WLA – Promoting network competition in superfast and ultrafast broadband

Virgin Media response

12 January 2018

Non-confidential Response

EXECUTIVE SUMMARY

Virgin Media welcomes the opportunity to respond to Ofcom's WLA – Promoting network competition in superfast and ultrafast broadband consultation ("**the consultation**").

While we believe the risks described in this consultation are unlikely to come to pass, we support the intent of Ofcom's proposals: safeguarding investment in competing ultrafast networks. Ofcom's recognition that lower wholesale prices for superfast services will damage the prospects of ultrafast network investment is important. Virgin Media urges Ofcom to apply this reasoning to the broader WLA market review. We have been struck by the irony of Ofcom wanting to avoid selective regional reductions in wholesale prices and, at the same time, proposing that BT reduces the price of its most in demand wholesale FTTC product across the whole country by 40% (in the central case).

Ofcom is concerned BT would deter investment by targeted wholesale price cuts. It reasons that when BT is faced with competing infrastructure investment, it will use its pricing flexibility (or the threat thereof) to undercut competitors and deter investment. It follows that BT would accept small short-term losses to safeguard its longer-term market position.[1]

To adopt this approach, BT would need to be optimistic about its ability to outwit Ofcom and weather the reputational damage from a transparent abuse of its power. To date, BT's response to investments and its consultation on FTTP investment indicate it would not pursue this strategy.

Given the risk that BT adopts this approach is low, we do not expect Ofcom's proposals will be burdensome to BT. If these remedies reassure potential investors, we welcome them in this context.

We hope that this consultation provides a signal of Ofcom's evolving approach to the WLA market as it concludes its review. Ofcom is concerned that low FTTC wholesale prices will erode returns and undermine business cases. Ofcom should recognise that its original WLA proposals are inconsistent with this consultation. Its overall approach to this market review should be brought into line to ensure that investment incentives are maintained nationwide, not just in localised areas.

The rest of this document is structured as follows:

- **The perceived risk:** the likelihood of BT adopting an entry deterrence strategy is low;

[1] Ofcom, Consultation: Wholesale Local Access Market Review - Promoting network competition in superfast and ultrafast broadband, 1 December 2017, https://www.ofcom.org.uk/consultations-and-statements/category-2/wla-competition-superfast-ultrafast-broadband, paragraph 4.2

- **The proposed remedy:** Ofcom's proposals are, in this context, appropriate, given they provide comfort to some CPs willing to invest and are unlikely to be a burden on BT; and
- **The priorities of this market review:** Ofcom should apply its reasoning in this consultation to its broader market review, where it is Ofcom, not BT, that risks deterring investment.

1. VIRGIN MEDIA'S RESPONSE

The perceived risk

Ofcom contends that in response to localised plans to make investment in ultrafast network by competitors, BT will deploy geographically targeted reductions in wholesale FTTC prices. The consequential (actual or predicted) reductions in retail prices by BT and/or its wholesale customers would be sufficient to deter rival infrastructure investment.

We think this risk is overstated. The required long-term payoff to BT looks unachievable; the cost and risk to BT of such a strategy are understated and BT's past conduct indicates it is unlikely to follow this strategy.

BT's past approach to entry

Ofcom recognises the parallels between the situation today and the risk that BT would deter investment in LLU around 2005.[2] Ofcom describes how the same risks to investors were present in that BT could have reacted to investment with targeted wholesale price reductions. Instead, BT voluntarily committed to maintain its national pricing approach.

If Ofcom had sought a similar voluntary agreement from BT during this market review and had been rebuffed, we would be more persuaded that there is a risk that BT could adopt this strategy. There is no indication from the consultation document that this has been the case. If the potential for a voluntary agreement has not been discussed, we would be interested to know why. It would be a pragmatic, proportionate and (assuming history is repeated) effective, approach to achieve Ofcom's objectives. More recently, Ofcom and BT were again able to come to a voluntary arrangement with regard to standalone landline services.[3]

BT has also had a potential incentive to cut wholesale prices in response to ultrafast investments announced by, for example, Virgin Media, CityFibre or Hyperoptic. Again, BT has not made any such attempt to manipulate wholesale prices and the threat (given the current ability) that it might do so has not deterred investment. Virgin Media announced Project Lightning in February 2015.[4] In terms

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[2] Ibid., paragraph 4.3.
[3] https://www.ofcom.org.uk/consultations-and-statements/category-1/review-of-landline-telephone-services
[4] http://www.virginmedia.com/corporate/media-centre/press-releases/virgin-media-and-liberty-global-announce-largest-investment-in-uks-internet-infrastructure-for-more-than-a-decade.html

of scale and strategic risk, it is the largest threat facing BT's wholesale broadband business today. Sharon White noted as much in a recent speech, *"Project Lighting is serious competition to BT, offering the first real prospect of an alternative network to Openreach in the majority of the UK."*[5]BT has had almost three years to introduce a wholesale price-based response to Project Lightning and has not done so.

Instead of targeted wholesale price cuts, Openreach has continued to rollout FTTC, pursue its G.fast upgrades and to consult its customers about the potential for widespread FTTP investment. We see no evidence that it would deviate from this approach of fighting investment with investment.

BT could not be confident that payoffs would be long-term

The premise of Ofcom's hypothesis is that if BT followed this strategy, it would expect ultimately to be successful in dissuading competing fibre investment and reap long-term benefits as a consequence. However, this expectation is fraught with uncertainty:

Ability to disrupt: BT could not be confident that its strategy would be successful and yet any wholesale price reduction could set a damaging precedent that BT may find challenging to reverse. Therefore, BT would need to weigh the (potentially short-term) delay in competitive infrastructure build against the lost wholesale and retail[6] FTTC revenues as well as the long-term consequences for its wholesale G.fast and FTTP prices (because these are constrained by FTTC).

Market review frequency: Given the three-year duration of market review periods, BT would expect would-be investors to voice strong concerns about such an abusive practice and Ofcom to respond appropriately. BT would need to consider the risk that the benefit of delaying material fibre investment could be brief and would therefore be far outweighed the longer-term consequences of having its pricing freedom constrained.

Emergency intervention: Ofcom has demonstrated[7] it is prepared to use emergency powers to address perceived competition concerns.

Therefore, even in the counterfactual, where Ofcom had not proposed ex ante remedies, BT would anticipate a regulatory response that would prevent it from deterring competing investment by reducing wholesale prices.

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[5] Sharon White, Only competition can unlock Britain's fibre future, 01/12/2018, https://www.ofcom.org.uk/about-ofcom/latest/media/speeches/2017/competition-britain-fibre-future
[6] As wholesale price reductions would be passed through to consumers.
[7] For example, Ofcom's recent temporary SMP conditions in relation to BCMR.

Reputational damage from deterrence would likely be extensive

Were BT to pursue an anti-competitive, geographically targeted, attack on nascent fibre investment it would be reasonable to expect it would be met with a backlash. We would expect the response from Government, Ofcom, network investors and likely the wider public to be swift and negative. BT would be seen to be holding back infrastructure investments in the long-term interest of the UK.

BT might surmise that the repercussions of its actions could be serious. For example, full separation of Openreach could be 'back on the agenda'.

The context of Ofcom's current WLA proposals

Ofcom currently proposes a c.40% cut in nationwide wholesale GEA40 rental prices during the forthcoming charge control period; reducing wholesale prices to its estimate of BT's cost. Later in our response, we note that Ofcom's proposals effectively amount to forcing BT to undertake a sustained nationwide entry deterrence strategy. Throughout the consultation process, BT has raised concerns about how these proposed price reductions will inhibit its ability to recover its efficiently incurred costs and invest in its network.

A further (even if geographically targeted) voluntary wholesale price cut would contradict BT's concerns about its ability to recover its costs, especially as any reduction would need to be material to be have the desired deterrence effect.

Furthermore, we expect it would be challenging for BT to justify targeted wholesale price reductions in areas impacted by build from competing ultrafast infrastructure. The average cost of serving homes in these areas would, all else equal, be expected to rise if customers substituted away from BT to another operator.

The risk to full-fibre investment

In its submission to Ofcom, Vodafone describes its longstanding concern about a price-based entry deterrence response by BT to its decision to invest in FTTP. The introduction of its letter concludes, *"We believe that a failure to act now will load disproportionate risk on would-be investors and the fibre ambition for the UK will be permanently grounded."*[8]

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[8] Vodafone, Letter: Anti-Competitive G.Fast Overbuild and targeted pricing by Openreach in response to FTTP roll-out, https://www.ofcom.org.uk/__data/assets/pdf_file/0020/108371/vodafone-letter.pdf, page 1.

CityFibre and Vodafone's investment agreement was announced in early November 2017 and Ofcom's consultation was launched in December. Even if the topic had been discussed between Ofcom and CityFibre/Vodafone, there were be no certainty the remedies would be introduced. Absent these safeguards, the investment proceeded and therefore it should be clear that the risk of BT pricing to deter would not 'permanently ground' fibre investment. Furthermore, Virgin Media, Hyperoptic and others have already made (or announced) large investments in ultrafast networks despite no such protections being in place. This hypothesised sword of Damocles has always been present, yet investment from a range of CPs has emerged and persisted.

The proposed remedy

In the previous section we set out why BT is unlikely to pursue a wholesale price-based deterrence strategy. Given this, Ofcom's proposed approach is unlikely to be burdensome or constraining on BT and, on balance, we do not object to Ofcom's approach. We once again draw a contrast between the safeguards and flexibility inherent in these proposed remedy and Ofcom's broader WLA proposals. As noted in the previous section, we do wonder why a voluntary prohibition has not been pursued with BT. Given the parallels with previous LLU investments, this would seem to have been the least burdensome first choice.

Retail price regulations are unwarranted

We agree that it would be inappropriate to restrict BT's retail pricing flexibility in response to this risk. As Ofcom notes, the need to maintain an adequate retail margin (to pass a margin squeeze test) would prevent BT from abusing its SMP. As Vodafone acknowledges, it should be expected that other CPs would respond to additional competition with changes to their own retail offers.[9] In this context, restrictions on retail competition should only be put in place if it were based on unreasonable wholesale prices, which Ofcom's proposals preclude.

Exemption for GEA-FTTP

We agree that for the practical reasons described by Ofcom, GEA-FTTP should not fall within Ofcom's restrictions on geographic pricing. BT's current FTTP plans are limited and its ability to

[9] Virgin Media's anecdotal experience confirms this retail competitor response via discounting and proactive re-contracting in response to Project Lightning build.

quickly change pricing would also be limited.[10] Were BT to invest significantly in FTTP, it would be a long-term business decision with significant risks. We would expect there to be a low risk that BT would choose to price wholesale FTTP aggressively to deter competing investors and damage its long-term business.

Price floor remedy

We agree that a price floor for G.fast would be unnecessary. G.fast is a new venture and an incremental improvement in broadband performance. As with any network investment, BT will be concerned about managing risk and ensuring that the project pays back. We agree that price controls, such as a price floor, would raise unnecessary risks of regulatory error. For example, competition or consumer demand may evolve in unexpected ways. If Ofcom were to impose a price floor on G.fast it may restrict BT's (legitimate) need to respond to these changes even though the reduction in wholesale prices was not motivated by deterrence, i.e. a Type I error.

Flexibility in extenuating circumstances

We agree that the backstop flexibility offered by SMP condition 4.1 (to allow Ofcom to consent to dis-applying these measures in appropriate circumstances) helps to ensure Ofcom's proposals are proportionate.

The priorities of this review

We do not object to Ofcom's proposals as they address the concerns of some potential infrastructure investors and are broadly appropriate remedies to impose on BT even though the risk is low. Furthermore, if BT identifies a legitimate need to introduce de-averaged wholesale pricing (and Ofcom agrees, after reviewing the evidence), Ofcom can provide special dispensation to dis-apply the remedy.

However, we are struck by the inconsistency in approach to promoting investment incentives between this consultation and the broader WLA market review in March 2017. Ofcom should not identify wholesale superfast price cuts as a risk to investment that it must intervene to avoid, while at the same time require BT to introduce large nationwide reductions.

[10] Ofcom, Consultation: Wholesale Local Access Market Review - Promoting network competition in superfast and ultrafast broadband, 1 December 2017, https://www.ofcom.org.uk/consultations-and-statements/category-2/wla-competition-superfast-ultrafast-broadband, paragraph 4.8.

Ofcom acknowledges that its proposals could limit BT's ability to reduce wholesale prices for (legitimate) reasons other than deterring competition.[11] Yet, in contrast to March 2017, Ofcom is willing to forgo or delay these potential price cuts for consumers to ensure that investment incentives are preserved.

The proposals set out in Ofcom's original WLA market review consultation[12] exacerbate the concerns raised by Vodafone and CityFibre by lowering potential returns per line, regardless of whether BT reacts strategically. If the threat of targeted wholesale price reductions would raise the level of risk of their investment and jeopardise the viability of business cases, nationwide wholesale price reductions proposed by Ofcom surely must do the same.

[12] Ofcom, Wholesale local access market review, March 31 2017, https://www.ofcom.org.uk/consultations-and-statements/category-1/wholesale-local-access-market-review