Briefing for analysts: Telecoms

Ed Richards
Chief Executive

16th December 2009
Agenda

• Introduction
  Ed Richards

• Mobile update
  Stuart McIntosh

• Spectrum update
  Graham Louth

• Pensions review
  Craig Lonie

• Developments in European regulation
  Alex Blowers

• Q&A
Mobile update

Stuart McIntosh
Partner, Competition
Mobile update

• Mobile Sector Assessment
• Mobile call termination charges
• Broader developments in the mobile sector
Mobile Sector Assessment: Core findings

- Competition has produced good outcomes for citizens and consumers
- Core challenge: To maintain the benefits from competition in a changing environment

We have also concluded that:

- A market review is not required at this stage, but have identified areas of continuing focus (eg spectrum and market entry)
- We need to continue to apply our consumer policy framework
- We should promote access to mobile for all citizens
- There is a need for greater focus on coverage, including working with industry and research on the causes of not-spots
Regime for mobile termination will be a focus in 2010

- Current control ends in March 2011
- European Commission’s Recommendation: LRMC
- We are currently consulting on 6 options:
  - Complete de-regulation
  - LRIC+ (as today)
  - LRMC (similar to Recommendation)
  - Capacity-based charging (similar to internet access)
  - Reciprocity btw fixed and mobile (similar to US)
  - True bill-and-keep (similar to internet peering)
- Consultation expected to be issued early in 2010
Broader developments in the mobile sector

- Evolving models of service delivery, applications and innovations in devices
- Infrastructure and network sharing
- T-Mobile/Orange - proposed JV
- Possible impact of spectrum policy issues
Spectrum Update

Graham Louth
Director of Spectrum Markets
Recent developments

• DSO and HD on Freeview
• Spectrum for mobile broadband
• Digital Britain: Spectrum Modernisation
DSO proceeding as planned

- Switchover in Granada now completed – biggest so far
- On track to complete switchover in UK by late 2012

Source: Digital UK
HD on Freeview now a reality

- HD on Freeview now being broadcast in London, Manchester and Liverpool
- BBC and ITV HD services broadcasting, with Channel 4/S4C to follow in 2010
- Launch in Glasgow, Birmingham, Newcastle and Leeds/Bradford in Q1 2010
- Available to 50% of the population in time for 2010 World Cup
Gathering momentum behind use of 800MHz band for mobile broadband across Europe

- Growing number of 800MHz release announcements

- EC Recommendation and Communication on the Digital Dividend adopted
  - Support harmonised use of 800MHz band for electronic communications services

- Technical conditions for use of 800MHz band nearing completion
More spectrum being made available for 3G services

• Revised GSM Directive and associated RSC Decision now enacted
  – 2G spectrum to be made available for 3G services
  – Impact on competition to be assessed and distortions addressed

• Transposition into national law required by 9 May 2010
Digital Britain: Spectrum modernisation

- Government consulting on Direction to Ofcom
  - Package of proposals intended to allow for release of spectrum and support delivery of next generation mobile services
- Consultation closes 8 January 2010
- Final Direction will require approval by Parliament
Current challenges

• Clearance of 800MHz band
• 2.7GHz radar interference
• Cable TV interference
• But auction timetable remains as planned
Pensions Review

Craig Lonie
Director of Competition Finance
What the papers said …

**Ofcom paves way for BT to lift wholesale charges by 4%**

- BT could pass on cost of plugging its £9.4bn pensions deficit, regulator suggests

**BSkyB attacks BT's plan to charge rivals for pension hole**

- Bailout would reward failure, says broadcaster
- Ofcom considers idea that could raise prices by 4%
Contents

• Why we are reviewing pension cost treatment
• How we treat pension costs currently
• How changes of approach might affect charges
• Objectives of the review
• Next steps
Why we are reviewing pension costs

Pension costs have grown
BT’s deficit was £9bn at H1 2009/10. Repair payments are £525m p.a. Liabilities, and costs of funding them, have grown.

We said we would look at this
BT argued our approach was different to other regulators. We said we would consult.

Scope is limited
We are only looking at defined benefit (DB) schemes. Only BT’s scheme affects regulated charges.

We are not evaluating BT’s scheme management, nor are we looking at efficiency of DB schemes per se.

3 parts to our review
Deficit repair payments
Ongoing service costs
Cost of capital
How we treat pension costs at present

MPF costs

- Deficit repair £4
- WACC £25
- Depreciation £20
- Operating costs £45

Excluded

Unadjusted

Price = c£90

Ongoing service cost £3
- Pay (ex pensions) £20
- Other £22

Other £22
How changes of approach might affect charges

MPF costs

- Deficit repair £4
- WACC £25
- Depreciation £20
- Operating costs £45

If we included current repair payments in full
+4%

If we reduced the cost of capital by 1%
-3%

If we used a ‘risk free’ discount rate
+1.5%
Objectives of the review

We will ensure our approach is, or remains, consistent with our duties, and is coherent:

<table>
<thead>
<tr>
<th>Higher charges</th>
<th>Deficit repair payments</th>
<th>Ongoing service charge</th>
<th>Cost of capital</th>
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<tbody>
<tr>
<td></td>
<td><strong>Fully included</strong></td>
<td><strong>P&amp;L charge (adjusted upwards)</strong></td>
<td><strong>Unadjusted</strong></td>
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<td><strong>accounting charge or Cash contributions (unadjusted)</strong></td>
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<td><strong>Fully excluded</strong></td>
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<td><strong>Adjusted down</strong></td>
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We also need to bear in mind:
- History (the ‘regulatory contract’)
- Other regulators’ approaches
- Practicability

We are looking for stakeholder input and evidence to inform our decision
Different regulators adopt different approaches

<table>
<thead>
<tr>
<th>Regulator</th>
<th>Deficit repair</th>
<th>Ongoing service charge</th>
<th>Duty to finance</th>
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</thead>
<tbody>
<tr>
<td>Ofcom</td>
<td>Out</td>
<td>Accounting</td>
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<tr>
<td>CAA (NATS)</td>
<td>In</td>
<td>Cash</td>
<td>✓</td>
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<td>Ofgem</td>
<td>Part In</td>
<td>Cash</td>
<td>✓</td>
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<tr>
<td>Postcomm</td>
<td>In</td>
<td>Cash</td>
<td>✓</td>
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<tr>
<td>Ofwat</td>
<td>Part In</td>
<td>Cash</td>
<td>✓</td>
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<tr>
<td>ORR</td>
<td>No policy</td>
<td>Cash</td>
<td>✓</td>
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<tr>
<td>CAA (airports)</td>
<td>Out</td>
<td>Cash</td>
<td>✗</td>
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## Next steps

<table>
<thead>
<tr>
<th>Date</th>
<th>Stage of review</th>
<th>Purpose of document</th>
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<tbody>
<tr>
<td>February 2010</td>
<td>Responses to 1st Consultation</td>
<td>Stakeholder responses</td>
</tr>
<tr>
<td>Spring 2010</td>
<td>2nd Consultation</td>
<td>Setting out specific proposals</td>
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<tr>
<td>Late 2010</td>
<td>Final statement</td>
<td>Publish broad principles</td>
</tr>
<tr>
<td>After statement</td>
<td>Implementation stage</td>
<td>Application of principles on a case-by-case basis if changes are proposed</td>
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Developments in European regulation

Alex Blowers

International Director
The revised Regulatory Framework

- Political agreement reached on 24 November
- Key elements:
  - BEREC Regulation (new NRA co-ordination body)
  - Better Regulation Directive – economic regulation
  - Privacy and Users’ Rights Directive
- Cause of delay: ‘Amendment 138’ – internet rights
- Member States now have until June 2011 to implement in national law
Framework: Economic regulation

- Strong reaffirmation of market-oriented policies
- No Commission veto on NRA remedies and no ‘super-regulator’….
- …..but increased scrutiny of NRA decisions….via BEREC
- ‘Net neutrality’ and reform of USO rules to be addressed early in lifetime of new Commission
Framework: Consumers and users’ rights

- Number portability: Mobile numbers will need to be ported within a single day of contract conclusion
- USO: recital obtained by UK allows Member States to extend scope of USO to cover broadband
- Internet quality of service: NRAs have power to impose, along with greater transparency in relation to limitations or restrictions of service
Framework: BEREC

- BEREC – Body of European Regulators in Electronic Communications – to soft launch early in 2010

- Supported by a small Office (growing to perhaps 20 people over time)

- Key tasks include
  - Creating common positions on regulatory issues
  - Advising Commission on future harmonisation initiatives
  - Scrutinising national notifications under revamped market review process

- Commission must take account of BEREC’s advice in discharge of various functions
NGA Recommendation

• Publication now anticipated late Spring

• Unlikely to signal radical shift in overall regulatory approach

• But will probably endorse modification of regulatory approach in relation to:
  – Risk-adjusted returns for at least some NGA investments
  – Pricing flexibility for regulated NGA products
  – Symmetric access to in-building wiring

• Outstanding issue is treatment of ‘co-investment’ or ‘multifibre’ schemes
‘Article 7’ process

- On 15 October, the Commission commented on Ofcom’s proposed remedies in fixed narrowband wholesale services market
- The Commission commented on Ofcom’s approach of imposing controls on altnets through industry reciprocity agreement
- Ofcom believes Cion alternative – direct controls on operators – would be burdensome – We can enforce reciprocity principle if necessary
- We will monitor effectiveness of reciprocity agreement
New Commission agenda

• Neelie Kroes earmarked as Commissioner for ‘digital agenda’

• Principal focus likely to be on implementation of Framework in near term

• Longer term issues include:
  – Reforms to promote single market in ‘digital content’
  – Measures to stimulate promotion of ‘smart ICT’
  – Measures to strengthen demand for and use of online services – including privacy and trust questions
Q&A
Coming soon ....

• Wholesale local access market review

• Wholesale broadband access market review

• Mobile termination rates second consultation