Vodafone response to Ofcom's Wholesale Fixed Telecoms Market Review

Part One

Introduction & Wholesale Local Access Market Considerations

May 2020

The structure of this response

Vodafone's submission is split over three parts. This section provides an introduction, summarising the key issues that we believe Ofcom need to focus on to ensure UK consumers and businesses have access to reliable and competitive retail services within the consumer broadband and business connectivity markets. It also considered the detailed policy considerations within the wholesale local access market, seeking to highlight measures to underpin competitive broadband in the UK.

Part Two examines the key issues relating to the Business Connectivity market, considering the right approach to robustly analysing the markets and the imposition of remedies relevant to the period ahead, assuring innovative product development and resilient network design.

The final part of our response focuses on the more detailed aspects of Ofcom's proposed competition and market modelling, looking at the key questions around the assumptions used and the risks, trade-offs and outcomes that might transpire. The response is complemented by a legal annex (Annex 1) which reviews proposed terms drafted by Ofcom to enact their proposals.

This submission is also supported by three external reports. The first (Annex 2) is from Alvarez and Marsal entitled *UK Retail Broadband Competition Wholesale Dependencies and the Impact on the Transition to Fibre.* The second (Annex 3) *Geographic Market Definitions and Remedies in the Wholesale Fixed Telecoms Market* is authored by SPC Networks. Finally, Frontier Economic have prepared (Annex 4) a report entitled *Ensuring BT's RFS is fit for purpose*.

Part 1: Contents

Introduction

1.1 This review matters. It is the most important market review that Ofcom has ever undertaken. It is the widest in scope, covering consumer and business connectivity over the longest regulatory time horizon. It will institute a large part of the UK's communications regulatory environment until April 2026. It comes at a pivotal moment in the transition between fixed access technologies, straddling the retirement of legacy copper, originally built to carry voice decades ago, as it now gives way to fibre. This new infrastructure is capable of satisfying our broadband demands today and in the future. We are in a period of great uncertainty as we work through the ramifications, both economic and societal, of COVID-19. The sheer scale of the economic challenge ahead completely overshadows all other significant market concerns.

Adjusting to new Economic Realities

1.2 The economic fallout from the pandemic is still to be fully understood, although its implications are likely to be profound with a significant influence on how we live and work in the future. In a period of just a few weeks, the value that consumers, businesses and the public sector places on connectivity has increased significantly. Consumer trends that were already in motion have dramatically accelerated their progress – we have seen years worth of behavioural developments take place in a matter of weeks. This comes at a time when the funds needed to pay for that investment, and the ability of consumers to fund it through paying higher prices, is under a significant amount of strain.

Communications is part of the solution

1.3 If the UK is to minimise the impacts of a recession and maximise its post-recession recovery, it needs a small number of critical capabilities. One of the most important is a world-beating digital infrastructure. Collectively, as an industry, we offer a source of optimism, becoming a force for positive change in how we live, work and interact. Our industry is well placed to offer hope, innovation and real economic growth at a time when the UK needs it most. Connectivity will play a major role in rebooting and rebalancing our economy. It can help level up the UK's nations and regions, power our creative industries, help digitise the public sector, increase business resiliency and underpin technologydriven growth in private enterprise. To do all this, we need the right regulatory regime - one that ensures our retail communications market functions effectivity, with product choice and healthy competition.

1.4 The outcome of this review will have far reaching implications for all of the UK's communication consumers, from the very largest enterprise customers, an increasingly communications-dependent public sector through to the individual residential broadband user. While this review is firmly focused at the wholesale level, concentrating on the services that communication providers purchase from each other or self-provide, its outcomes will ultimately be felt in the various retail markets where consumers large and small purchase the services they need to interact, trade, consume content and engage with essential public services.

Effective Retail Competition must not be compromised while Wholesale Competition is explored

1.5 Retail competition is only sustainable if there is either effective wholesale competition between multiple access networks or robust regulation in place to remedy significant market power, addressing the adverse impact of any access network competition deficit.

1.6 Predicting market outcomes is even more challenging given the huge amount of uncertainty around the economic conditions that lie ahead. From concerns around access to investment funding, weaker consumer demand, greater consumer price sensitivity and suppressed market confidence. There are also very real physical and administrative constraints that naturally limit the speed at which residential fibre can be rolled out.

1.7 The competitiveness of the broadband retail market must be safeguarded throughout this period. Ofcom's ambition to encourage network competition is something we all share and we recognise the benefits that effective wholesale competition can bring to a market. However, the greatest risk from this review is an outcome where Ofcom withdraws key regulatory safeguards in an attempt to encourage future competing access infrastructure, while significant market power remains. Wholesale competition therefore ultimately fails to materialise at any scale.

1.8 Such an outcome would be a travesty for UK citizens, with consumers looking back from 2026 with the realisation that they had over-paid for their retail fixed communication services over successive years, with no right of redress. The risk of this dead weight loss scenario is high and retail competition would be diminished even in the period beyond 2026, with five years having been lost in the pursuit of an ambition.

1.9 Given the active and economically rational over-build avoidance culture (geared towards maximising customer take up and asset returns) amongst FTTP investors, the prospects of three gigabit capable networks covering a material portion of the country are limited, and may only appear by chance where build plans unintentionally overlap. It is therefore vital that retail consumers benefit from a range of regulated copper broadband products over the period while fibre competition plays out.

Regulation that works for all types of consumer: promoting healthy retail competition

1.10 The UK needs wholesale regulation that works for both UK business and residential broadband consumers. It also needs to facilitate 5G connectivity, accommodating more sites and the higher bandwidths our mobile networks will need to keep us connected. While Ofcom are right to encourage residential FTTP build, allowing this investment to benefit from lighter regulatory controls at higher 'fibre only' bandwidths (with key safeguards at lower speeds where copper alternatives are absent), it is still vital that retail competition remains healthy and sustainable.

1.11 The retail market is where consumers interact with CommunicationProviders (CPs), it is where prices are set and the benefits of competition manifest themselves. This is a wholesale review, but Ofcom must prioritise the interests of retail consumers' in its thinking. Healthy retail markets are founded on robust, effective and sustainable wholesale competition or, in its absence, built on a range of regulated wholesale inputs, where wholesale charges are scrutinised and set by regulation. This is the only way to safeguard retail competition. The impact on retail competition should be a key question, considered when reviewing every one of Ofcom's proposals and at every stage in this process. If retail competition cannot flourish from 2021 - 2026, then Ofcom's mission will ultimately end in failure.

1.12 To achieve its goals, Ofcom must encourage fibre investment, protect the consumer interest and, in so doing, safeguard competition in the retail market at all points along the way. We have never believed that the twin objectives of encouraging alternative build while simultaneously protecting the consumer interests are incompatible. Indeed, there are clear benefits for consumers, where competition occurs, complimented by effective wholesale regulated safeguards where wholesale access network competition has not emerged. This twin approach sustains healthy retail competition, promotes sensible investment choices and delivers for UK consumers in the long term.

1.13 We have no disagreement with Ofcom over its aspiration for the future, however UK consumers should never be put in a position where they are left over-paying for service due to an absence of either effective regulation or effective wholesale competition to underpin competitive retail supply. We are not asking Ofcom to reduce its ambition for the market. We do not even have to agree on what a realistic view of a probable competitive fibre build out should be. However, for the sake of citizens we need to ensure that the backstop safeguards to protect consumer welfare are up to the task, protecting all the retail markets in scope, regardless of what level of competitive infrastructure investment transpires in the period to 2026.

1.14 Today's economic climate is one of ever more uncertainty. We need a regulatory regime that promotes stability, helping to underpin a competitive retail market. There are no second chances on this review and the UK's consumers and businesses need Ofcom to have their backs, ensuring the retail market has the wholesale inputs it needs, either through competition or regulatory safeguarding. This is the only way to ensure the UK and its residential and business consumers are well placed to capitalise on the digital transformation that is underway.

A Market Review that delivers for Retail Consumers: Maintaining Ofcom's influence

1.15 As it stands, the limited wholesale regulatory measures Ofcom are proposing are far too light touch, resulting in Ofcom's remit retreating to a point where it can no longer materially influence or safeguard retail consumer outcomes in large parts of the country, with no realistic means of redress until 2026. In doing so, Ofcom's influence will be diminished, as it makes what amounts to a risky tactical regulatory withdrawal ahead of Openreach's Significant Market Power (SMP) being addressed through the emergence of robust and effective wholesale competition. It is retail consumers and businesses that will have to deal with the consequence of this regulatory disarmament – paying more from the outset, with no guarantees that an investment dividend will soon follow, with Ofcom's role reduced to that of an industry observer.

1.16 Positive retail market outcomes for the UK's consumers and businesses can be safeguarded in the period to 2026 without discouraging competitive infrastructure build. Ofcom should not seek to stand back in its competition safeguarding role for the majority of the UK's consumers – instead it should take the following, measured, proportionate steps to ensure consumers are safeguarded and the retail market functions effectively:

i. **A fit for purpose, priced capped Broadband Anchor on copper-based speeds**, based on a basket approach covering all services up to 160/30 and allowing wholesale pricing freedom on fibre speeds in excess of this. This will ensure retail operators can offer price focussed, accessible broadband products to consumers, including those who have been adversely affected by the current financial crisis.

ii. **A prohibition on both volume and geographic wholesale broadband discounting** to prevent existing scale retail players foreclosing the market to new entrants or inhibiting the progress of challenger brands and smaller operators from gaining scale and market share.

iii. **Recognition that WLR is, in the main used as a copper bearer**, therefore retaining WLR on the list of regulated remedies and retaining price alignment with MPF. Appropriate regulation to ensure all retail operators can access copper (which is essential to deliver broadband) at the same prices regardless of the time period they entered the market.

iv. **Introduce clear safeguards to set maximum wholesale prices in Area 3** to protect rural consumers, including a requirement on Openreach to sell all products - without exception - on an Equivelents of Input (EoI) basis, with clear monitoring of Openreach profitability to maintain accountability.

v. **Reconsideration of the boundaries of Area 2** to ensure it is drawn to better reflect the genuine prospect of access network competition. Currently the area it is too large and lacks homogenous characteristics.

vi. **Mandate Dark fibre Access throughout the UK as a SMP remedy** to ensure the product required by network operators to deliver innovative network services (including 5G), reduce their carbon footprint and simplify their networks can be delivered quickly and effectively to support the UK's economic recovery.

vii. **Promote a health competitive wholesale market**; take measures to ensure that Broadband Retailers **can switch at scale** between wholesalers (with Wholesalers having an obligation to support such a move).

A Rapidly Changing Landscape: The post-COVID Economy

2.1 Even in the most stable of economic times, one of the most challenging aspects of Ofcom's job is to set forward looking regulation that remains appropriate throughout the life of an entire market review. Regulation that works for consumers and businesses, assisting competition in pursuit of longer-term benefits for all. That challenge was always set to get harder, with the review period increasing from the previous standard of three years to five and with the uncertainties around the true impact of Brexit and the consequences of any trade deals and single market access yet to be agreed. These were forecast clouds on the horizon, but falling within a range of tolerance that robust businesses have come to expect

2.2 In the space of a few short weeks between February and March 2020, the world we felt we understood was turned on its head. Airlines have stopped flying, the leisure and entertainment industry are on hold, schools are closed, sporting fixtures are off and much of the economy has pulled the shutters down and patiently awaits a phased reopening, all the while wondering what level of prosperity and consumer confidence will greet them when their doors eventually reopen. At this point in time, the intensity and duration of the economic storm remain unclear. Like an aircraft suddenly flying through severe turbulence, the cabin crew have returned to their seats and the seatbelt light is on, but we have no way of knowing for how long the light will be on for and what state we will all be in when the light eventually goes off.

2.3 Our industry has stepped up. The connectivity we supply, while always vital, now finds itself at the forefront of a truly national effort, one that spans all aspects of our lives. From providing direct support to the emergency services and our NHS, to helping businesses of all sizes adapt and trade, sustaining an army of new home workers in the process. We have kept communities, friends and families in touch with each other, whilst simultaneously enabling access to news, media and entertainment sources that are now so valued at a time when many aspects of normal life are closed off.

2.4 When we lift our heads from the immediate task of keeping our customers connected, we are mindful of the wider economic impacts of the crisis and the sudden financial distress that it is causing to some of our customers and the medium and longer-term impact on our economy. We are seeing growing amounts of macro-economic data from a variety of trusted sources that point to a prolonged recession, coupled with prolonged unemployment. ONS data suggests the UK's economy was 2% smaller in the first quarter of 2020 than in the previous three months, the fastest rate of contraction since the global financial crisis over a decade before. However, that figure only captures a glimpse of the economic chaos caused by Covid-19.

2.5 With the UK's lockdown beginning in late March, the economy was 5.8% smaller in that month than in February. Forecasters are already predicting that the economy could shrink by between 20-30% in the second quarter of 2020. A recent study by the London Business School found that household spending has plunged 40% – 50% during the crisis. Kristalina Georgieva, the head of the IMF has warned that the impact for the global economy had worsened since it had published its own gloomy predictions in April.

2.6 The crisis is unprecedented and we have little to compare it against. While it is global, it also deeply affects people personally. The virus is an invisible enemy, yet its consequences are very visible to us all. There is no discrimination on who can be infected, but its fall out has and will discriminate. Many are predicting we will see a polarisation of the market – with spending down in every category, but with a gap opening up between those who can afford better connectivity and those who will struggle.

2.7 For the first time employers are likely to care about how effective their employees' home broadband connections are. There is expectation that the trend from homeworking will persist long after the health crisis has passed, allowing new people that previously struggled to participate in the labour market to do so. For those that are following this path, getting FTTP sooner will be a priority.

2.8 With the expectation of a polarised consumer impact, there needs to be rethink around the policy approach for copper-based broadband speeds (ie. those delivered over GEA Copper). For many, especially those adversely effected by this crisis, the cost of faster broadband connections will be out of reach unless regulation ensures that the price of these higher copper speeds are constrained. These connections will represent a route back to economic participation and prosperity and there is a real risk that by failing to ensure these prices are kept in check, inclusion in wider economic participation will be lost for many. Such an approach is not damaging to the prospects of fibre,. Indeed, it allows consumers to ascend the bandwidth ladder allowing for easier future migration to FTTP - either on demand or because of copper switch off.

2.9 The speed at which we are moving towards a digital society is accelerating, with this crisis a watershed moment for many individuals and organisations. The fibre goal that was set before the crisis remains the target, but we need more safeguards to keep the economy inclusive. Likewise, there are opportunities to accelerate and change the way we do things for the better, including how we support the planet by working and living more sustainably. All this requires affordable, resilient networks. Taking a fresh look at both the real benefits to consumers and businesses of safeguarding copper GEA pricing for all and at the benefits of a wider dark fibre solution is a proportionate and practical way of helping the UK get back on its feet quickly. All without compromising on our longer term ambitions for a future with more fibre infrastructure.

Wholesale Local Access: Retail Market Analysis

Question 2.1 Do you agree with our description of retail markets? Please set out your reasons and supporting evidence for your response.

3.1 Ofcom has undertaken a detailed retail market analysis, the finding of which we largely agree with. Ofcom has correctly identified the key participants in the retail market and there respective market shares. Ofcom understands how these retailers function in the market and their apparent differences in retail strategies and focus on specific customer segments (although we note that much of this data is redacted).

3.2 Ofcom's evidence highlights the importance of the relationship between the retail and wholesale markets, in particular how the wholesale market has dictated change in the retail market. Ofcom correctly identifies examples of where changes at a wholesale level have had retail market consequences. For example, the accelerated transition to 80/20 due to a specific Openreach pricing decision. A lack of wholesale competition leaves the retail market vulnerable to SMP leverage from the wholesale market. It is therefore necessary to consider the impact of any wholesale market changes on the retail market carefully before proceeding.

3,3 Today, the UK's retail broadband market delivers choice and value to consumers, with a range of providers competing to offer a wide variety of retail products at different bandwidths, either as standalone products or set within bundles. However, we should not take this competition for granted. The four largest providers account for around 90% of the market, with BT itself taking over a third of the UK's retail market. Ofcom has identified survey results that find price and value are the most important factors in the choice between available broadband packages followed by reliability and speed. Most of the variation in price and service within the market comes from providers outside of that 90%, players with lower market shares who nevertheless punch well above their weight and have an important influence on the level of competitiveness across the entire retail market. Much of this drive is in an effort to gain market share and secure the necessary scale needed to compete effectively over the longer term.

3.4 There is a clear trend of consumers using their broadband connections more intensively year on year. The demands of content streaming, more equipment connected online, a rise in home working and the specifications of the next generation of in home equipment (such as 4k and 8k smart TVs) contributing to this greater demand for bandwidth. With many households having to support multiple devices streaming simultaneously, the trajectory of ever higher speeds shows no sign of stopping. Within the wholesale market, Openreach's once dominant 40/10 service is no longer considered the mainstay product. Recent Openreach special offers, introduced during the COVID-19 crisis, will accelerate demand for 80/20 making it take the base load of broadband demand, outselling 40/10 by almost two-to-one this financial year. At the start of this year, ADSL-based broadband was predicted to account for just 13% of the market by 2023, however with many retailers no longer selling this legacy variant and current imperatives requiring a higher quality connection, we anticipate standard broadband (ADSL) will account for even less of the market than that which was forecast when this consultation commenced.

3.5 ✂

3.7 Without regulation, Openreach's SMP in broadband will have an adverse impact on retail pricing and affordability, as Openreach will be able to profitably raise wholesale prices without fear of a competitive wholesale response. Today Openreach has an incentive to get Sky and TalkTalk users off standard ADSL broadband, moving them from MPF to GEA. Openreach special offers have been designed with this in mind, seeking to accelerate this move away from MPF and COVID-19 is also likely to accelerate this transition. Openreach makes considerable more margin from the sale of GEA/SOGEA than MPF, so today that incentive is strong. Once the market has moved to GEA/SOGEA and with no credible scale threat at a wholesale level, we can then expect to see Openreach prices rise to the detriment of consumers and the long term health of the retail broadband market.

ADSL and 40/10 are weakening constraints on higher speed pricing

3.8 It is imperative that Ofcom recognise the interdependancy between the UK's wholesale market and retail broadband market. Historically, it has been underpinned by regulation on GEA 40/10 and MPF. However the influence of these two products is waning fast (we anticipate rapid deterioration in demand for both due to their inadequate bandwidth). ✂ This all results in an outcome where the UK's retail broadband market is at the mercy of BT, harming both the interest of BT's competitors and ultimately consumers.

3.9 Ofcom rightly highlighted in the 2018 WLA review that they expected the constraining impact of standard ADSL broadband pricing on superfast services was likely to decline overtime. We believe that COVID-19 has accelerated that effect. It would be unthinkable for the vast majority of consumers to go back to an ADSL service (a fact also acknowledge by Ofcom in 2018). Likewise, Ofcom considered that the price of 40/10 GEA would constrain the price of higher speeds. That constraining impact is weakening by the day and at a much faster pace that even Ofcom envisaged when this consultation was published in January.

3.10 This growing lack of substitutability between various speed grades of fixed broadband products in the eyes of consumers should be carefully considered. Standard ADSL broadband isn't likely to be credible substitute for 80/20 in the eyes of most 80/20 users and Ofcom need to consider these bandwidth 'fire brakes' within their market analysis, to ensure that regulatory safeguards are in place for the consumers of standard ADSL broadband, 40/10 and 80/20. Seeking to include all these services within the same market may be administratively convenient and logical in one sense (given the history of the services and evolution of consumer demand). But if by doing so Ofcom fails to place proper pricing safeguards in place for each group of users consuming these products, then it will have failed to accurately reflect consumer behaviour around these products (for example simply reflecting the fact that many 80/20 users would never contemplate moving down to 40/10, let alone standard ADSL broadband). That being the case then, Ofcom should seek to identify separate markets around these bandwidth ranges to reflect the reality of the market and consumer behaviour, or impose remedies that safeguard pricing for each within a bandwidth agnostic copper broadband wholesale market.

Wholesale product market definition

Question 6.1 Do you agree with our provisional conclusions on product market definition for wholesale networks? Please set our your reasons and supporting evidence for your response.

3.11 Ofcom proposes to define a focal product to be the supply of WLA services by fixed networks to support the delivery of broadband services to residential and business customers. Ofcom has altered its definition to include all fixed networks – fibre, FTTC, existing copper and cable connections.

Fixed Analogue Exchange Lines

3.12 We consider that MPF, WLR and SOGEA all effectively function primarily as the local access bearer over which the broadband connectivity is provided. Ofcom's approach is to simply roll forward the same regulatory approach from historic market reviews and fails to recognise that the principle market product, WLR is no longer primarily used as a fixed analogue exchange line product, but is in fact a copper bearer used to underpin broadband access delivery, performing an near identical function to MPF. Ofcom need to consider WLR within the context of the copper bearer market and not simply turn the handle on a regulatory approach that fails to reflect how WLR is used today. We examine this market in more detail in section four of this response, highlighting the practical need for Communication Providers to consume WLR for some time to come, if they are to save their customers from having to undertake a disruptive two-stage migration..

Approach to Standard and SuperFast Broadband

3.13 Given the increasingly weak substitutability of lower speed connectivity for higher speeds, we considered that it is no longer appropriate to classify standard broadband and superfast broadband within the same market. Certainly, even by the mid-point of this review period their substitutability will be in doubt for almost all consumers. For practical purposes Ofcom can address this lack of substitutability by considering them as separate markets, or design remedies that safeguard wholesale purchasers of each product classification within a wider market context (that for administrative ease is focused at a much higher level).

Wholesale Broadband Access

3.14 We accept that given the prevalence of GEA usage, it would not be appropriate to continue to regulate this as a standalone market and should be absorbed into the wider Wholesale Local Access Market. A key part of the WBA market is focused on delivering connectivity for rural consumers. While we accept the WBA market is no longer distinct enough to be identified as a separate market, the safeguards ensuring affordable retail broadband for rural users must continue. In the majority of cases this will be GEA sold in combination with WLR as the copper bearer, as the economics around deploying co-location space to support MPF delivery have never been present in these WBA Market A areas. If Ofcom is to absorb these users, previously reliant on the WBA market's bit-stream products into the wider market and effectively require these users to consume retail products reliant on GEA and WLR, then it is vital that WLR as the copper bearer of choice in WBA Market A locations continues to be regulated on similar terms to MPF in the rest of the WLA. Ofcom should not contemplate an outcome that would disadvantage rural retail users, by leaving former WBA users with no access to price-safeguarded copper bearer access, leaving them vulnerable to steep WLR price rises and may well eventually impact their retail market choices.

ISDN

3.15 ISDN legacy services will be retired by 2025. They are used by business customers to provide quality connections to their premises for a variety of purposes. Their usage is declining year-on-year, but there remains a rump of end users on these services and it is important their interests are safeguarded in the period ahead of transition.

3.16 Given ISDN services will be subject to a stop sell in 2023 and very few end users are ordering new connections today, the key focus must be on finding a sensible approach to aid the transition away from existing ISDN connections. Like single WLR users, it may well be the least disruptive course of action for ISDN users to migrate to FTTP once it becomes available. The timing of FTTP availability will of course vary by geography and it may be as late as 2024 or 2025 for many businesses. This means ISDN must remain available until this occurs. We disagree with Ofcom's conclusion that transitional arrangements are not required. Under the circumstances, it is vital that transitionary pricing safeguards are put in place for existing ISDN users (not those seeking new supply), to prevent punative price rises occurring if they are legitimately waiting to move to FTTP and avoid any intermediate steps. We would hope this pricing safeguard (with a clear percentage cap of no more than 4% on the extent of any ISDN annual price increases until 2025) could be brokered by Ofcom and delivered by Openreach in the form of a voluntary commitment (improving the clarity and certainty on the text already proposed by Openreach). In the absence of this arrangement being reached we believe Ofcom should take formal steps to limit the extent of price rises on existing ISDN users to limit consumer harm.

Wholesale geographic market definition

Question 7.1 Do you agree with our provisional conclusions on geographic market definition for wholesale networks? Please set out your reasons and supporting evidence for your response.

3.17 The task of geographic market analysis is to discover whether a product market has sub markets based on geographical area. The sub groups must show a uniformity within the group and be distinct from other groups of areas.

3.18 Ofcom has grouped postcode sectors together to form geographic markets, seeking to create sectors that have broadly homogenous competitive conditions so that appropriate remedies can be applied to them. Three different geographic WLA markets have been defined:

a. Area 3, encompassing 30% of UK premises, where there is no rival operator to Openreach (and little prospect of rivals emerging);

b. Area 2, encompassing 70% of UK premises, where there is either a single competitor to Openreach already present (generally Virgin Media) or where one or more operators have plans to construct an FTTP network of their own; and,

c. Area 1, would be where there are at least two established rival networks to BT. Currently no parts of the UK fall into this category.

3.19 Area 3— is the most straightforward to consider. There is no competition and no expectation of it. Competitive conditions within this market seem likely to be similar throughout the period, with a single major wholesale operator active (any exceptions to this are likely to be below the network coverage threshold).

3.20 Area 2 – is the most controversial due to its proposed scale and the apparent lack of homogenous conditions that prevail across it. We believe Area 2 is too large. Over the period of the review and post 2026 there will be substantial heterogeneity across this grouping. In a sub set we can expect three access networks to exist. While in a further sub set of the area, the Openreach-Virgin Media duopoly area will be maintained. A final subset of Area 2 will only have Openreach (and could still well only have Openreach in 2026).

3.21 Area 1 - locations are yet to be identified, although there is an expectation that a small number of locations will emerge where there is wholesale access competition from multiple networks by 2026.

Virgin Media's Lack of Participation in the Wholesale Market

3.22 The role of Virgin Media in the wholesale market is crucial to this analysis. Today, Virgin does not participate in the wholesale market – it may self-supply its own retail broadband operations, but it is an integrated business and isn't a wholesaler to other broadband retailers. While Ofcom's consultation speculates that Virgin Media may seek to offer wholesale services at some point in the future, it has yet to do so. ✂This creates a simple gating factor, that must be passed before Virgin's MSN can be considered an access network wholesaler. In other words, until such time as Virgin actively start participating in the wholesale market, its presence must be discounted. We note in the leased lines market, vertically integrated retailers actively wholesale their network facilities. Its constraining impact on the wholesale market, given that it only sells to itself, will be severely limited. It cannot therefore be modelled as an equivalent wholesale market participant to Openreach. While Virgin may act as partial indirect constraint in the wholesale market, its impact in terms of the benefits to enhacing wholesale competition will be weak. Given Ofcom's Area 2 geography approximately maps on to the Virgin Media footprint, we believe their presence must be withheld from any area 2 market modelling until such time as they begin to offer wholesale services at scale to other broadband retailers.

Homogeneity in geographic markets has not been met within Area 2

3.23 Area 2 is a diverse area that is not at all homogenous. Given the significant effort FTTP builders make to avoid other fibre players, the bulk of the area will likely remain Openreach + 1. In the majority of those cases, that plus one will be Virgin Media who do not wholesale. Some parts of Area 2 will be Openreach and an access network that does wholesale (such as CityFibre), but the reality is that by 2026, these areas will not be extensive. The end result for this market review period would be a monopoly and duopoly access network situation that isn't likely to result in consumer benefit over any time horizon.

3.24 Ofcom's justification for why conditions in Area 2 are sufficiently homogeneous is weak. There is considerable uncertainty around investment plans and how much rival build we might see and the competitive impact of any build that does occur. There are a number of clearly distinguishable outcomes that may occur within what Ofcom currently defines as Area 2:

a. Two existing access networks, plus the possibility of a third by 2026 – of which one network will not be an active wholesaler;

b. Two existing access networks throughout the period, but only one is a wholesaler;

c. Two existing access networks throughout the period, where both acts as wholesalers;

d. One existing access network acting as wholesaler, with the possibility of a second by 2026 (which may or may not be an active wholesaler).

3.25 From these very different starting points, and when considered alongside the possible outcomes that may or may not transpire, there is a considerable amount of uncertainty across a large part of Area 2. Duopoly and monopoly outcomes are the most common likelihoods in 2026 (notwithstanding the complication of some access networks choosing not to wholesale their services). There is therefore a significant question mark over the merits of withdrawing significant amounts of regulation in an effort to stimulate investment. Especially as that investment is either earmarked to take place regardless of Ofcom's deliberations in this market review, or will not occur by 2026. In most locations that best outcome is likely to be a duopoly, and the prospect of transition to Area 1 status is never likely to materialise.

3.26 Ofcom need to look again at both the boundaries for Area 2 and the remedies imposed within it. It is clear there is a lack of homogeneous conditions for competition for the postcode sectors included within Area 2 and trying to shoehorn these postcode sectors into a single geographic market would be wrong.

3.27 Ofcom should look to redefine Area 2, recognising these flaws in its original proposals. It also has to ensure that adequate safeguarding remedies exist in the market for the bandwidths that consumers purchase today, including 80/20. Leaving 80/20 outside the scope or remedies in Area 2 would be a serious error. Its wholesale price safeguarding would do nothing to deter the march of fibre, yet it would protect a large volume of UK consumers from the worst impact of market failure within Area 2.

3.28 Area 3 appears to be more correctly defined, appropriately defined, although its boundaries are likely to expand if Ofcom make the necessary changes to Area 2. We would welcome a reassement of Ofcom's geographic market definitions and the assignment of different postcode sectors into geographic markets.

3.29 This is issue is discussed at length in the accompanying report by SPC.

Setting the right Coverage thresholds for Multi Service Networks

3.30 With the exception of Openreach, an individual network operator's current and planned deployments are not likely to map precisely to postcode sectors and their rollout in a postcode sector will rarely cover 100% of premises in that sector. This coverage deficit could occur for commercial reasons, technical reasons based on the location of existing network assets and nodes or due to the presence of physical or administrative barriers (such as the refusal by local authorities or landowners to grant consent for civil works, or the difficulty of deploying a network in conservation areas, for example in cobbled streets). It does however remain necessary for Ofcom to set a coverage threshold for a network to be regarded as 'present' in any postcode sector. This is the level of presence required for an alternative network to be able to impose a competitive constraint within that postcode sector. Deriving the percentage where competitive constraint is imposed needs to be carefully considered and modelled, to ensure it is an accurate reflection of what would occur, being both robust and evidence based. We are concerned that Ofcom appear to have taken an arbitrary decision on setting that threshold, setting it at just 50%.

3.31 In proposing the 50% figure, Ofcom have not conducted any detailed modelling or analyses to support this number. In reality, it would be quite possible for Openreach to profitably raise wholesale prices within an area, if a rival had only connected 50% of premises. The ability of Openreach to behave in this way and drive profitability by raising prices within the postcode sector and boosting profits to their maximum level safe in the knowledge that only 50% of consumers could migrate, with the remainder having no choice, it is key to understanding where the coverage threshold should be drawn.

3.32 In the circumstances it would be entirely appropriate to consider a 'SSNIP test' to help define where the threshold line should be drawn. The test considers the impact of a monopolist increasing prices above the competitive level. As broadband is increasingly regarded as an essential, utility-style product, Openreach have the ability to raise prices by 5% or even 10% and in so doing, raise profitability across the entire postcode. If Openreach can do this, safe in the knowledge the consumers who have an access network choice don't decide to switching away in sufficient numbers and those with no access network choice have no alternative and must pay the higher prices without complaint. Such an outcome raises profitability for Openreach across the postcode sector, and would be a clear illustration that the coverage threshold line has been drawn in the wrong place.

3,33 Understanding the balance between inelastic consumer demand and the more elastic demand is essential if the coverage line is to be placed at an economically meaningful percentage . Even in premises where there is a choice of access network, consumers may be reluctant to switch away for a variety of reasons (contract terms, fear of a loss of service etc). Such considerations may deter short term switching in the face of a price rise at the wholesale level, even if it is passed on in full or in part at a retail level. The combination of a lack of switching in the short run for consumers with a choice of access networks and up to 50% of premises in the postcode sector having no competitive choice is all points to Openreach being able to exert market power in that postcode sector and suggests that 50% coverage is far too low.

3.34 In considering this issue, we are mindful that other post-market analysis remedies that Ofcom may or may not impose (such as wholesale pricing controls) are not valid considerations at this stage of defining the market and it is important to assess what postcode sector profitability Openreach could achieve with varying levels of alternative access network coverage.

3.35 ✂

3.36 We firmly believe that Ofcom should be focusing its efforts to model the impact of pricing changes to determine where the line should be drawn. Initial indications suggest that the line needs to be drawn at a level greater than 60% premises coverage within a postcode sector in order for Openreach not to see a net benefit from rising prices.

The role of Wholesale Price Regulation in underpinning retail Broadband Affordability

3.37 While the true extent of both the duration and the depth of the current economic crisis remains unknown at this point, the importance of quality residential broadband connectivity is now universally recognised. Quality, reliable bandwidth is a key contributor to positive societal outcomes, benefiting health and economic prosperity, with citizens placing more reliance on it as a means to communicate, work and as a route to access content.

3.38 Consumer dependency on broadband is only likely to increase in the months and years ahead, as businesses and organisations, large and small, adapt to the constraints imposed by the pandemic, seek to move all or parts of their businesses online to ensure a more resilient future. As we outlined at the beginning of this submission, the economic data that is emerging makes for sombre reading, with a very significant number of households facing a materially adverse hit to their prosperity. In short, while the need for quality broadband in the home has never been greater, the ability of many consumers to fund it has now been severly compromised.

3.39 Ofcom itself has kicked off a series of work streams within its Consumer Policy function to consider this very issue, recognising that affordable broadband is a vital, non-discretionary element of household spending (like energy) and is required for well-being and societal participation. To date, competition has been critical at keeping retail broadband costs down, with consumers reaping those benefits in recent years. As bandwidth demands increase, to support both enhanced and additional services online, it is critical that retailers can offer affordable packages over a range of different bandwidths to consumers within the context of a truly competitive retail market.

A Pricing Anchor that Reflects the Market and Protects Consumers

3.40 To achieve this, it is imperative that there is a degree of certainty over wholesale pricing in the market. With Ofcom only proposing to safeguard the wholesale price of the basic 40/10 service, there is considerable concern that many consumers may be adversely impacted as the constraining effect of an anchor set at 40/10 ceases to have any meaningful effect, causing pricing to increase above competitive levels resulting in consumers paying too much or stuck on slower speeds due to affordability concerns. 40/10 is likely to provide insufficient bandwidth for an increasing number of economically constrained consumers and there will be a need to consume services at 80/20 and beyond to meet their bandwidth needs.

3.41 Ofcom have a key role to play in making sure that the right wholesale safeguards are in place to protect consumers, enabling the retail market to flourish and to continue delivering the best value. Key to that is having a fit-for-purpose broadband pricing anchor that actually reflects mainstream broadband usage over the life of the review period. We believe this should be a basket-based approach constraining the pricing for 40/10, 80/20 and up to and including 160/30 GEA, accompanied by safeguard caps on individual products to prevent sharp upward pricing movements within the basket.

3.42 This approach, focused firmly on legacy copper bandwidth speeds, promotes price certainty at these basic wholesale price points. Meanwhile FTTP investment is free to compete for the growing retail appetite for much higher speeds (specifically above 160Mbit/s).

The current Anchor is set too low: insufficient to safeguard welfare or affordability

3.43 Today Ofcom are proposing to continue using the 40/10 service as the anchor product, which is the only service subject to price regulation in Area 2 (the location containing the vast majority of consumers). We believe there is strong evidence to suggest the Area 2 Anchor product has been set at too low a speed and will not provide the consumer safeguarding necessary to constrain pricing of mainstream residential broadband services in the UK.

3.44 Even before this current economic crisis, a number of mainstream providers choose not to offer 40/10. Instead, they focused their entry-level mainstream broadband product at higher speeds (Sky and BT consumer included). Today, in 2020, the anchor looks to be set too low and by 2026 it, risks falling into obsolesence in offering no constraining impact what so ever.

3.45 Ofcom judged 40/10 as the suitable point for the anchor in 2018, believing that the continued presence of standard broadband services (using MPF and ADSL) would also help to act as a constraint. The long-term future of MPF standard broadband services looks uncertain, as consumers are increasingly turning their back on it, as it struggles to cope with a content market increasingly turning to streaming video on demand instead of viewing linear television. It falls short for home workers and risks being withdrawn as a product for many over the next few years.

Consumers Never Regress on Bandwidth demand

3.46 There is compelling evidence to suggest that consumers rarely decide to regress their broadband speed, meaning customers who are already receiving services above 40/10 will not revert back to it, even if the retail price of the service they are now consuming increases. In these conditions, there is an obvious opportunity for Openreach to incentivise use of the higher speed non-anchor services through special offers and discount schemes. Once retail customers have committed to them, and become accustomed to the broadband capacity the services provide, they will not risk dropping to a lower speed to save money, severely muting any constraining effect of the 40/10 anchor. Over time, this effect is only likely to become more pronounced, providing an easy profit maximising route for Openreach, absent any regulatory constraint.

3.47 With few parts of Area 2 having competitive access network provision (3 or more networks), this is an easy strategy to pursue from the outset, particularly when so many customers are now on 80/20 due to the way in which Openreach have designed its main 2018 GEA discounting scheme. As this scheme comes to an end, Communication Providers are likely to come under considerable pressure to move their base upwards from 80/20, and there will be no appetite from consumer to move backwards, rendering the market effectively free, in every practical sense, of all price regulation.

Weak Wholesale Regulation harms retail competition

3.48 A weak anchor damages retail competition. Given the low market shares of non-Openreach access providers ✂, Openreach is free to impose terms at a wholesale level that will directly shape the retail market. A Communication Provider who is unable to access the latest discount scheme, and the preferential pricing it offers, risks curtailing any prospects to grow in the market and moves into a defence strategy to retain their base. This defensive behaviour is likely to result in poor consumer outcomes, with end users paying far more for mainstream services, as wholesale pricing is unconstrained by regulation or the presence of effective competition for most consumers within Area 2.

3.49 In Annex 3 Consultants SPC set out their findings on the likely effectiveness of the 40/10 anchor, contrasting consumer behaviour from the UK and across Europe. The report highlights that for a lower quality product (like 40/10) to be an effective anchor it must offer at least the same utility as the superior quality product. Consumers must therefore be prepared to trade-off the lower access speed for the lower price or, conversely, be prepared to pay more for a superior quality product. However, the clear evidence on consumer behaviour points to a strong desire not to reduce down the bandwidth gradient, even when faced with higher pricing, especially in the context of a market where bandwidth demand is growing year-on-year. SPC conclude that 40/10 will cease to be an effective anchor during the period of this review, highlighting that Openreach would have the incentive and ability to increase the price of 80/20 above the competitive level, resulting in higher consumer prices at a time when consumers are least able to pay higher retail prices.

Wholesale market remedy

3.50 The most effective way to safeguard the consumer interest is to protect retail competition and preserve affordability by price regulating all copper broadband speeds in a basket based approach (covering 40/10, 80/20 and 160/30). The benefits of fibre connectivity arise above these bandwidth levels and price regulating copper broadband will not diminish any consumer appetite for fibre. Raising the anchor to cover higher copper based speeds (including 80/20 and 160/30), will do little to demish the underlying appietite for fibre, where entry level speeds are typically set well above copper levels (especially when you take account of the fact that copper GEA product speeds are identified by their maxium speed, rather than the actual speed delivered to the consumer, which is often lower.

3.51 It is clear that a 40/10 anchor is no longer a suitable constraint on wholesale pricing on 80/20 and 160/30 and Ofcom needs to update is remedy in this section the market to protect the interests of consumers.

Duration of Contracts

3.52 Ofcom are proposing to place a limitation on the fixed term of BT's contracts for Virtual Unbundled Local Access (VULA) services and migrations of one month. There would be nothing to stop BT agreeing longer term contracts overall, but these contracts will effectively have monthly break clauses.

3.53 As far as we are aware, this limitation will not apply to BT's competitors who would be free to agree long fixed terms. We assume it is this asymmetry that BT is discussing with Ofcom.

3.54 We believe BT may circumvent this obligation through the use of pricing and/or rebate arrangements to avoid triggering the obligation. This would involve either incentivising Communication Provider customers for staying in the contract long term or penalising them for exiting at an early stage. We note that the Direction applies to contracts going forward, not those already in place. Please see Annex 1 for a more in-depth discussion of this issue.

Ability of Broadband Retailer to Switch at an aggregate level

3.55 To enable the wholesale market to function effectively, it is vital that retail broadband providers are able to switch at scale between access network wholesalers to secure the best deal for end users. Measures which prevent broadband retailers from moving their base of customers over to another network will result in retailers being tied indefinitely to one access network. There are significant practical obstacles that must be negotiated by a retailer who chooses to change the underlying access network for their existing base (not least the fact that most/many premises will required a new installation), so it is therefore important that contractual restrictions are not imposed that either prevent or deter a retailer having freedom of choice over which access network should be used where a wholesale choice was available .

3.56 Migrations of this kind are complex and time consuming, so as well as providing the ability for retailers to freely select the wholesale access network they need to use, safeguards should be imposed to prevent a wholesaler from exploiting a situation where a lengthy migration needs to occur. Such conduct is likely to deter wholesale access network choice amongst broadband retailers, reducing the effectiveness of any localised competition at a wholesale level. A simple safeguard that reference the price paid in the prior period is all that is required, thus preventing sharp wholesale price increases from occurring, at a time when the wholesaler has nothing to lose from such an increase. If a wholesaler can prevent or deter a retailer switching access networks (either for their existing base or for new supply), it will have a damaging impact on the retail market, chilling the market opportunity for new residential fibre investment. We would refer Ofcom to our legal annex for further discussion on how Ofcom's proposed terms might be improved.

The Reality of the Copper Bearer Market

4.1 In this section we outline:

I. There is compelling evidence to confirm that WLR and MPF reside within the same market. Both products are technically similar and perform a near identical purpose, underpinning the UK's broadband connectivity.

II. The primary usage of WLR has shifted considerably since it launched as a voice exchange line product. For the majority of consumers, it is now used as a copper bearer to support GEA broadband, with around 10 million lines using it for this purpose, supporting more superfast broadband connections than LLU.

III. There are a growing number of consumers no longer using any dial tone functionality on WLR (noting that LLU also offers the facility to support dial-tone voice). ✂ of Vodafone Consumer broadband customers do not use voice exchange line features.

IV. The proposed regulatory approach to WLR fails to recognise the primary purpose of the product as it is used today, viewing it only as a voice exchange line service.

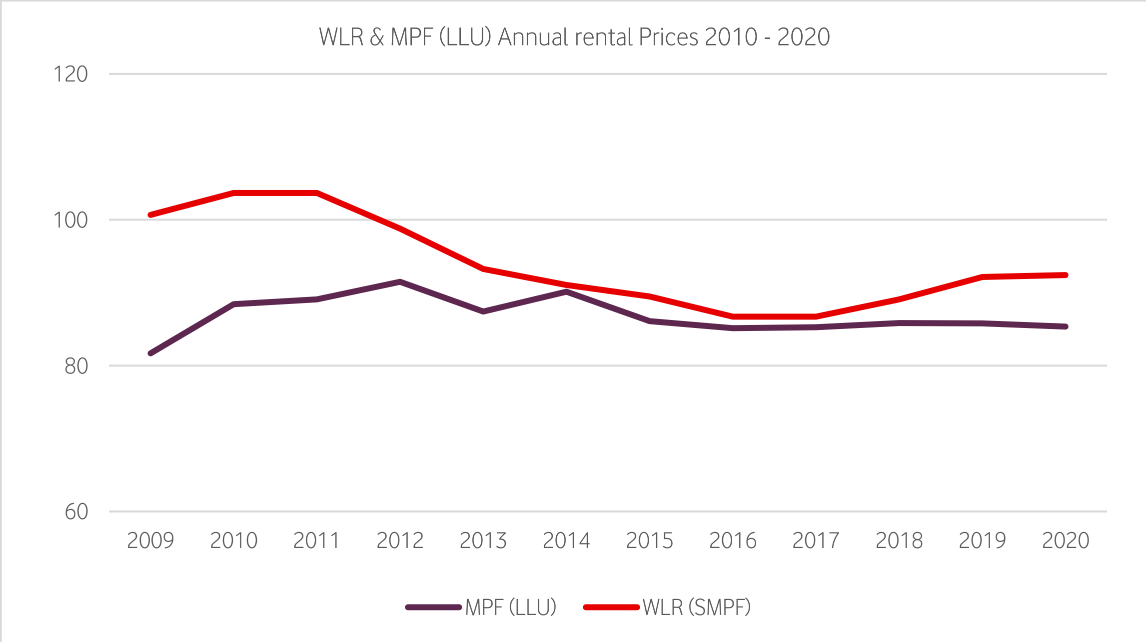
V. Failing to regulate WLR in step with MPF will distort the UK's retail broadband market, harming those retailers who rely on WLR copper bearers and affecting all consumers by potentially weakening the competitive intensity of the UK's retail broadband market.

VI. Retailers seeking to minimise consumer migration disruption will require WLR for some time to come, particularly if they wish to moving end users straight to FTTP (avoiding a disruptive and confusing three-product hop: WLR –SOGEA –FTTP).

4.2 Broadband competition today, and for the foreseeable future, will largely be focused on a service-based competition model. Through the purchase of inputs from Openreach (either directly or indirectly), a variety of retail broadband providers have been able to participate, creating today's highly competitive UK retail broadband market. The vast majority of broadband services purchased involve a copper connection into the customer's premises.

4.3 These copper connections, or bearers, are purchased at a wholesale level by broadband retailers in one of two ways - either using Openreach's WLR or MPF products. The decision on which of the two copper bearer variants to buy is largely determined by origins of the individual broadband retailer's market entry. With the scale launch of GEA in 2012, it was no longer rational for new market entrants to invest in the exchange presence needed to consume MPF, so WLR became the rational copper bearer choice for post-2012 broadband retailers.

4.4 While WLR and MPF are both primarily used as copper bearers to support broadband access and /or telephony access, for historical reasons they are dealt with separately under regulation. In recognition of the near identical nature of the products, Ofcom has previously sought to harmonise both their supply terms and their price.



MPF and WLR are in the same market

4.5 While they may have come from different starting points, MPF and WLR are near identical products used primarily for the same purpose – providing copper bearer access to support broadband. They are nearly identical even at the physical component level, with WLR having an additional line card. This often goes unused in the broadband environment as end users select their broadband services without fixed line telephone functionality or, where it is present, decide not to plug in a telephone.

4.6 Our data shows a growing number of WLR lines are not used to provide voice with ✂ of our consumer broadband base not doing so. Similarly, while WLR can be used to provide a standalone exchange line (usually in an enterprise context), LLU can also be configured to provide exchange lines (without broadband), with the LLU operator adding line card functionality to provide dial tone, where this is requested by the end user.

4.7 Given the near identical physical and usage characteristics, and the legacy nature of the services (recognising the transition of all service supply in the medium term to FTTP) it would not be appropriate to treat these products differently in regulation. We see no justification for any divergence. Indeed, by taking an inaccurate approach to market definition and choosing to take a different regulatory approach, there is a significant risk of undermining the retail market for broadband by favouring existing LLU providers over WLR operators.

4.8 WLR and MPF are within the same copper bearer product market, so the same regulatory approach should apply to both these wholesale services. Given the need for a smooth single stage consumer transition to FTTP, WLR and MPF are likely to have similar residual lifespans in the market. It is therefore vitally important to maintain a pricing link between WLR and MPF to safeguard retail broadband competition.

WLR and MPF Usage Past and Present

4.9 There is a different historic context to the usage of WLR and MPF. Although WLR is the older product, it is used by new entrants with the advent of GEA and superfast broadband. In contrast, MPF is favoured by providers who had scale market entry in the period 2005-2010.

4.10 WLR availability and scale usage pre-dates that of MPF[1], with WLR launched purely as an exchange line product, designed to pair with Carrier Pre-Selection (CPS) and offer lines and calls to consumers using the Openreach network, without the need to contract with BT at a retail level. Historically it had a bigger role in the enterprise market for this reason. MPF was launched in the early 2000s, but did not take off at any scale until after 2007. It was designed around providing standard broadband services, with telephony overlaid if requested.

4.11 Given the demise in popularity of standard broadband and the launch at scale in 2012 of Generic Ethernet Access (GEA), Openreach's FTTC broadband product (regulated as Virtual Unbundled Local Access), the market has shifted to focus on the need for copper bearers in order to consume GEA.

4.12 This is because the current generation of Openreach GEA requires Communication Providers to purchase a copper access bearer (the copper access line to the premises) alongside any GEA product. This bearer can be provisioned as a Metallic Path Facility (MPF) or a Wholesale Line Rental (WLR). The choice of which product to use is essentially driven by when a provider entered the market at scale – if between 2005 and 2010, then they will have a large exchange presence as that was the most optimal approach to broadband at the time. With this equipment being a sunk cost, usage of MPF is rational. In contrast, entrants after this had no reason to deploy line termination equipment at scale in local exchanges, so WLR is the rational choice of copper product.

4.13 Openreach's SOGEA product, just launched on a nationwide basis in March 2020, will combine the copper access and broadband into one product. It is essentially GEA and the copper bearer under one order. However, given SOGEA's recent nationwide availability and the long delays in launching it (SOGEA was first mooted in 2014), it will take Communication Providers some time before they can start consuming it at any scale. Plus, it may not now be the best path for broadband retailers who eventually wish to transition to FTTP (adding an extra migration step of end users). These factors result in broadband providers' continuing need to consume WLR or MPF for some time to come. Due to the legacy nature of MPF (one that requires an extensive investment in a serving exchange footprint), it is not realistic for a WLR-using retailer to change to MPF. The primary reasoning for consuming WLR is now related to broadband provision rather than for telephony.

[1] WLR3 is the current product variant, with WLR2 retired in 2011.

The need for a smooth transition to FTTP

4.14 While it makes sense for GEA broadband retailers to divert orders for new connections to SOGEA (once it is nationally available and integrated into retailers' systems), they are then left with a series of dilemmas on how best to migrate their existing base of WLR customers. It would not be as simple as placing SOGEA orders, as SOGEA itself will become a legacy service in Openreach FTTP areas.

4.15 Openreach have indicated that WLR will be subject to a stop sell by the end of 2023, with a full product withdrawal at the end of 2025. It is expected that Openreach will have covered a considerable proportion of the country with FTTP by this time, although the exact details of which locations will be covered is far from certain. It therefore makes no sense for a broadband retailer to push an existing customer whose service relies upon WLR on to SOGEA in locations where Openreach FTTP is to be made available (and where copper will eventually be switched off), as eventually that customer would have to migrate once more from SOGEA to FTTP. This triple hop migration (WLR – SOGEA- FTTP) will be both expensive for the retailer and create a considerable amount of inconvenience for the customers.

4.16 Broadband retailers will have no desire to put customers through this experience and would far rather they migrated once and only once, to minimise the inevitable disruption caused from a change to the underlying access network. This situation inevitably means Communication Providers face consuming WLR all the way up until 2025 (if that is the date when FTTP is made available by Openreach).

Retail Market Consequences

4.17 The retail broadband market is highly competitive, with a range of different retailers offering different services at different price points. Margins are often tight and competition for new subscribers is fierce. However, the big four retail providers (BT, Virgin, Sky and TalkTalk) have a market share of c. 90%. Smaller retailers however currently provide services to c. 1.8 million customers, accounting for less than 10% of the total market, but are responsible for most of the competitive pressure in the market as their customer base is more price sensitive, and likely to switch providers.

4.18 If Ofcom fails to safeguard the WLR rental price, Openreach will be free to drastically increase the rental price and it will harm competition as it will mean customers still served by WLR will pay more and may seek to secure services from either an MPF-based retailers or new provider using SOGEA, unaware they will be required to eventually move to FTTP in the near term. Openreach may seek to raise prices under the pretense of discouraging legacy technology use and encouraging movement to newer services. This, however, would be a fallacy as the least disruptive and lowest cost course of action should be to await the arrival of FTTP while remaining on a WLR copper bearer and consuming GEA until FTTP is brought on stream at their location. The estimated consumer harm resulting from smaller providers exiting the retail broadband market due to higher wholesale pricing pressures may ultimately amount to between £340 and £400 million per annum[2].

[2] ALVAREZ & MARSAL report for Vodafone May 2020

4.19 At the moment Openreach are only proposing to provide Communcation Providers (CPs) with a short-term view of their FTTP roll out, perhaps only a 6 or 12-month forward look. This will not assist the planning for WLR switch off in 2025 in many areas. Even if CPs do get clarity from Openreach on its confirmed final stage network plans for FTTP, there will be a need to ensure an orderly migration for CPs' existing WLR-using customer base. A phased approach will need to be adopted over a number of years to ensure both Openreach and CPs' network, systems and customer service functions can handle an orderly and phased exit from WLR, to prevent overloading the system and ensuing we have the resources to support customers through the transition. This all points to reliance on WLR for some time to come.

No WLR Regulation means BT has a free hand

4.20 BT's voluntary commitment letter on WLR offers nothing in addition to their obligations under the Competition Act not to margin squeeze. The voluntary commitment falls considerably short of offering any real commercial assurances to retail providers, who are reliant on WLR and who are keen to conduct an orderly and well-planned migration over successive years to the best product available (prioritising FTTP over SOGEA). The problems facing WLR-based broadband retailers are further complicated by the by the fact that MPF continues to offer price certainty over the same period.

4.21 This outcome risks distorting the UK broadband market in favour of the three largest providers. Sky and TalkTalk, both users of MPF bearers, would continue to receive pricing certainty under Ofcom's charge control. BT, who make use of WLR, would face no external cash outflow if WLR prices were to rise sharply (profits would simply shift away from BT's retail operations toward Openreach, with BT Group margin enhanced). This would leave only external WLR broadband retailers, like Vodafone, to suffer the margin consequence of this regulatory oversight.

4.22 Vodafone has a key role in the retail market, offering the keenest pricing over a prolonged period, and in so doing providing an important constraining influence on retail prices across the breadth of the retail market. The absence of effective wholesale regulation on WLR will adversely affect consumer welfare by distorting retail competition towards the three largest players, chilling the entire retail market and reinforcing existing market share proportions.

Approach to Market Definition and the Three Criteria Test

4.23 We believe Ofcom have used a historical and now incorrect market definition that fails to reflect both the copper bearer nature of WLR and the fact that it sits within the same market as its sister copper bearer product, MPF. All existing MPF users could substitute their demand to WLR , with the European Commission highlighting that "*from an economic point of view, for the definition of the relevant market, demand substitution constitutes the most immediate and effective disciplinary force on the suppliers of a given product, in particular in relation to their pricing decisions. A firm or a group of firms cannot have a significant impact on the prevailing conditions of sale, such as prices, if its customers are in a position to switch easily to available substitute products or to suppliers located elsewhere.*"

4.24 Crucially, given the legacy nature of the co-location kit needed to consume MPF, MPF isn't going to attract any new communication providers (with existing WLR users not able to substitute to MPF consumption), but in contrast the larger pool of MPF users are able to consume WLR if they chose (even taking account of FTTP and SOGEA considerations).

4.25 The European Commission state that a *"relevant product market comprises all those products and/or services which are regarded as interchangeable or substitutable by the consumer, by reason of the products' characteristics, their prices and their intended use.[3]"*

4.26 It is clear given the similarities between MPF and WLR and their identical intended use, they are part of the same copper bearer market. Ofcom does not need to undertake a three criteria test, but simply regulate the copper bearer variants at a generic level.

4.27 If the three criteria test were undertaken, WLR would pass the test, taking account of its position in the copper bearer market, as an input used to supply retail broadband (which represents the bulk of WLR usage) rather than that of its now minority and purely historic position to supply voice exchange lines with dial tone. Vodafone has sold a broadband-only service since 2018 and in January 2020 78% of Vodafone broadband customers, either adopted this service or do not use landline functionality. MPF is also used in a minority of cases to provide exchange line capability (without broadband).

4.28 It is clear that WLR is functionally equivalent to MPF. However, MPF remains regulated and charge controlled until 2026. Indeed the costs of WLR and MPF are largely identical, given the bulk of the cost relates to the copper and its routing. WLR has additional line card costs to provision landline dial-tone, but as discussed above, in the majority of cases, this is either ignored by the end customer or not provisioned.

4.29 There are significant retail competition considerations if MPF remains charge controlled and WLR does not. Both these wholesale services underpin retail broadband competition for a majority of consumers and although we anticipate FTTP adoption to proceed at scale, it will take many years for FTTP delivery of broadband to overtake that of copper bearer delivery. Indeed, it is expected that copper bearers will still be the largest access method for retail broadband services in 2025.

4.30 Given these circumstances, it is imperative the WLR is given the same treatment as MPF, with pricing maintained to prevent retail market distortion. Maintaining a linkage on price between the two products where broadband is consumed was lauded by Ofcom in 2018, in its Wholesale Local Access Review, as it fully recognised the potential for retail distortion to occur if some level of price safeguarding on WLR was not introduced. Ofcom said:

In the meantime, prior to the widespread deployment of SOGEA, the effectiveness of our decision to charge control VULA 40/10 services could be undermined if Openreach were able to require telecoms providers to purchase VULA with another service (e.g. voice telephony capability) to provide the copper

[3] COMMISSION NOTICE on the definition of relevant market for the purposes of Community competition law (97/C 372/03) (Text with EEA relevance).

bearer, and to set charges for this copper bearer above the costs of provision. In Section 10, we set a cost-based charge control on MPF so that for the case of MPF+GEA 40/10, both the copper bearer and the GEA service would be subject to cost-based charge controls. However, it may not be economic to use MPF in all situations. Existing telecoms providers using MPF have largely invested in their own equipment to provide retail packages including voice and SBB services and are unlikely to undertake further rollout. New entrant telecoms providers are unlikely to invest in exchange-based equipment and rent access connections in the form of MPF as they are likely to focus on providing retail packages offering superfast broadband services. Vodafone, for example, which is expecting to expand its broadband sales significantly from its currently small share, does not use MPF and instead relies on WLR as its copper support to FTTC.

Where the copper bearer is not provided via MPF, but e.g. via WLR or SOGEA, we have decided that any charges related to the copper bearer must be fair and reasonable, which we would interpret as reflecting the costs of providing that bearer. While we will consider Openreach's approach to pricing on a case-by-case basis, in our view the charge controlled MPF service provides a reasonable starting point for considering the cost-based charges for the copper bearer. Openreach raised a concern with this approach on the basis that it adds complexity to the fair and reasonable charging obligation imposed on WLR in the 2017 NMR. In the 2017 NMR Statement we removed the charge controls for WLR when used to provide voice services, and imposed a fair and reasonable charging obligation, giving BT more pricing flexibility. In response to Openreach, we emphasise that it does not have to use its existing WLR service as the copper bearer to support its VULA service over FTTC. However, as WLR is currently the only alternative to MPF for providing the copper bearer, we would consider fair and reasonable charges for WLR to be those which reflect the costs of provision, in instances where it is used to provide the copper bearer to support the VULA 40/10 service. For Openreach to be able to make full use of its pricing flexibility for WLR envisaged in the 2017 NMR, it will therefore need to provide the ability for telecoms providers to use the VULA 40/10 service without needing to also purchase WLR in its present form (or MPF). This may be when SOGEA is launched, but will depend on the effectiveness of SOGEA in allowing telecoms providers to provide retail packages of SFBB without relying on BT's WLR service (which sits downstream from the WLA market). In relation to Openreach's point on complexity in the case of WLR pricing, the position is as follows: WLR is subject to a fair and reasonable charges obligation. Where WLR is used to provide voice services only, or is taken with SMPF or non-charge controlled VULA services (i.e. other than the VULA 40/10 variant), we will interpret the fair and reasonable charges obligation as set out in the 2017 NMR Statement, i.e. that prices which amount to a price squeeze would not be fair and reasonable. As TalkTalk suggested, we will monitor demand for SOGEA and will act accordingly if competition concerns emerge[4].

[4] https://www.ofcom.org.uk/__data/assets/pdf_file/0020/112475/wla-statement-vol-1.pdf [9.188]

The Copper Bearer Market: ensuring WLR and MPF equivalence

4.31 This logic set out by Ofcom above remains true today and will do so for much of the next market review period. It is clear without sufficient safeguards, Openreach's approach to WLR pricing could distort the retail market and encourage disruptive, triple service migration journeys that are not in consumers' best interests. This disruption would create adverse customer perceptions and general mistrust of the information customers are being provided with on migrations (posing questions such as why am I being asking to migrate again?). A broadband user whose underlying service is delivered via WLR bearer, forced to migrate early to SOGEA and then subsequently to FTTP to avoid copper switch off is going to rightly question why they did not simply make a transition straight to FTTP.

4.32 While Openreach have made some attempts to link their WLR closure project with their FTTP deployment (the Salisbury trial is to be welcomed), much more could be done to ensure these projects are fully coordinated. Even with greater co-operation, it is imperative that WLR pricing is maintained at MPF levels while this occurs.

4.33 It is clear that for non-FTTP areas we need ensure an orderly migration for our existing WLR base, with a phased approach adopted over a number of years. This means we will be reliant on WLR for some time to come and it is imperative is regulated in parallel with MPF. All the available evidence on the physical characteristics of the products and its usage suggests that MPF and WLR sit firmly within the same market and as such they should be regulated in an equivalent manner to protect consumer welfare and protect the competitiveness of the UK's retail broadband market.

Discount Dangers: Wholesale discount influence on retail competition

Wholesale Discount can shape the retail market

5.1 Openreach's enduring Significant Market Power within the wholesale market means it has a large amount of control over the development and direction of the retail market. The wholesale prices Openreach set are reflected in retail pricing. If that pricing is selective, with certain retailers able to secure a better price over their rivals, then Openreach can effectively hand pick the winners in the retail market. Central to this debate is the role that wholesale price discounting can play in dictating outcomes in the retail broadband market. Today's retail broadband market is a competitive one. Although other factors play a part (such as service quality and customer service), price remains the key factor (indeed Ofcom's own survey evidence confirms this).

5.2 Openreach's current GEA discount scheme has incentivised broadband retailers to move their base off LLU and the regulated 40/10 product, on to 80/20 or higher. This trend is likely to be repeated when taking account of Openreach's recent wholesale upgrade special offer. This recent offer was launched to allow retailers to provide a time limited retail price offer for consumers to move to higher speed services beyond 40/10.

5.3 Understanding Openreach's capability to influence the entire retail market based on the structure of commercial offers at a wholesale level is critical. While Ofcom have previously recognised the dangers of targeted geographic discounting as a significant deterrent on rival build, there has been little consideration on the impact that scale volume discounts may have and the their impact on the long term health of the retail market. While at face value offers may be open to all, they can often be cleverly constructed to be accessible to just one or two players. When only one or two players have access to lower wholesale price, it has an almost immediate impact on the ability of others to compete in the retail market. Switching may be also discouraged (as less tempting retail offers from rival providers emerge) and those broadband retailers with access to the lowest wholesale prices stand to benefit disproportionately from the commercial imbalance at the wholesale level, in turn having a distortive influence on retail competition. Scale players tend to already have cost advantages in the market (able to spread their customer support costs over a wider pool base), allowing them to enjoy a lower wholesale price will exacerbate this cost differential in the market and have a distortive impact on the retail competition.

Regulatory Oversight of Wholesale Discounting

5.4 We welcome the proposed 90-day notice period that Openreach will be required to give for new offers and pricing. Much of the focus on discounting has been viewed from the perspective of limiting geographic wholesale offers to prevent targeted pricing in areas of current or planned competitive build. These measures are entirely necessary to allow rival commercial build to occur without the risk of take up being harmed through predatory wholesale price discounting in specific parts of the country.

5.5 We do however believe that the biggest risk posed from predatory wholesale discounting remains unaddressed - straight-line volume discounts based on existing market shares. Depending on where Openreach choose to draw the line on eligibility, this practice could pull up the drawbridge on future competitive entry and prevent all but one or two scale retail players from accessing the lowest wholesale prices in the market. Overnight, this approach could have an almost immediate and devastating impact on the retail market, reducing competitive intensity and harming retail competition at all levels in the market, foreclosing it to future market entry and making it almost impossible for players with lower volumes to compete effectively.

5.6 Value players, which are typically smaller in scale, will be hardest hit as they operate on lower retail margins and the wholesale pass through price makes up a larger proportion of their retail pricing.

5.7 The impact is not likely to be confined to the value end of the market and is likely to also be felt at the higher end of the market, with lower priced services acting today as a constraint and reference point for all levels of the retail market. The adverse impact on the lower priced broadband retail segment is especially concerning in the context of tough economic conditions and a prolonged recession, characterised by weaker consumer spending power and thus a larger proportion of the market becoming more cost conscious and keen to seek affordable broadband. Failing to prevent straight-line volume discounts that concentrate retail market share, deter switching and disproportionately harm consumers on lower priced services goes against Ofcom's key consumer objectives.

5.8 We would stress that we are not opposed to the use of equivalent discount schemes in the wholesale market. They can be a useful tool and help encourage adoption of new technology and bandwidths. However, straight-line wholesale volume based discount, which by their design, have unequal outcomes is effectively market foreclosure. It could be legitimate for a discount scheme to seek to incentivise the growth of sales, consequently there may be a place for carefully considered volume-based discounts which relate entirely to new customer connections onto a retailers service platform but they should never be discriminatory.

The need for Upfront Discount Prohibition Guidance as a deterrent

5.9 There are clearly a range of anti-competitive discounts schemes which Openreach could devise that would enable them to leverage SMP within the wholesale market into retail markets. Ofcom must explicitly prohibit these practices.

5.10 The 90days on its own will not be an adequate safeguard, as it will be unable to protect retailers and other network wholesalers from the adverse impact of any potentially anti-competitive pricing schemes promoted by Openreach, unless it accompanied by a clear 'playbook'. It can take Ofcom many months to thoroughly investigate these schemes. They are often very detailed, seeking to cover a range of potential situations, with various targets and sub-targets within them. Understanding the details of the scheme (the contracts to support them can easily run to more than 60 pages) would be far from straightforward and take some time. Ofcom would simultaneously need to understand the impact of the schemes from a range of different perspectives. This all takes time and even allowing for 90 days' notice, it is likely to be insufficient to either completely deter anti-competitive pricing schemes, nor stop them in their tracks should Ofcom find fault.

5.11 It is not clear to us what Ofcom would use this period for, would it trigger an own initiative investigation should an early review indicate concerns? What mechanism, other than informal pressure, would Ofcom use to pause the price change or discount scheme from being introduced while the matter is being investigated? There needs to be a level of accountability and credibility for the actions that would take place within this extended notice period and we would welcome Ofcom publishing details of the likely activities and course of action it would undertake during this period. This would be in addition to clear playbook guidance on what discounting behaviours and outcomes aren't appropriate in regulatory terms.

5.12 The 90 days notices requirement is necessary, but it needs to be accompanied by clear guidance, provided upfront around likely prohibitions on certain types of pricing behaviour. It also needs to be accompanied by guidance on what stakeholders can expect to occur within the period, should they raise concerns about a proposed discounting scheme.

90 Day Pricing Notification Rule

5.13 We recognise the discretion and creativity that would be open to Openreach when designing discounts. We realise that in seeking to ban one form of discounts, Openreach could simply redesign schemes to be compliant with the letter of any regulatory prohibition, but the end result of exclusionary behaviour and the favouring one or more retail provider may still prevail. To this end we welcome Ofcom's decision to introduce a 90 day notification period for new Openreach prices and discounting schemes, hoping it will bring about a more considered range of pricing that is better suited to all retailers. The additional 90 days' notice period is not a substitute for a strict ex-ante prohibition on certain types of behaviour, such as straight-line volume or geographic discounting. The notification regime could be used to ensure that such anticompetitive offers are not repackaged and brought to market. It may be the case that Ofcom needs to publish clear guidance on what it would interpret as anti-competitive conduct, focusing on end outcomes. This would provide comfort and clarity to all stakeholders on what discounting conduct is healthy and assists the consumer market, and what is exclusionary and ultimately anticompetitive.

5.14 Annex 2 is a report by Alvarez and Marsal that considers the impact of wholesale discounting on the UK's retail broadband market. It looks at the consequences for consumers if lowest wholesale pricing was made inaccessible to key market participants. It consequently examines the harm that would occur if future demand was allowed to concentrate around existing scale providers due to their ability to access straight-line volume discounts in the wholesale market.