

## KCOM - Response to Ofcom's Wholesale Local Access and Wholesale Broadband Access Market Reviews

### 1. Introduction

- 1.1 KCOM Group PLC ('KCOM') welcomes the opportunity to provide input in response to Ofcom's review of wholesale local access ('WLA') and wholesale broadband access ('WBA') markets in the Hull Area.<sup>1</sup> The Consultation includes proposals on the definition of relevant markets, market power determinations and remedies package for the respective wholesale markets.
- 1.2 Ofcom's Consultation recognises the increasing importance of broadband services for both business and residential consumers in the UK and the growing relevance of next generation access ('NGA') services in delivering superfast and ultrafast broadband to those customers.<sup>2</sup>
- 1.3 Ofcom is correct to recognise the positive developments that have taken place in the Hull Area in relation to the provision of retail broadband services and KCOM remains open to offering a range of content service to retail customers in the case where such content is made available to it on wholesale basis.
- 1.4 KCOM considers it important that both residential and business retail customers in the Hull Area are able to obtain the benefits of next generation broadband investments made by us and from competition in the Hull market. Our fibre investment, and those made by competing providers will play a critical role in the development of Hull and East Yorkshire region both now and into the future. Specifically, KCOM's view is that full fibre (FTTP) networks provide the only future-proof NGA solution that is capable of effectively meeting the future demands of customers both in terms of scalable bandwidth and in terms of their reliability.
- 1.5 KCOM provides broadband services to a range of businesses and consumers in the Hull Area. Specifically:
  - KCOM provides both current generation broadband access services (ADSL2+) and next generation broadband access services (FTTx) on an end-to-end basis using our own network infrastructure in the Hull Area.
  - KCOM's 'Lightstream' superfast / ultrafast broadband services will be deployed to 150,000 residential and business premises by the end of

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<sup>1</sup> The area defined as the 'Licensed Area' in the license granted on 30 November 1987 by the Secretary of State under Section 7 of the Telecommunications Act 1984 to Kingston upon Hull City Council and Kingston Communications (Hull) plc (KCOM).

<sup>2</sup> This has been evident in the average usage which has risen from 58GB to 132GB per month and the increase in average speeds that have increased from 23Mbit/s to 37Mbit/s.



2017, which represents three quarters of our total on-net premises served by our network in Hull and East Yorkshire.<sup>3</sup>

- KCOM is in the process of considering the business case for the deployment of its Lightstream to the remaining ~55,000 of our total on-net premises.
- 1.6 In light of the solutions that we provide in the Hull area KCOM has a clear interest in the outcome of the WLA and WBA reviews as the regulation that flows from it has direct commercial and operational implications for our business. This is not least because of the £60 million investment that we have made in our fibre network, as well as any prospective commitment to deploy to the final quarter of on-net premises. Ofcom is aware of the regulatory balance, recognising in the Consultation that the regulation of the WLA and WBA markets should build on the competitive growth that is evident but measures introduced by Ofcom do not undermine our current or prospective investment.
- 1.7 KCOM considers that in broad terms Ofcom is seeking to apply appropriate and proportionate regulation in response to the competition concerns that Ofcom has identified in the respective WLA and WBA markets.
- 1.8 Set out below is a summary of the key points of KCOM's response to the Consultation. The representations contained within this response by definition focus solely on KCOM's business within the Hull Area. We hope that Ofcom finds our contribution helpful.

## **2. Summary**

- 2.1 KCOM agrees with the stated objective of the WLA and WBA reviews in the Hull Area, which includes reference to the achievement of Ofcom's broader strategic objectives set out in Strategic Review of Digital Communications.<sup>4</sup>
- 2.2 KCOM notes Ofcom's assessment of the potential interactions between the remedies package applying in WLA and WBA markets where full fibre networks are deployed.
- 2.3 KCOM agrees with Ofcom's provisional product market definitions for the WLA and WBA, which are consistent with the product market definition applying in the rest of the UK. We further agree that the geographic scope of the relevant product market is the Hull Area. Furthermore, KCOM agrees with Ofcom's provisional finding that KCOM holds SMP in both the WLA and WBA markets in the Hull Area.

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<sup>3</sup> KCOM's network in the Hull and East Yorkshire area comprises both the Hull Area and a geographic area outside this boundary where KCOM is not subject to SMP regulation, or a Universal Service Obligation (USO). In this East Yorkshire Expansion ('EYE') area KCOM competes with BT on an end-to-end basis in the provision of communications services. The 150,000 commitment is not limited to deployment in the Hull Area that has ~182,000 of the ~205,000 on-net premises.

<sup>4</sup> <https://www.ofcom.org.uk/phones-telecoms-and-internet/information-for-industry/policy/digital-comms-review>



- 2.4 KCOM agrees with Ofcom proposals with respect to general access remedies and a number of complementary transparency and reporting (regulatory accounting) obligations, subject to certain specific qualifications. We consider that these interventions are in broad measure appropriate and proportionate. By extension, we do not consider it necessary for Ofcom to introduce specific access products in either the WLA or WBA markets.
- 2.5 KCOM considers it critical that we should be permitted a 'fair bet' on our FTTP investment, which began in 2011 by Ofcom permitting us to benefit from sufficient upside potential from this investment such that it offsets the downside risk of its failure.
- 2.6 In meeting reasonable request for network access we note Ofcom's proposal to impose a reasonable charges obligation in each of the WLA and WBA markets should be appropriately formulated in order to ensure the 'fair bet' principle isn't undermined.
- 2.7 As the Consultation is currently worded Ofcom's proposals to apply reasonable charges obligation in each of the WLA and WBA markets, set on a Long Run Incremental Cost plus (LRIC+) basis, including a reasonable rate of return and a reasonable contribution to common costs appear inconsistent with its strategic intent to promote full fibre deployments. As such, if Ofcom continues to propose the introduction of a 'standard' approach we would welcome the opportunity for further engagement with Ofcom and intend to make submissions on this point in response to the Ofcom's further consultation on proposed accounting provisions applying to KCOM in the Hull Area.
- 2.8 KCOM consider Ofcom's proposals concerning non-discrimination to be appropriate and have a clear view that the imposition of a strict form of non-discrimination (Equivalence of Inputs ('EoI')) would be disproportionate in meeting the competition concerns identified by Ofcom.
- 2.9 KCOM notes Ofcom's intention to require revisions to our regulatory reporting obligations including the introduction of cost accounting and accounting separation obligations in both the WLA and WBA markets. We further note Ofcom's intention to consult later this year (2017) on the specific form of accounting separation requirements that Ofcom is proposing to impose. Amongst other things, this will include details of the implementation timescales for the revised requirements applying to our Regulatory Financial Statements.



## 3. Response to Ofcom's consultation questions

Question 3.1: Do you agree with Ofcom's proposed market definition? Please provide reasons and evidence in support of your views

3.1.1 KCOM agrees with Ofcom's provisional product market definitions for the WLA and WBA, which are analytically consistent with the product market definition applying in the rest of the UK. Specifically:

- For WLA, the proposed product market is defined as:
  - *A single product market for the supply of copper loop, cable and fibre-based wholesale local access at a fixed location.*
- For WBA services the proposed product market is defined as:
  - *Asymmetric broadband access and any backhaul as necessary to allow interconnection with other telecoms providers, which provides an always-on capability, and allows both voice and data services to be used simultaneously.*

3.1.2 We agree that the geographic boundary to the relevant wholesale markets is the Hull Area.<sup>5</sup>

Question 3.2: Do you agree with Ofcom's proposal that KCOM holds SMP in the supply of WLA and WBA products in the Hull Area? Please provide reasons and evidence in support of your views.

### SMP assessment – Wholesale Local Access

3.2.1 KCOM agrees with Ofcom's provisional finding that KCOM has SMP in the WLA market in the Hull Area.

3.2.2 However, we would note the following. On Ofcom's own analysis there is clear evidence of market entry and expansion based on competing end-to-end full fibre networks. The infrastructure provision in the Hull area could change materially over the course of the current review period. In particular, end-to-end infrastructure investments have been made, or may be made, mean that competing full fibre technology (FTTP) deployments in the form of MS3<sup>6</sup> and CityFiber<sup>7</sup> may subsequently present stronger competitive constraints than Ofcom's current analysis suggests.

<sup>5</sup> The Hull Area being the area defined as the 'Licensed Area' in the license granted on 30 November 1987 by the Secretary of State under Section 7 of the Telecommunications Act 1984 to Kingston upon Hull City Council and Kingston Communications (Hull) plc (KCOM)

<sup>6</sup> <http://www.ms-3.co.uk/pages/about-us.html> and <http://www.connecthull.co.uk/>

<sup>7</sup> <https://www.cityfibre.com/gigabit-cities/hull/>



## SMP assessment – Wholesale Broadband Access

- 2.10 KCOM agrees with Ofcom’s provisional finding that KCOM has SMP in the WBA market in the Hull Area.

Question 4.1: Do you agree with the remedies that we propose to impose? Please provide reasons and evidence in support of your views.

### Proposed SMP remedies

- 4.1.1 KCOM agrees with Ofcom proposals with respect to general access remedies and a number of complementary transparency and reporting (regulatory accounting) obligations, subject to certain specific qualifications. We consider that these are in broad measure appropriate and proportionate. This includes Ofcom’s proposal to remove the requirements for us to provide Local-Loop Unbundling (LLU) but to leave available the option for a communications provider to request Sub-Loop Unbundling (SLU) for a service that uses D-side (distribution side) copper components in the access network.
- 4.1.2 KCOM does not consider it necessary for Ofcom to introduce specific access products in either the WLA (e.g. VULA) or WBA markets. This includes, but is not limited to, the choice not to impose a passive access remedy in the form of duct and pole access. As Ofcom is aware, we like other network providers are subject to the requirements of the Communications (Access to Infrastructure) Regulation 2016 (the ‘ATI Regulation’), whose explicit purpose is to reduce the cost of next generation broadband deployments.<sup>8</sup>
- 4.1.3 KCOM have publically confirmed the launch of our fibre retail-minus, white label product and are currently working on the commercial and operational parameters of the product. Initial details of this retail-minus product have been published on our website, with communications providers able to order it at the end of November 2017.<sup>9</sup> This product provides communications providers’ with the ability to own the retail relationship with customers and therefore provides them with a low risk entry strategy and information that will better inform a decision to move up the ladder of investment in the Hull Area.

<sup>8</sup> *The Communications (Access to Infrastructure) Regulations 2016*, Statutory Instrument 2016, No.700, available at: [http://www.legislation.gov.uk/uksi/2016/700/pdfs/uksi\\_20160700\\_en.pdf](http://www.legislation.gov.uk/uksi/2016/700/pdfs/uksi_20160700_en.pdf). The ATI regulation is a sectoral intervention (i.e. it is not a Significant Market Power (SMP) remedy) that applies symmetrically to all qualifying undertakings (i.e. it is a passive access measure that applies in equally to all network provider across various sectors (communications, energy, transport, water etc.)). It provides a tool by which relevant network providers can obtain network access to passive infrastructure (excluding dark fibre) owned by a communications provider, and other qualifying utilities. The introduction of the measures contained with the ATI Regulation means that qualifying undertakings cannot simply chose to reject infrastructure access requests without an objective justification. Importantly, as far as we understand it, there are no proposals / plans to withdraw the ATI Regulation with the UK’s exit from European Union (‘Brexit’).

<sup>9</sup> <http://www.kcomplc.com/regulatory/kcom-wholesale/service-information/new-services/>



## **Requirement to provide network access on reasonable request and to provide such access on fair and reasonable terms conditions and charges**

### *Requirements to provide network access on reasonable request*

- 4.1.4 KCOM agrees with Ofcom's proposals to impose obligations on it in the WLA and WBA markets in the Hull Area that requires KCOM to grant reasonable requests for network access, alongside a requirement to publish guidelines about how communications providers can obtain new forms of network access, obtains the right balance between ensuring that communications providers can obtain access to the wholesale services that they need to compete, and not requiring us to develop products which would be expensive to develop and which might not meet the needs of local communications providers.
- 4.1.5 KCOM agrees that where product development work is undertaken to meet a reasonable request for network access that the directly attributable costs associated with that development work can legitimately be recovered in the charge applied for wholesale network access.<sup>10</sup>
- 4.1.6 KCOM agrees that communications providers operating in the Hull Area are best placed to define the access product(s) that they need to deliver services. To that end, we are engaging with both existing and prospective wholesale customers on the form of access product that they need.

### *Requirement for charges to be fair and reasonable*

- 4.1.7 Ofcom notes that it considers it necessary to require KCOM to set prices based on LRIC+ to mitigate against the risk of KCOM charging excessive prices.
- 4.1.8 KCOM considers this remedy to be inappropriate for the following reasons:
- There is significant evidence of the competitive constraints in place which restrict KCOM's ability to raise prices.
  - Ofcom has not provided any evidence to suggest that KCOM has or will charge excessive prices.
  - Ofcom's proposed approach to restricting prices on FTTP services at this point in the investment lifecycle will disincentivise future investment in FTTP by KCOM and other investors in other areas of the UK.
  - Ofcom's approach to determining whether or not to regulate KCOM's FTTP prices is harsher than that it adopted when considering whether or not to regulate BT's FTTC services which arguably represented a less risky investment.

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<sup>10</sup> New product development will often comprise more than direct costs. Under the provision that these costs are legitimately incurred these are similarly recoverable through the network access charges.



- Ofcom's proposed use of LRIC+ as a measure of 'fair and reasonable' is overly restrictive and fails to provide KCOM with a 'fair bet' return on its risky investment in fibre.

We discuss each of the above points further below.

- 4.1.9 KCOM has noted that there is clear evidence of both market entry and expansion based on competing end-to-end infrastructure providers (see paragraph 3.2.2 above), which imposes a real competitive constraint by credible providers who are actively offering competing retail services in the Hull Area. Moreover, Ofcom's network access proposals present the realistic prospect of delivering wholesale competition. This is likely to add further downward pressure on KCOM's retail pricing, which are currently under review.
- 4.1.10 Given the existing level of competition and Ofcom's stated regulatory objectives of encouraging investment, KCOM considers that absent any evidence that KCOM's prices are excessive, Ofcom's proposals to require KCOM to set prices based on a LRIC+ methodology to be unnecessary and disproportionate. Currently KCOM's retail price for our comparable Lightstream (FTTP) services are broadly in line with BT's standard FTTP Infinity 3 and 4 services.
- 4.1.11 It is important to balance both competition and investment objectives and Ofcom is therefore correct to recognise that KCOM should be permitted a 'fair bet' on our FTTP investment. While this investment began in 2012 our deployment did not begin scale until much later and is yet to be completed. Indeed, while there have been efficiencies achieved during deployment the investment case in the 'final quarter' of HEY remains challenging. As Ofcom understands, FTTP is an overlay investment with a risk profile materially different to that of incremental upgrades to existing copper deployments (FTTC). Importantly, given we were in the vanguard of full fibre investment in the UK and are continuing to invest it is appropriate that we should be permitted to benefit from sufficient upside potential from this investment such that it offsets the downside risk of its failure.
- 4.1.12 Clearly, KCOM is not an isolated case. BT Openreach have made clear that there are significant risks attached to long term investments in FTTP and given the continued uncertainty of the business case and the funding commitment required they are rightly seeking an appropriate level of regulatory and governmental certainty about the form and structure of price regulation.<sup>11</sup> With a range of models being reviewed with industry, communications providers considering co-investment models will likely consider it similarly important to understand clearly what the risk profile looks like.
- 4.1.13 Ofcom's approach to access charges in the Hull Area will therefore send a critical regulatory signal that must be consistent with Ofcom's stated strategic intent to

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<sup>11</sup> BT (2017), *Upgrading the Access Network with FTTP*, Openreach Consultation, 17 July 2017, available at: <http://www.btplc.com/news/#/pressreleases/openreach-seeks-support-to-future-proof-digital-britain-2070816>



promote full fibre investment. As Ofcom recognises, price interventions that take place too early run the risk of inconsistent signals with the effect of chilling investments both in the Hull Area and elsewhere in the UK market. Indeed, any decision to impose this level of intervention at this stage in the investment cycle requires an evaluation of the potential impact on investment. Amongst other things, this evaluation will recognise the time that has elapsed compared to the expected payback period at the time the investment was committed, the perceived riskiness of the initial investment, the performance of the investment against initial expectations, and the level of returns.<sup>12</sup>

4.1.14 Moreover, in KCOM's view, such an analysis will indicate that, based on applying the same criteria, it is premature for Ofcom to require KCOM to set prices for its FTTP service based on a LRIC+ costing methodology.

4.1.15 Even if Ofcom considered it necessary to place a constraint on KCOM's pricing to address the risk of excessive pricing, KCOM considers that the use of LRIC+ approach to determining prices to be unnecessarily restrictive. Ofcom has previously accepted the benefits of providing firms with a greater of flexibility. This is particularly the case in nascent markets where new infrastructure is being deployed and the demand for new services is uncertain.

4.1.16 In KCOM's view Ofcom should explain why it considers the proposed LRIC+ pricing constraint necessary. In the past, Ofcom has accepted the use of a stand alone cost ceiling as an appropriate constraint on the pricing of services:

*"In other situations, such as cost orientation in a prospectively competitive market, the details of the condition might be specified somewhat differently (e.g. there might be a stronger argument to use DSAC instead of FAC+)."*<sup>13</sup>

4.1.17 In KCOM's view a requirement to set charges for its FTTP services within DLRIC and DSAC floors and ceilings would represent a more proportionate and appropriate remedy against anti-competitive prices, should such a remedy be appropriate (which KCOM does not consider to be the case).

4.1.18 If Ofcom does impose a fair and reasonable obligation on KCOM's prices along the lines proposed it is critical that Ofcom explains what a 'reasonable' rate of return is in this context and how it will ensure that KCOM will be able to earn a return consistent with Ofcom's stated fair bet principles.

4.1.19 Furthermore, Ofcom is proposing to benchmark these wholesale charges against BT's rates for comparable bandwidths in the rest of the UK. Amongst other things, such an exercise will need to reflect the approach that Ofcom takes to the regulation of BT's FTTP network and to similarly recognise that the products

<sup>12</sup> Ofcom, Annex 8 WLA Market Review, 31 March 2017, paragraph A8.1.

<sup>13</sup> Ofcom Cost Orientation Review, Consultation, 5 June 2013 paragraph 1.9



offered in the respective WLA and WBA markets will not be the same as those provided by BT.

## Request for new forms of network access

- 4.1.20 KCOM agrees with Ofcom's proposals to impose obligations on it to publish specified guidance for communications providers seeking new forms of network access (Statement of Requirements ('SoR') process).
- 4.1.21 KCOM is content to publish an appropriate level of non-confidential detail on the SoRs it receives. However, it does seem excessive to require KCOM to notify Ofcom each time it receives such a request given the other elements of monitoring at its disposal.
- 4.1.22 KCOM considers it helpful to publish details of the requests made for network access against. While there are numerous SoR KPI metrics Ofcom is requiring KCOM to report against Ofcom is proposing that these are published on a bi-annually (April- September and October-March respectively) basis. This balances the need for effective monitoring by Ofcom but does not require a significant administrative overhead.
- 4.1.23 KCOM intends to include escalation routes within its revised guidance concerning any rejected requests for network access. This will include both KCOM internal complaints handling and explicit reference to the external complaints handling by Ofcom.<sup>14</sup>
- 4.1.24 KCOM is content to make clear when we consider a request falls within a regulated market when a SoR is made.

## Requirement not to discriminate unduly

- 4.1.25 We consider Ofcom's proposals concerning non-discrimination to be appropriate. Furthermore, we agree with Ofcom that the imposition of a strict form of non-discrimination (EoI) and it would be disproportionate to impose such an obligation given the competition concerns that Ofcom has identified and the costs that would need to be incurred in order to serve the prospective take-up up WLA and WBA products by competing providers in the Hull Area.

## Transparency and notification obligations

### *Requirement to publish a Reference Offer ('RO')*

- 4.1.26 KCOM considers it proportionate to require the publications of ROs in both the WLA and WBA markets in the Hull Area.

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<sup>14</sup> *Enforcement guidelines for regulatory investigations*, Guidelines, 28 June 2017, available at: [https://www.ofcom.org.uk/data/assets/pdf\\_file/0015/102516/Enforcement-guidelines-for-regulatory-investigations.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0015/102516/Enforcement-guidelines-for-regulatory-investigations.pdf)



## *Requirement to notify changes to charges, terms and conditions*

4.1.27 KCOM considers it proportionate to require the notification of charges, terms and conditions of the form and to the timescales detailed in the Consultation.

## *Requirement to publish Quality of Service ('QoS') information*

4.1.28 KCOM considers it proportionate for Ofcom to impose a QoS transparency obligation in both WLA and WBA markets in the Hull Area but only as directed by Ofcom. As such KCOM would not be required to publish specific information from the date of the imposition of the proposed obligation.

## *Requirement to notify changes to technical information*

4.1.29 KCOM considers it proportionate to require the notification of changes to technical information of the form and to the timescales detailed in the Consultation.

## **Proposals regarding regulatory financial reporting requirements**

4.1.30 KCOM notes Ofcom's intention to require revisions to our regulatory reporting obligations including the introduction of cost accounting and accounting separation obligations in both the WLA and WBA markets. The prospective changes, particularly with the introduction of financial reporting obligations in WLA, are material to KCOM and will require significant work by us. As Ofcom is aware, KCOM is in the process of introducing a new activity based costing system that will improve our financial reporting and allow KCOM to provide the requisite Regulatory Financial Statements (RFS).

4.1.31 We note Ofcom's intention to consult later this year (2017) on the specific form and detail of the accounting separation requirements that Ofcom is proposing to impose. Amongst other things, this will include details of the implementation timescales for the revised requirements applying to our RFS. As Ofcom recognise, it is important that the development work for this system is undertaken in a structured and systematic manner and we are provided with an appropriate period of time to introduce material changes to our financial reporting regime.

4.1.32 We welcome the opportunity to engage with Ofcom on the detail of its consultation on revisions to KCOM's RFS obligations.

