BT Group plc

Regulatory teach-in
3 April 2014

Potentially hazardous quantities of regulatory information are handled in this area.
Mark Shurmer,
Group Director, Regulatory Affairs
Agenda and introductions

- UK Regulatory landscape
- Wholesale narrowband
- Fixed access copper regulation
- Fixed access fibre regulation
- EU directives
- Pay TV and Mobile
VOTE – Do you feel you have a good understanding of UK regulation?

CAUTION

REGULATORY INFORMATION HANDLING AREA

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1 = Yes
2 = No
3 = Unsure
UK regulatory framework today

BT’s Undertakings
Offered by BT in lieu of reference under the Enterprise Act
Creation of Openreach, Equivalence of Inputs (EOI), Equality of Access Board

General UK legislation
Competition law
Consumer protection legislation

UK Communications Act
Gives Ofcom regulatory powers and implements the EU Directives

EU Directives
Establish EU-wide “Common Regulatory Framework”
Specify market review process for imposing remedies, including frequency
National regulators must consult EU on remedies, including charge controls, to ensure consistency
UK regulatory framework market review process

- Step 1: Market definition
- Step 2: SMP assessment
- Step 3: Impose remedies

Principles

- Regulate only where competition is not effective
- Focus on “access bottlenecks” to facilitate competition at the deepest economically viable levels
- Review key access markets (set out in EC Recommendation) every three years to assess where regulation is still required
UK regulatory framework **SMP remedies**

**Severity of constraint**
- **Low**
  - **Supply**
    - Must supply services in market to others on reasonable request and terms
  - **Non-discrimination**
    - Must not discriminate against others/in favour of own activities
    - EOI is a stronger form
  - **Accounting separation**
    - Must publish financial statements to enable transparency for compliance and regulatory oversight
  - **Cost orientation**
    - Must ensure prices are reasonably derived from costs of provision

- **High**
  - **Charge control**
    - Must ensure prices change by no more than CPI-X% each year
UK regulatory framework enforcement powers

- Dispute resolution
- Compliance investigations
- Competition Act investigations
Key market reviews looking forwards

Business Connectivity (BCMR/LLCC)

Current CC Apr 13 to Mar 16
Next CC Apr 16 to Mar 19
Consultation
Final statement
Consultation
Final statement

Fibre, copper access and wholesale broadband (FAMR & CC; WBA MR & CC)

CC to Mar 14
Next CC Jul 14 to Mar 17
Next CC Apr 17 to Mar 20
Consultation
Final statement
Consultation

Wholesale voice services (WNBMR & NCC)

Current CC Oct 13 to Sep 16
Next CC Oct 16 to Sep 19
Consultation
Final statement
Consultation

Key market reviews looking forwards

Business Connectivity (BCMR/LLCC)

Fibre, copper access and wholesale broadband (FAMR & CC; WBA MR & CC)

Wholesale voice services (WNBMR & NCC)

Current CC Apr 13 to Mar 16

Next CC Apr 16 to Mar 19

CC to Mar 14

Next CC Jul 14 to Mar 17

Next CC Apr 17 to Mar 20

Current CC Oct 13 to Sep 16

Next CC Oct 16 to Sep 19

Consultation

Final statement

Consultation

Final statement

Consultation

Final statement

Current 2013/14

2014/15

2015/16

2016/17

2017/18

2018/19

2019/20

UK Policy Framework

New Ofcom Chairman Apr 14

UK government election May 15

2.3 & 3.5 GHz spectrum auctions 2015

700 MHz spectrum auction 2018

EU

Adoption of NGA Recommendation Sep 13

EU Parliament elections May 14

Possible review of EU Framework Directives

EU Parliament elections May 19

Adoption of Single Market Regulation May 14
The approach to UK regulation has resulted in good outcomes for consumers & businesses

“Price rises push SSE customers to switch energy suppliers”. 
FT, Jan 2014

“Centrica delays investment after Ofgem calls for energy probe.”
FT, Mar 2014

“Energy companies face break-up threat over high profits and prices.”
Telegraph, Mar 2014

Change in real prices since 1990

Source: UK office of National Statistics, July 2013
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Our requirements: Principles-based approach to regulation and a focus on supporting our growth agenda

- Fibre
- TV and content
- Mobility and future voice
- UK business markets
- Leading global companies

- Fair return on investments
- Level playing field
- Access abroad
- Ability to bundle services at retail level
- No artificial entry assistance
Wholesale narrowband
Michael Rickard
Group Regulatory Finance
Wholesale narrowband market review

- Change of pricing approach for Call Origination and Call Termination
  - With effect from 1 Jan 2014
    - Call Termination price has fallen due to the move down to LRIC.
    - Call Origination has increased to partially compensate
  - BT overall is a net terminator so this has a negative impact on BT Wholesale
Openreach has two main portfolios covering copper access products:

- Wholesale Line Rental (WLR) market
- Wholesale Local Access (WLA) Market, consisting of Metallic Path Facility (MPF), Shared Metallic Path Facility (SMPF) and Co-mingling

2012/13 Openreach Copper Revenue £3bn¹

¹ Source: WLR and LLU market revenue (including internal) from 2012/13 RFS
Awaiting final confirmation of third WLR LLU charge control prices
  – expected to come into effect 1 July 2014
Ofcom includes cost allowance for minimum service standards
- unclear whether final cost allowance will be sufficient to deliver the requirement

One off charges - significant year 1 reductions in TRC/SFI and caller display
Fixed Access Regulation Continuing subsidies for MPF?

- Independent consultants Plum believe there is strong evidence that MPF operators no longer need to be encouraged to enter market.
- UK now has one of the most competitive broadband markets in the world.
- LLU Operators have benefited by around £600m since 2005.
- Delaying closing the gap until the 2017 would add a further c.£400m of distortion, with a total impact of almost £1bn.

WLR+SMPF – MPF price differential sets key entry signals

- Ofcom proposing £10 differential
- Cost differential is £0-£4

Figure 8.1: WLR+SMPF minus MPF charge differential over time (£ per line per annum)
Fixed access regulation – Fibre
James Tickel
Head of Operational Regulation and Economics
Should fibre prices be regulated today?

1 = Yes
2 = No
3 = Unsure

Potentially hazardous quantities of regulatory information are handled in this area.
Fixed Access Regulation Current Fibre Status

- Fibre is regulated in almost every aspect except its price:
  - we have to provide access on request and under EOI; and
  - must be offered on fair and reasonable terms;
  - should be developed in an open and consultative way with other CPs;
  - specification should meet certain characteristics
  - we expect to have to cut migration price to £10-£15 from £50.
Fixed Access Regulation Current Fibre Status

- Ofcom has given three reasons for limited price regulation

  - "competitive constraints exist" – from copper services and from Virgin Media

  - "uncertainty about future demand for NGA services and the profile by which NGA investment should be recovered"

  - "risk of setting inappropriate price levels that would particularly harm incentives for efficient investment and BT’s ability to experiment with pricing"
Will BT’s fibre be price controlled in 2017?

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Fixed Access Regulation Future Fibre Status

- Current FAMR will fix rules until end March 2017
- Next Review will start H2 of Cal. 2015 when debate about fibre price regulation will begin again
- Key, linked, questions will remain the same:
  - is fibre price constrained by price of copper and/or availability of Virgin services?
  - to what extent is copper still viewed as substitute for fibre by sufficient customers?
  - what returns is BT making on fibre and have initial (risky) investment costs have paid back?
  - what further investment is required to support future demand (total volume of lines and/or speed requirements)?
  - how certain is future demand and/or unit costs of supply?
  - would price intervention choke off further BT investment or limit BT’s commercial pricing innovations?
- Too early to say how and when fibre price will be regulated post 2017
Do you think there is a fibre margin squeeze?

1 = Yes
2 = No
3 = Unsure

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Margin squeeze: the concept

BT’s retail market price

Dominant Provider’s retail market price

Efficient costs of supplying downstream service using key input

Charge from Dominant Provider for key input

Margin squeeze

Margin available to downstream competitors
Complaint from TalkTalk Telecom Group plc against BT Group plc about alleged margin squeeze in superfast broadband pricing

CW/01103/03/13

Complainant: TalkTalk Telecom Group plc

Complaint against: BT Group plc

Case opened: 1 May 2013

Issue: Alleged margin squeeze in relation to the selling of superfast broadband by BT to wholesale customers

TalkTalk has received a complaint position in breach of the Order that BT has engaged in a margin squeeze in the supply of superfast broadband to wholesale customers.

As set out in section 25 of the Order, TalkTalk is entitled to investigate this new complaint and determine whether it is substantiated.

Fibre – building gradually

- 43,000 customers added in H2 vs. 22,000 in H1, taking base to 73,000
- Overall demand in our base is still modest
- Actively selling 76Mbps product – to sub 3Mbps base to support TV demand
- Launched fibre for business customers
  - Fibre customers:
    - Revenue and EBITDA accretive
    - Reduced churn and costs to serve
    - Incremental SAC, pays back in 18m contract term
- Expect stronger regulation to deliver greater certainty over economics, which will make our fibre more attractive

TalkTalk Q3 2013/14 interim statement

24,000 new mobile and 35,000 new fibre customers added

Following strong promotional activity for our SIM-only product during Q2, Q3 mobile net additions returned to a more normalised pattern of growth. Fibre growth also benefited from promotional activity during Q2 and has since returned to a more regular pattern of growth. Demand for fibre from our customers remains modest except when it can deliver transformational improvements in their broadband experience, such as for those customers who currently achieve less than 2Mbps speeds and might wish to take TV.
Fibre margin: next steps

- **Competition Act investigation** ongoing – precise timings unclear

- April/May 2014: Separate consultation on **guidance** around approach Ofcom would take to ex ante assessments of margin
  - likely to be closer to competition law than protectionist approach demanded by TalkTalk
  - guidance finalised over summer
Fixed access regulation – EU
James Tickel
Head of Operational Regulation and Economics
EU Framework

- EU Directives underpin the framework we operate within
- Major initiatives come from Brussels – call termination rates, mobile roaming, digital agenda, fibre recommendation, net neutrality
- Ofcom regulatory decisions on remedies have to be cleared by the Commission
- The UK also influences the EC – e.g. Fibre Recommendation, VULA

BT perspective

- Good impact in Europe based on our delivery in UK
- Lobbied for digital single market with Global Services as pan European operator
- Pleasing emphasis on business services and wholesale access
- Overall, moving slowly in right direction
- Industry consolidation must not come at expense of competition, clearance should be conditional on wholesale access obligations as a competition remedy
BT Group plc

Content/Pay TV, Mobile and conclusions
Mark Shurmer
Group Director, Regulatory Affairs
Content/Pay TV

Current inconsistent regulation is to the detriment of consumers, competition and innovation

Telecoms
- Subject to ex-ante regulation with an analytical framework for identification of market failure
- European framework sets out a set of general remedies and SMP conditions

Pay TV
- Similar economic characteristics evident in Pay TV value chain
- Reliance on general competition law plus various legacy provisions

- UK consumers benefit from amongst lowest fixed/BB prices but highest Pay TV prices amongst major countries
- Pay TV switching rates 3x lower than other comms markets
- Consumer protection rules for BB do not apply to Pay TV subscribers
Content/Pay TV – where we are

- Encouraged by Court of Appeal ruling on Sky Sports 1&2 access
  - Sky seeking leave to appeal to Supreme Court

- Ofcom expected to rule on Sky Sports 1&2 on YouView in autumn

- Switching regime not consistent
  - should be Gaining Provider Led
  - DSL/Cable should follow same rules

- BT open to wholesale content deals on fair terms
Regulation of the UK mobile sector

- Wholesale access / MVNO market
  - pleased with EE MVNO
  - but need long term level playing field: four wholesalers or two networks?

- Mobile termination – Ofcom updating cost based rates
  - BT supportive of continuing current approach with right cost base
  - reducing rates create more equal competitive conditions for new entrants to mobile and fixed operators

- Switching regime not consistent with fixed / international best practice
  - should be aligned with fixed move to Gaining Provider Led

- International roaming in EU
  - support removal over time of roaming premiums across EU – reduces legacy advantage of incumbent MNOs
Conclusions / Take-aways

- FAMR decision due shortly
  - base case rental glide path less punitive, but tough cuts to ancillaries/engineering services
  - outcome on service and entry assistance still unclear

- Fibre
  - Ofcom likely to broadly maintain their current regulatory approach that has delivered good outcomes for investment and competition
  - we will look closely at proposed guidance on ex ante margin squeeze
  - our focus now is also on the next market review in 2017

- Some progress on Content/Pay TV
  - more to do to level playing field in an increasingly bundled market
  - switching should be Gaining Provider Led, as in broadband

- More to do on mobile
  - level playing field in terms of wholesale access and switching processes
  - mobile and fixed termination costs should converge
## Glossary

<table>
<thead>
<tr>
<th><strong>Business Connectivity Market Review (BCMR)</strong></th>
<th>This review assesses the state of competition in the market for retail leased lines; wholesale symmetric broadband origination (access and backhaul services) and wholesale trunk segments, and considers whether regulation is required in these markets. A leased line is a communications service which provides dedicated transmission capacity between fixed locations, which can be used to carry voice and data traffic.</th>
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<tbody>
<tr>
<td><strong>Co-mingling</strong></td>
<td>This product offers physical co-location of LLU operators’ equipment within a BT exchange.</td>
</tr>
<tr>
<td><strong>Equivalence of Input (EOI)</strong></td>
<td>This requires a vertically-integrated company to offer its product and services to its downstream divisions on exactly the same terms and conditions including price and over the same systems and gateways as it does to other CPs. This is the strongest form of non-discrimination.</td>
</tr>
<tr>
<td><strong>Local Loop Unbundling (LLU)</strong></td>
<td>A product that offers passive access over the metallic path that forms BT’s local loop. There are two forms, a fully unbundled local loop whether the CP has control of the whole line and a partial version where it has control only of the broadband element.</td>
</tr>
<tr>
<td><strong>Engineering services</strong></td>
<td>Engineering Services are provided by Openreach and allow a CP to use Openreach engineers to carry out a wide range of engineering activities: including the installation and jointing of customer-owned cables and fibres and internal wiring work. These services include Special Fault Investigations (SFI) and Time Related Charges (TRC).</td>
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# Glossary

<table>
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<td><strong>Fixed Access Market Review (FAMR)</strong></td>
<td>This review assesses the state of competition in the markets for LLU, WLR, fibre access and physical infrastructure (duct and pole) products and considers whether regulation is required in these markets.</td>
</tr>
<tr>
<td><strong>Generic Ethernet Access (GEA)</strong></td>
<td>This is the Openreach name for its wholesale fibre access product. It is Openreach’s implementation of Ofcom’s virtual unbundled local access (VULA) requirement.</td>
</tr>
<tr>
<td><strong>Leased Line Charge Control (LLCC)</strong></td>
<td>This charge control is implemented by Ofcom to address SMP on products in the BCMR. Ofcom consults separately on this and seeks views from interested parties about specific charge control proposals.</td>
</tr>
<tr>
<td><strong>Long Run Incremental Cost (LRIC)</strong></td>
<td>Long Run Incremental Costs are defined as the long run avoidable cost of an incremental unit of ‘production’</td>
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<td><strong>Metallic Path Facility (MPF)</strong></td>
<td>The provision of access to the copper wires from the customer premises to a BT exchange that includes both narrowband and broadband.</td>
</tr>
<tr>
<td><strong>Network Charge Control (NCC)</strong></td>
<td>This charge control is implemented by Ofcom and associated with the WNBMR.</td>
</tr>
<tr>
<td><strong>Next Generation Access (NGA)</strong></td>
<td>A new or upgraded access network capable of supporting much high capacity broadband services than traditional copper access networks. Generally an access network that employs optical fibre cable in whole or in part.</td>
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<td><strong>Significant Market Power (SMP)</strong></td>
<td>The Significant Market Power test is set out in European Directives. Broadly, an operator with SMP has the ability to profitably raise its price above the competitive market level. It is used by National Regulatory Authorities (NRAs) such as Ofcom to identify those communications providers who must meet additional obligations under the relevant Directive.</td>
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<tr>
<td><strong>Shared Metallic Path Facility (SMPF)</strong></td>
<td>Enables a CP to offer broadband through access to the copper wires from the customer premises to a BT exchange. Bought alongside WLR.</td>
</tr>
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<td><strong>Special Fault Investigations (SFI)</strong></td>
<td>These are chargeable fault investigations to resolve broadband/connectivity issues that arise despite the PSTN line working.</td>
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<td><strong>Time Related Charges (TRCs)</strong></td>
<td>Time Related Charges are raised when engineers perform work not covered under Openreach’s terms of service.</td>
</tr>
<tr>
<td><strong>The Undertakings</strong></td>
<td>A set of legally binding commitments offered by BT to Ofcom that, among other things, led to the creation of Openreach as a functionally separate part of BT and the provision of its key services on an EOI basis.</td>
</tr>
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<td><strong>Virtual Unbundled Local Access (VULA)</strong></td>
<td>The SMP remedy imposed by Ofcom for wholesale fibre access. VULA provides a connection from the nearest ‘local’ aggregation point (e.g. the local exchange) through the FTTC cabinet and into the customer premises, and is effectively the equivalent to LLU for fibre.</td>
</tr>
<tr>
<td><strong>Wholesale Broadband Access (WBA) market</strong></td>
<td>The Wholesale Broadband Access market relates to the wholesale broadband products that communications providers (CPs) provide for themselves and sell to each other.</td>
</tr>
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</table>
## Glossary

| **Wholesale Local Access (WLA) market** | This covers fixed telecommunications infrastructure, specifically LLU, fibre access and PIA (duct and pole sharing) products. |
| **Wholesale Line Rental (WLR)** | The service offered by Openreach to BT’s retail units and other, typically smaller, CPs to enable them to offer retail line rental services. |
| **WLR and LLU charge control** | This charge control is implemented by Ofcom associated with the FAMR. |
| **Wholesale Narrowband Market Review (WNBMR)** | This review assesses the state of competition in the markets for wholesale products for exchange lines and calls on fixed networks. These wholesale products are used by retailers to provide products to citizens and consumers. |