accounts. Assets is estimated from BT's regulated accounts as the sum of the mean capital employed for the fixed access market, business connectivity market and residual wholesale market

[47] assuming that its enterprise value (EV) equals its regulated asset value (RAV) of £13bn. The market capitalisation (MC) equals EV less debt. To be in FTSE 50 requires a MC of about £7bn

[48] a 'blue sky' option to address the margin squeeze could be to impose rate of return regulation on GEA/VULA whereby the wholesale charge is based on *actual* costs (including a return on capital employed). This would reduce the disincentive to invest that can result from a charge control whereby prices are effectively capped ex ante. However, this form of regulation has very poor incentives for productive efficiency.

- The VULA margin regulation would need to be product by product to prevent *inter alia* BT margin squeezing on UFBB by 'cross-subsidising' from SFBB

4.33 Whilst these options for avoiding margin squeeze improve on the current situation they are inferior to structural separation in preventing margin squeeze and distortions:

- setting wholesale price caps from launch has, according to Ofcom, the potential to discourage investment in the early stages of roll-out[49]. The disincentive could be reduced by setting light caps (i.e. prices some amount above cost) but this then would be insufficient to avoid a margin squeeze and abuse of market power
- we think it likely to be difficult to design and apply margin regulation that fully (or even mostly) eliminates distortions. As we explain above the current VULA margin regulation has not eliminated distortions. Further, margin regulation is highly complex and resource intensive, susceptible to regulatory failure (i.e. making incorrect assumptions) and can be gamed by BT. The problems with it are likely to increase following the acquisition of EE and the likely increase in bundles including mobile services

4.34 In practice, we think that where a vertically integrated monopolist makes new investments (such as SFBB or UFBB), it is extremely difficult to simultaneously ensure effective competition and efficient investment [50].

4.35 Ofcom could also impose other additional regulation to address the other problems that result form BT being vertically integrated:

- Openreach could be required to develop and offer non-discriminatory 'anchor tenant' terms for non-BT CPs. However, BT Group has no incentive to allow this to happen and it is not clear how regulation could in practice set or enforce equivalent anchor tenant arrangements
- [✂ CONFIDENTIAL ✂] (see §4.9 above]
- Changes in the product development process so that non-BT CPs are genuinely treated equally to BT Retail. This might be difficult to regulate since there is no clear or measureable 'transaction' that can be monitored to identify discrimination and the favouritism is subtle and difficult to detect
- More strict price basket controls to prevent BT gaming the regulation by increasing relative prices on products BT Retail buys less of
- Stronger service quality obligations. Structural separation will create stronger incentives for Openreach to improve quality – see §4.21. In a model without structural separation quality could be improved by extending the scope and

[49] Fixed access market reviews, June 2014 §12.140

[50] for example, to remove distortions Ofcom would need to set the 'correct' anchor tenant arrangement and the 'correct' charge control

tightening minimum service standards and imposing some price regulation on enhanced services

- Stronger regulatory accounting and cost obligations. If BT remains vertically integrated then stronger rules on cost allocation would be appropriate to prevent costs being allocated from non-regulated activities onto regulate products.

4.36 In theory it is possible that behavioural regulation could be improved from the situation today which could address some of the problems created by vertical integration. However, behavioural regulation is inherently less effective than structural solutions in addressing competitive distortions:

- regulation does not tackle the underlying cause (e.g. incentive to discriminate) but rather attempts to treat the symptoms as they are detected
- regulation can only, at best, tackle detected / known problems. It cannot tackle undetectable or unknown forms of discrimination
- due to the limited resources available to Ofcom and the inherent lag in regulation being imposed – behavioural regulation will only ever partially address the competition problems

4.37 Another problem of vertical integration is that it can attract political involvement in Ofcom decisions – for instance, a government may, in order to secure a roll-out commitment from Openreach seek relaxed regulation of BT.

4.38 In summary, the current regulatory approach (behavioural remedies under vertical integration structure) could be modified to improve the prospects for efficient investment and effective competition. However, we believe that such a model would result in a greater amount of more intrusive, complex, contentious, expensive and litigated regulation that ultimately will not be effective.

4.4 Summary of options for fixed and case for a referral

4.39 Though it has been successful in the past we do not think that the current model where BT remains vertically integrated will be effective in the future. It is highly unlikely to deliver the effective competition and efficient investment that the UK demands over the next decade. Structural separation will deliver a step change improvement to competition, investment and quality. It will also allow significant de-regulation. Whilst some improvements could be made to the existing vertically integrated model, it is fundamentally incompatible with effective competition and will lead to ever more complex, expensive and intrusive (though ultimately ineffective) regulation.

4.40 Ofcom does not have the powers to require BT to divest Openreach or structurally separate. Instead, Ofcom can refer the matter to the CMA as a market investigation reference ("MIR").

4.41 Ofcom may make MIRs to the CMA under section 131 EA02:

"[Ofcom] may...make a reference to the CMA if [it] has reasonable grounds for suspecting that any feature, or combination of features, of a market in the United Kingdom for goods or services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom".

4.42 We consider that there are features of the market (namely the combination of BT's upstream market power and vertical integration) which distort competition particularly in relation to new investments and that this condition is clearly met.

4.43 The additional administrative criteria as to when to make a reference set out in CMA's guidance on MIRs are that:

- sectoral or competition law powers at Ofcom' disposal will not be sufficient to address the concerns identified;
- undertakings in lieu of a MIR are not appropriate;
- the scale of the problems identified clearly merit a MIR; and
- there is a reasonable chance that appropriate remedies will be available.

4.44 We think that these conditions are also met.

- As we describe above we do not consider that substantial further sectoral / *ex ante* regulation could address the problem. Competition law is even less effective than *ex ante* regulation
- There are no undertakings 'on the table' today though of course BT may come forward with undertakings that address the concerns
- The telecoms market effected is large and the problems have a significant impact on consumers
- Openreach divestment is in our view an appropriate remedy and it is available to the CMA

4.45 In deciding to consult and make a reference it is important to recognise that Ofcom does not need itself to reach a conclusion as to whether or not structural separation would be proportionate. Rather Ofcom needs to satisfy itself that the s131 EA02 'reasonable grounds for suspecting that a feature of the market distorts competition' test is satisfied. Following a reference it is then for the CMA (though almost certainly with extensive advice from Ofcom) to decide on any remedy, if any. This process will leverage both the CMA's EA02 powers and expertise in structural remedies with Ofcom's expertise in telecoms.

4.46 We think that Ofcom should consult on whether to make a referral as soon as possible and there is no need to wait for the phase 2 publication (currently pencilled for early 2016). The distortion of competition continues and the longer it continues unchecked the greater the harm to consumers and the longer distortion will persist for.

5 De-regulation

5.1 We agree with Ofcom's objective to reduce regulation since unnecessary regulation can be detrimental to consumers. However, de-regulation should not be seen as an end in itself but rather a natural consequence of a player holding less market power or the market being subject to less vertical integration, meaning that regulation is less necessary to protect consumers' interests. The surest way to achieve de-regulation is therefore to increase competition and address vertical integration.

5.2 As we explain above we consider that structural separation will enable a significant reduction in *ex ante* regulation. Regulations that could be removed include: VULA margin regulation; equivalence requirements; restrictions of bespoke commercial arrangements; and restrictive basket price regulations. If structural separation allows greater competition it may also lead to no SMP findings and deregulation in certain access markets. By contrast if structural separation is not introduced then more intrusive regulation would be required in more markets for longer.

5.3 In general we consider that the market review process is the most appropriate vehicle to assess whether reductions in regulation are appropriate because no SMP is found or market power has weakened to allow lighter remedies. Notwithstanding the central role of the market review process we think the following markets / regulation are candidates for considering less regulation:

- Wholesale line rental – the price of WLR is (indirectly) constrained by operators using MPF and/or Virgin such that BT's market power is reduced/weak
- Wholesale call origination. BT has to provide call origination to CPs who take WLR. If regulation on WLR was reduced/withdrawn so too could regulation on call origination be relaxed / removed. Furthermore, wholesale call origination is no longer on the list of Recommended Markets susceptible to *ex ante* regulation
- Wholesale call termination (which currently is 0.03ppm or less than 10p per average customer per month). One option here may be to set call termination to zero so effectively the terminating network bears the cost. This will reduce the regulatory burden on Ofcom and reduce transaction costs between operators.
- WBA Market A (in market B, BT has no SMP). Though BT will continue to have SMP in market A for the foreseeable future the remedies could be reduced and/or simplified
- Universal service obligation (USO). Currently Ofcom has chosen to impose the USO on BT, which may be less appropriate if BT Retail is separated from Openreach. Ofcom could consider other mechanisms to ensure universal service, such as e.g. a central fund

5.4 We note that that the roll-out of UFBB by rivals to BT and Virgin may result in different geographic markets and/or different remedies in different geographic areas as has happened in the wholesale broadband access and business connectivity markets. This in effect will be de-regulatory as it is likely to lead to less regulation in some areas than would result if there was no geographic differences in regulation[51].

– END –

[51] It is worth noting that a move to geographic markets is likely to slightly increase the regulatory burden on Ofcom.