Ofcom
Briefing for analysts: Telecoms
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Welcome

Good morning ladies and gentlemen. Thanks very much for taking the time to join us this morning, particularly for taking the opportunity to walk across the bridge in such welcoming weather. Those of you who are listening in on the internet who didn’t care to cross the river you should be ashamed of yourself; it is such a nice day!

I recognise quite a number of faces from some of our previous sessions, but for those of you who don’t know me, my name is Stuart McIntosh and I lead the Competition Group within Ofcom. Ed is not going to be joining us for this morning’s session, so I will Chair this as best I can.

We have seen quite a number of significant developments in the telecoms sector over recent months. Broadband penetration continues to grow apace and we are now up to over 75% of homes in the UK having access to broadband, either fixed or mobile. We have seen continuing and quite significant investment in the roll out of NGA networks and over 60% of homes today in the UK are passed by a network capable of providing and supporting superfast broadband services.

We have also seen quite a dramatic take-up in the acquisition and use of smartphones and tablet devices and people using those to access the internet with huge increases in data traffic, particularly over mobile networks. At the same time over the past year the Government has made very substantial commitments in terms of investment support to support the roll out of superfast broadband services across the UK, so not just in the core urban areas where commercial provision is likely to be viable, and also to address the mobile not spots issues as well.

Agenda

The topics that we are going to focus on this morning touch on a number of these themes. First, my colleague Gideon Senensieb will talk about a consultation document we produced recently on the business connectivity market review. Those of you who have had
the opportunity to read that document will realise that it is probably one of the largest and most complex market reviews we have to undertake. It basically deals with the essential telecoms plumbing which underpins the UK economy and that includes the backhaul of services which are relied on by mobile network operators and internet service providers.

Secondly, I will give you an update in respect of where we are in respect of a number of charge controls that we set over these past several months and the appeal proceedings that have related to almost all of those.

Then Graham Louth will give you an update in terms of where we are with regards to the combined spectrum auction which we are planning to kick-off later this year.

Finally, my colleague David Harrison will take a longer-term look at spectrum requirements and in particular the consultation we issued recently on UHF spectrum strategy.

Those are the main areas that we are going to discuss. There will be an opportunity at the end of each session for you to ask questions specifically on the points and issues that have been raised in that session and, depending on how the time goes, there should also be some time at the end for more general questions that you might have.

Normal rules apply, which are if you have a question, flag that you have a question, say who you are and what your affiliation is and if you can wait until you get the microphone that would be helpful because we are broadcasting this on the web and it is very helpful for those who are listening in to hear not only the answer, but to hear the question.

Then finally, just a gentle reminder if you have a mobile phone or a Blackberry please turn it off because it does interfere with the broadcast.

With that I will hand over to Gideon.

**Business Connectivity Market Review**

**Gideon Senensieb**

**Project Director**

Thank you. Good morning. I am going to talk about the business connectivity market review consultation document we published about two weeks ago. We will in the next few days also publish accompanying proposals for a charge control in this market, but that will come later.
One thing I would like to clarify before I start is that I am going to be talking about the market in the UK with the exception of Hull. In Hull the incumbent is KCOM. I am not going to talk about that in this presentation because of its brevity.

**Business Connectivity Market Review**

The business connectivity market review concerns leased lines, which is a type of communication services - I am sure many of you know, in which a provider dedicates capacity on its network between two fixed locations. The range of applications of this type of service is very wide: it ranges from traffic lights, control of traffic lights, monitoring of water levels in reservoirs at one end of the spectrum, to transmission of data from datacentres; very, very high capacity at the other end.

The key asset in providing this service is a physical network. It is copper wires, it is increasingly optical fibres and to some extent it is point-to-point microwave links. Many organisations, both in the public and the private sectors, depend on these services for all their ICT services, but in addition to that, as Stuart has mentioned, consumer broadband services, both fixed and mobile, depend on leased line to connect, as in the middle of that picture, mobile base stations to the mobile operators’ networks, or at the bottom of the picture, to connect BT’s exchanges where the copper wire terminates to the ISP’s network in the case of residential broadband services. It is a very important market with a very wide range of services involved.

There is also correspondingly a very wide range of speeds involved, from a few bits per second to control a traffic light, to 10s of billions of bits per second to connect datacentres at the other end.

**Leased lines use a variety of technologies**

Correspondingly there is a wide variety of technologies used to provide those services. For regulatory purposes we aggregate these technologies into three groups. This review has been described as a cascade of acronyms and I am going to spare you a cascade, but I would like you to get to grips with three of them. The first one is “TI” which stands for traditional interface. These are the legacy technologies: analogue and two types of legacy digital technologies. “AI” stands for alternative interface, which is mainly Ethernet and the way we have classified it spans a range up to 1Gb/s, one billion bits per second. We have invented a new acronym for this review, which is “MI”, multiple interface, for services which are faster than 1Gb/s and also includes services, importantly, which are delivered with wave division multiplex technology actually installed at the customer’s premises - wave division multiplex technology, capable of multiplying the amount of data that
an optical fibre can transmit by transmitting many colours of light simultaneously down the fibre.

**London is more competitive**

The key partitioning of the market also involves geographic examination of the market. We have looked at all services throughout the UK, looking for geographies in which the competition conditions are perhaps different from the generality of the geography. We have identified only one such area, which is essentially a central swathe across London. In a previous review that we carried out four years ago we identified the central and eastern part of London, whose boundaries are shown in green in the picture, as having these distinct competitive conditions. In this review we propose to define a wider area which extends pretty much all the way to Heathrow, across London. We did have an acronym for that, but I am not going to use it in this case, I am just going to refer to this area as London in the rest of this talk, if I may.

**Growing demand for bandwidth**

The key trend in the market, unsurprisingly, is a growing demand for bandwidth, growing very fast and there has been sustained growth in demand over some years and we expect that trend to continue. The industry is responding to that trend by moving increasingly to newer technologies, so leaving progressively the TI, the traditional interface technologies behind, increasingly installing Al, Ethernet technologies for new installations and we are also seeing some very rapid growth, although from a very small base of the MI technologies. You can see the nature of this transition in the bottom two charts there.

On the left a particular thing to notice is that the Al technologies are eating into the top end of the TI leased lines, so the bottom end of the TI leased lines are declining less quickly and that is because users who just need a little bit of bandwidth don't need to move to the modern technologies yet.

**Main proposed findings on BT’s market power**

What are we proposing to find? Just one more acronym here, SMP (significant market power), an important finding for us, because if we find significant market power it means we need to regulate. We propose to identify BT as having significant market power along the following lines: firstly in the TI segments, our findings are largely unchanged relative to last time, but perhaps significantly we have this time divided the trunk TI market into two parts - regional and national. The trunk market consists of the aggregated links between population centres where operators can aggregate a lot of traffic. Last time, in the last review, 2008, we identified a single market for TI trunk. In this review we have divided
the trunk routes into two: the national routes, which are the longer distance routes between major population centres, between London and Manchester, London and Birmingham, Birmingham to Glasgow, etcetera and the regional routes which are smaller branch routes between smaller population centres in regions of the UK.

We have only identified BT as having significant market power in the regional routes and not in the national routes. Otherwise our findings in the TI segment are the same as last time, so BT has SMP we propose in the TI segment at low bandwidth throughout the UK and in higher bandwidths, we propose it has SMP everywhere outside of the London area that I described earlier. We are also proposing as before that BT has SMP in the retail market, not just the wholesale market in the low bandwidth TI segment.

In the AI segment this is the fast growing Ethernet segment of the market, the change that we see is better prospects for competition in London, but not elsewhere. Nevertheless we still propose to find that BT still has SMP, even within the London area in addition to having SMP outside the London area. We propose to deal with the difference with the way that we look at the remedies, which I will come onto.

The third segment, the multiple interface, this new segment which we have looked at, we propose that BT has SMP outside of London only and that within London there is sufficient competition for us not to worry about it.

**Main proposals for remedies to BT’s SMP**

Moving onto our proposals for remedies in these markets. Firstly in the TI segment there is a mature set of remedies that we have applied in the past, including a charge control. We propose to apply the same remedies going forward. The exception is that there will not be a charge control on national trunk routes if our proposals go forward because we don’t find that BT has significant market power in those national trunk routes.

We are also proposing a safeguard price cap on the retail analogue services to protect end users as BT moves towards shutting down the platform for those services over the next six years or so.

In the AI segment we are proposing a charge control outside of London. We currently apply charge control, before this review, throughout the UK. This time we are proposing to apply it outside of London only. We are proposing a lighter touch price control as a safeguard within London.

In the MI segment where we propose to regulate for the first time, we are proposing to confine charge control to Ethernet services faster than 1Gb/s. We would not propose to
apply charge control to wave division multiplex services at any speed anywhere. Of course the charge control on the Ethernet services would apply outside of London only.

**Next Steps**

The next steps in this process is that we expect to public leased lines charge controls consultation most probably during the course of this week. Our consultation on the market review closes on 24 August and subject to both of these consultations we expect to reach final conclusions and to put the new controls into effect during the course of the first quarter of the next calendar year. The new controls would run for three years from then.

Thank you.

**Questions?**

**Stuart McIntosh:** This means we have time to take questions. Does this mean that you have all digested thoroughly the 600 page document we published two weeks ago and that anticipated and answered all concerns you might have? In which case we are delighted. Well reflect on it further and if there are any questions you would like to come back on...

**Simon Weeden (Citigroup):** I would hate to deprive you of a question after all that work. My question is why are you still finding SMP in so much of the country for BT and what threshold do you regard as being the threshold at which that can be relaxed, particularly the higher speed stuff, the Ethernet?

**Gideon Senensieb:** As I mentioned, the key asset in this market is a physical network and BT’s physical network reaches pretty much everywhere in the UK and that is an asset that is very difficult for competitors to replicate. That is the underlying reason. We look at many factors, but the principal one is market share and BT still has a dominant market share in many of these markets as a result of its physical network presence.

**Stuart McIntosh:** As I said, if on reflection, you have further questions on this you can pick these up at the end, assuming we have some time. Gideon, thank you very much.
Charge control update:

LLU/WLR

Mobile Call Termination Rates

Wholesale Broadband Access

As I said at the beginning what I would like to do is to provide a bit of an update in relation to what we have been doing on a number of charge controls over this past several months, including particularly local loop unbundled services, wholesale line rental and also wholesale broadband access and mobile termination rates.

Notwithstanding the fact we have been setting charge controls, either we or our predecessor organisation, Oftel, have been setting charge controls for the best part of 30 years. It is an area which has become increasingly contentious in recent years and it is quite interesting to note that of the eight major charge controls that we have set since 2007, six out of that eight have been appealed. The matter is no longer settled when we issue our final decision on charge control reviews nowadays, very far from that.

LLU/WLR Charge controls

Moving to talk about local loop unbundling and WLR, we published our decision in respect of this in March of this year and we concluded that there should be reductions in the prices of all the core rental services. The MPF rental service, SMPF and WLR and taking MPF as an example, the price preceding the new charge control had reached £91.50 and we concluded that the price needed to be reduced to £87.41 as of 1 April this year, declining by RPI -5.9, or changing by RPI-5.9, in the second year of the control. There were similar reductions in the case of SMPF, more substantial reductions related to that control.

Why the direction of prices has changed

This did represent a change in trajectory compared to the previous charge control and you might reasonably ask why was there this change of heart? Why did we have a change of mind in relation to this? It was really driven by the parameters which themselves determine the charge control. If one goes back to the earlier charge control and look at the analysis that we conducted during the course of last year and earlier this, probably the two largest changes driving this change in trajectory were a) a recalibration of the cost of capital for BT and BT Openreach and in this case we concluded that the cost of capital had declined
from just over 10% to 8.8% for Openreach. Bearing in mind this is a very capital intensive part of BT’s operation that has quite a significant impact on the charge control.

The second big factor was the fact that Openreach has continued to drive quite substantial efficiency savings, more than we had anticipated in the previous charge control. That is fine because charge control is deliberately designed to provide Openreach with the incentive to do that, but over time, as we see those greater levels of efficiency being delivered we look to claw those back so that consumers get some benefit from that as well. There were a number of other factors which issued this change in direction, but those are probably two of the most important ones.

**LLU/WLR Charges appealed by both sides**

As you may have seen if you follow this area closely the LLU/WLR charge controls have been appealed by what we have characterised it here as both sides and by that I mean that BT has challenged their decision, but so too have Sky and TalkTalk. BT have focussed on three main areas: one is to do with the regulated asset value, quite a technical area, but one which is fundamentally important, going back as I mentioned earlier to the critical importance of capital intensity in this part of the market. Secondly, they have appealed issues to do with the treatment of BT’s pension cost and in particular BT’s contribution to its pension deficit repair payments, which are a contribution to the pension deficit and also the treatment of certain aspects of the cost of capital which I can go into in a minute or two. Then there are specific cost allocation issues which they have challenged in relation to our treatment of certain corporate overheads, line test equipment and so forth. The largest factor by far is to do with the regulated asset value.

On the other side, however, Sky and TalkTalk have argued that we have been overly generous to BT in relation to a number of the assumptions that we have used to calibrate this control. They have cited a number of areas in their appeal and they are to do with, for example, line volume forecasts, so they have said that they anticipate that the line volumes will be higher by the end of the period than we have actually assumed. They have challenged certain aspects of the way that BT’s rates bill has been calculated and flowed through to this charge control, also issues to do with duct valuation. It is quite a lengthy list and it may well be added to. In the course of doing these charge controls nowadays we quite routinely publish a great deal of information relating to the underlying data and assumptions which drive the charge controls. To the maximum extent possible we also publish the financial models we use in setting the controls. Inevitably we are not able to publish everything because there is invariably some confidential information which can’t be generally disclosed.
As part of the appeal process, however, it is possible for Sky and TalkTalk’s advisers to get further access to that confidential information. Once they have secured that access and had the opportunity to look at that further, it could well be that they will add to the list of items which they are challenging.

You can see in relation to his charge control there is quite a rich panoply of issues which are going to have to be considered over the coming months.

Where we are in that process is that the appeals having been lodged. They will be considered by the Competition Appeal Tribunal and particularly once Sky and TalkTalk have finalised and confirmed the grounds of their appeal. The CAT will then determine the extent of which these are charge control issues as opposed to, say, process and procedural issues. To the extent that they are charge control issues, and I would imagine that would apply to the majority, if not necessarily all. It will then be referred onto the CC, who have a period of up to six months to conduct their examination of the appeal and to reach their conclusions and refer that back to the CAT.

What you can take from that is that our best guess at the moment is that this appeal process will not be concluded this side of this calendar year and it is very likely to extend into the early part of next year. At this stage we are not altogether clear on exactly when it might be resolved next year.

Just so you are aware the charge control which we have set at the moment is due to expire in March of the following year, so it is quite likely we will have to kick off work in relation to the next charge control before the appeal of the current charge control has actually been completed.

**Mobile call termination rates after the CAT judgement**

Moving to the next one; this is only one slide on mobile termination rates. Many/all of you will be very familiar with the story here. We set the new regime for the charge control in March 2011 and our decisions were appealed by the MNOs: three on one side, Vodafone, O2 and EE and one on the other – Hutchison, it was also appealed by BT. BT and Hutchison were fearing that we had been overly generous in some of the assumptions we made in respect of the charge control.

That process was conducted through the CC. It went back to the CAT and, as you will have seen just over a month/two months ago, the CAT confirmed that the main decisions we had taken, particularly with regard to the change in methodology for determining mobile termination rates should stand, which is moving from the old LRIC Plus methodology, which had been used over several charge controls, to one based on long run incremental cost.
There were some small additional changes in respect of some cost parameters, but probably the big thing that changed relative to our finding was the glide path. We had concluded that the numbers should glide from the old rate, which is just over 4p per minute to a new rate of around 0.7p per minute by 1 April 2014. The Competition Commission, based on its examination of the issue, felt that the glide path should actually be shortened; that was the argument that was put by BT and Hutchison. The outcome of that process was we are going to end up roughly in the same place with regard to the number, only a year earlier.

**WBA July 2011 Statement**

The final charge control I would like to touch on is the charge control in respect of wholesale broadband access. This relates to a wholesale product which is provided by BT Wholesale and is used by a number of providers across the UK. We set a charge control in relation to the service that they provide directed towards that part of the market, largely in rural areas where companies have typically not unbundled BT’s exchanges and if they wish to offer a broadband service and they wish to compete with BT, they have no choice other than to use BT. We set a charge control in July of last year. These prices should be reduced by RPI -11.

This charge control was significant in and of itself, but it had brought a significance because it was the first time that we had taken account of the work we had done to review the treatment of BT’s pension cost in a charge control. Those of you with long memories may recall we did a review of the treatment of their costs and we issued some guidance on that about six months before we completed work on this charge control. We also in the course of this charge control updated our estimates of BT’s cost of capital and we are continuing to use both that methodology and at the moment the broad parameters that fed into that assessment in the current round of charge controls.

**Recent WACC estimates**

2009 was when we set the last WLR/LLU charge control and at that point we refreshed our estimates of BT’s cost of capital and concluded that for BT Group the number was in the order of about 10.6% and we disaggregated that between BT Openreach and the rest of BT on the basis that the risk characteristics of those two parts of BT are somewhat different. We estimated the cost of capital for Openreach was about 10.1% and for the rest of BT 11%.

We revised those estimates in the context of doing the work in WBA and came to the conclusion that the cost of capital for BT had fallen, reflecting a number of factors and the
fact that the risk free rate had fallen materially over this period, changes in BT’s asset beta and also changes in respect of the corporate tax rate. Our conclusion was that the cost of capital had fallen from 10.6% to around 9.2% and that the disaggregated numbers had fallen to 8.8% in respect of Openreach and 9.7% in respect of BT. Those are pre-tax nominal numbers.

**WBA appeal concluded**

The appeals: as I mentioned earlier there are two main appeals in respect of the WBA review. One was in respect of the treatment of pension repair payments and the other was on the cost of capital estimate. BT challenged two aspects of that: one was the fact that we used a forward looking cost of debt; they argued that we should be using the cost of embedded debt. The second was they argued that we should be using a prospective gearing ratio, whereas historically we had based the gearing ratio on a recent analysis of what has actually happened in the market, going back months or years depending on which was appropriate.

The appeal was concluded after the Competition Commission had examined both sets of issues and you may have read the Competition Commission’s findings, but basically that supported the position that we had taken. Quite an important set of conclusions, because it led the CC to look further at our methodology in respect of cost of capital and it also led them to examine in some detail how we had gone about applying the guidance in respect of the treatment of BT’s pension repair payments and had concluded that we had acted appropriately in both cases.

In setting charge controls, if I can summarise, we are continuing to do the right thing in the sense of setting these controls is about protecting the purchases of these services, it is about providing the right efficiency incentives to BT so that as they become more efficient they retain some of the benefits of that so they have an incentive over time to continue to be efficient. It is also to provide BT with an incentive to invest and to innovate, so that they are able to make a return on the reasonable investments that they make in providing services.

As you can see from what I have gone through over these past few minutes, appeals in this market are now a fact of life and in the main our decisions so far in relation to charge controls have been upheld. I have to say “in the main” because you’re guys who do a lot of detailed analytical work and you know that if you have a complex piece of analysis it is always possible for someone to pick something and say “You could have done this differently” and to argue a case. There are certainly instances where there have been changes around the charge controls, but in the main our decisions have been supported so
far in the appeals processes. However, as I am sure all of you are only too fully aware, past performance is no guide to future performance, so you have to continue to watch this space.

Questions?

With that I will pause and I am happy to take questions. Just so you don’t feel that I am fobbing you off, I have covered quite a lot of territory and I had the foresight to ask a few of my colleagues to come with me, just in case you ask me some tricky detailed questions, the answers to which I don’t know, which is distinctly possible.

Maurice Patrick (Barclays): A couple of questions: the first one on fibre regulation. BT held an event recently where they said fibre should never have been regulated and if it were, pricing would go up compared to the current GEA pricing. I would love to get your thoughts on a) your thoughts towards regulating it and b) if you would agree with the maths that pricing would go up if it were regulated.

The second question is on MPF pricing, where you have seen an historic increase in the last review, going towards prices falling and as we look at the next three year path how you think about that directionally, i.e. was it a one-off, downwards revision due to a various one-off assumptions, or is that more of a trend of things to come?

Stuart McIntosh: With regard to the first on fibre, by fibre here we are talking about the wholesale product that Openreach provides, their virtual, unbundled line access product. When we conducted the wholesale local access market review in 2010, we concluded at that point that it wasn’t appropriate to regulate the price of that product for a couple of reasons: one, we perceived there to be quite a lot of risk at the time in making those investments and that we didn’t want to put the dead hand of regulation on that.

The second was that, based on the analysis we did at the time, we felt that the pricing in the wholesale market was likely to be constrained by the pricing of first generation broadband services. As far as we can tell, certainly the second assumption seems to be holding. If you look at pricing for NGA particularly, BT’s wholesale pricing, that seems to be the case and that has been reflected somewhat in what is happening in the retail market, because there is a premium in some measure, but it is not necessarily huge.

We will look at that again in the course of the market reviews that we will be conducting during the course of next year – we will kick them off towards the end of this year and we will look at the competitive circumstances as we find them then. As BT are only too fully aware, we cannot give a commitment stretching beyond the market review period that
we conduct these assessments in, so we have to look at the facts and the circumstances as we find them and the data and determine whether or not the market seems to be competitive or not. If it isn’t competitive, what action or what intervention appears to be appropriate? That is the decision we took last time and we will get back to that during the course of what we will be doing next year.

With regard to MPF prices, it may sound as though I am repeating my answer: we will look at the data at the time. One of the things which has been quite striking, and this is a good thing, is that Openreach, having established the business and having become more mature, has nonetheless been able to continue to drive quite significant improvements in efficiency and that is one of the factors that has led to the prices not increasing. We would like to see that continue. Has it reached some natural limit? I don’t know. We will have to look at it the next time we look at the charge control.

John Karidis (Oriel): Can I ask a question on Article 12, just in case there isn’t time at the end? It sort of fits with what you were talking about just now. I listened to what BT and Ofcom said at the House of Lords inquiry, the Select Committee Inquiry. The way I understand it BT basically said Virgin Media has network in the final third of the population and they are not opening it up. A few days later Ofcom said, “Sure, we can use Article 12, but there has to be an element of proportionality, we have to judge costs versus benefit”. Then you said you were looking for evidence. The first question, is there going to be some sort of consultation on this and then secondly, when you are talking about costs and benefits in this particular case are you talking about cost to Virgin Media on the one hand and then benefit to the population that lives in the final third of the country on the other hand? It just would feel instinctively that you would go straight to serve the benefits of the population in that final third and therefore the decision will be quite straightforward.

Stuart McIntosh: With regard to will there be a consultation I anticipate that this is one of the issues that we are going to have to have a look at in the context of the market reviews I discussed earlier. At the moment there is an obligation on BT to provide access to its ducts and poles which was imposed under the wholesale local access market review. We are going to have to look at that again in the context of the next market review. I anticipate that quite a number of stakeholders will express interest in the possibility of using other parties’ ducts. That issue is going to come forward and they will make the argument that we need to look beyond simply having to conclude that someone has significant market power before we think it appropriate to consider providing access to alternative duct.
It is also the case that to this point, I think I am correct in saying this, that no-one has come to us and said, “I have definite plans that I could pursue which would be to the benefit of UK consumers if I had access of this form to this infrastructure”. It is not that there would be necessarily more weight wholly on that, but we have made it clear to people that if that is their perspective and they feel that there are significant opportunities they should come and talk to us about those.

In terms of benefits and costs we haven’t articulated the framework yet for exactly how we would look at this. Clearly our primary concern is in relation to what happens to consumers. We have to be mindful that if we take decisions which, ostensibly are in the interest of consumers, that the costs aren’t disproportionate to that, almost regardless of where those costs fall.

**Guy Peddy (Macquarie):** Just a couple of quick questions. On regional regulation we heard on the first part, but no regional regulation on the second part, so I am intrigued as to what is so different between the different markets that one warrant regional regulation and the other doesn’t?

Secondly, when you talk about the interest to consumer how do you manage the process of a three year charge control outlook with a 15 year capital investment cycle, given that price isn’t everything, as we have been shown? How do you reconcile those two together?

**Stuart McIntosh:** With regard to the first point I made, I may not have fully understood you, but as Markham indicated, in respect of the BCMR there are some aspects of that market where we have concluded it has a geographic dimension where the competition conditions are different from the rest of the country. In those circumstances we feel it sufficiently different that we need to think about different approaches to regulation, or different remedies, using the regulatory word.

In other markets we have reached a similar conclusion, so if you look at the wholesale broadband access market we have classified that into three elements: one is market one, which accounts for about 11% of the country, where there is limited choice beyond what BT offers and then there is markets two and market three. Market three is wholly competitive and there is no regulation of wholesale broadband access in market three. I can’t remember the exact proportionate split, but that probably accounts for at least half the country: 70 something per cent. Then market two accounts for the difference.
When we do these reviews, we look at products, we also look at geography and we look at the data to let us understand whether there is a difference in the competitive conditions, either associated with different products or associated with different geographies. It is not that we have an approach and one market view which is different from another; we look at both considerations when we do the reviews. You may come to different conclusions because the investments that are being made by other parties are not consistent across the country; the circumstances do vary.

Your second question I have lost as I was talking, my apologies – sorry.

**Guy Peddy:** Yes, for the interests of the consumer – how do you measure that given three year outlook versus 15 year capex cycle?

**Stuart McIntosh:** We are obviously very mindful of investment incentives in addition to looking after the investor. We do have to work within the constraints of the legal framework as laid down in Brussels and as are enacted here in the UK. It is the case that there is a three year cycle associated with that. What I would say, however, is while there is variation from time-to-time, if you go back and look over the history of regulation, what you will find is there is a good measure of consistency with regard to the way that we have gone about regulation. I can’t quote chapter and verse, but for example, if you were to go back and look at BT’s investment history you would find that in relation to its regulated products and services it has made the sort of returns and probably slightly exceeded the sort of returns that either we, or Oftel before us, put in place.

That should give the company some measure of confidence that over the longer term we are not going to get into a situation where they make big investments which we then treat as sunk and decide we are not going to let you recover the cost of that investment. We know if we did that it would have big implications for future investment.

I am going to take one more question and then we will have to move on. If we have time we will come back at the end.

**Andrew Entwistle (New Street):** A very quick one first which is when do you expect to look at BT’s WACC next as a review? The second one refers back to this event BT put on for us on the regulatory accounts which someone referred to earlier, where they acknowledged fairly explicitly that the regulatory accounts were no use to sell side analysts because we couldn’t see anything useful in there. I know you don’t use them in the charge control work, so given that they seem to be a bit stranded as a piece of work I wondered if you had any thoughts on the future of their regulatory accounts?
Stuart McIntosh: With regard to the WACC we look at that in terms of the parameter values that go into our current methodology each time we set a charge control. For example, in relation to the consultation document that we will put out in the next few days we are going to be basing it on the estimates that I mentioned earlier on, but we have checked to satisfy ourselves that the underlying parameter values are still within the range of what seems reasonable today. When we come to finalise this we will look at that again. We do that on a recurring basis.

We do anticipate, however, that during the course of this financial year we will probably kick off a review of our overall methodology. It has been a bit of a time since we last did that and we think it is probably appropriate to do it. Other regulators have conducted such reviews, so we think it might be about time for us to do the same thing.

With regard to the regulatory accounts it is not the case that we don’t use them, we do use them, it is where we start from in trying to calibrate our understanding as to where the numbers are today. They are very important. However, it is the case that there are differences between the accounts, as articulated by BT and what we then use, because we will make some adjustments that they don’t necessarily accept. I don’t think that is altogether a desirable state of affairs.

We have flagged that we anticipate that we are going to consult on how the regulatory accounts might change and evolve. I anticipate that we will put something out on that possibly before the Olympics, or perhaps shortly thereafter, but it is going to be relatively soon.

I will close there. If we have time we will come back to these questions later. I hadn’t anticipated so much interest on charge controls and related issues. I’ll hand you over to Graham for a, truly, much more gripping topic.

Spectrum update

Graham Louth
Director of Spectrum Markets

What spectrum is to be auctioned?

Good morning everybody. Now I have to work out how the machine works. This is by way of an update on where we are with the most important issues on the spectrum side of the house. I hope it is obvious the top priority for Ofcom on the spectrum side of things is
the auction of the 800MHz and 2.6GHz spectrum, which we believe will be the foundation for 4G services here in the UK.

Just a quick reminder this is a very large amount of spectrum, it is considerably more than was auctioned in 2000 when the 3G auction was held. It is getting towards being comparable to the total amount of spectrum that we have in use for 2G and 3G services in the UK today.

In terms of availability of this spectrum it is not available yet. It will, however, in the case of the 800MHz spectrum start to become available during the next calendar year and in particular it should be available UK-wide before the end of the next calendar year.

The other issue that has to be dealt with in the case of the 800MHz spectrum, as you have probably read in the press, is the likelihood of there being interference into DTT reception. Obviously that is an issue we are dealing with. The Government has decided that £180 million should be spent on providing consumer support to deal with that issue, but there is a lot of work going on at the moment to make sure all of that is in place in time to allow 4G services to be rolled out in the 800MHz band during next calendar year.

As far as the 2.6GHz spectrum is concerned we have a similar, but not quite so challenging issue, in the shape of aeronautical radar which will potentially be interfered with by new mobile services in the 2.6GHz band. We have a programme of work in place with the full cooperation of the CAA, the airport authorities and the radar manufacturers to upgrade those radars so they will not suffer harmful interference from these new services, but that is an on-going process which, likewise, is going to be rolling out over the next year or so. The 2.6GHz spectrum should be available for new use through much of the UK by the end of the next calendar year at the latest.

Overview of mobile spectrum bands

In terms of where these frequencies are, I am sure you have all seen this picture before, but we have a very wide range. At one end we have the new 800MHz spectrum, which is right down here at the low end of the frequency range, right next door to new DTT services, also right next door to the 700MHz band, which David will be talking to you about in a few minutes’ time. At the other extreme we have the 2.6GHz band, which is right at the top end of the range of frequencies that are currently considered to be useful for mobile services. As this diagram indicates that is right next door to the radar that is used for aeronautical navigation.

For completeness I have included the existing frequency bands in here, so we have the 900 MHz band here, used for 2G services mainly today, although in fact Telefónica is
now using part of those frequencies to deliver 3G services. The 1800MHz band, which is predominantly held by Everything Everywhere and used for their 2G services. Then we have the 2.6GHz band up here, which is used by four of the existing operators of 3G services today.

**Who holds what today?**

In terms of who holds what, as I have indicated, it is not the same for everybody. In particular there is this fairly large bifurcation between O2 and Vodafone on the one hand, who hold quite a lot of 900MHz spectrum, so low frequency spectrum, but not a lot of the 1800MHz. By contrast Everything Everywhere, who hold a large amount of 1800MHz spectrum, but don’t hold any 900MHz spectrum.

Then we have Hutchison who only hold 3G spectrum and therefore have, in total, a relatively small amount of spectrum as compared the other three operators.

I have also indicated on this picture the 2x15MHz of 1800 MHz spectrum that Everything Everywhere is required to divest as one of their undertakings to the European Commission when their merger was approved. That process is on-going as I understand it, but it is for them to divest that spectrum. I have also indicated on the far, right-hand side from your point of view, the spectrum that we are planning to release. As you can see, it is a very substantial amount of spectrum relative to the existing holdings of the various operators.

The challenge for us is that because the existing operators all hold such different amounts and types of spectrum, they all have very different views about who should be allowed to bid for what in this auction, who should be prevented from bidding for what and so on and so forth. Very strong views held by the mobile operators about the design of the auction.

**What are our objectives?**

What are our objectives for the auction? In line with our statutory duties, they are to make sure that this spectrum is used as efficiently as possible for the benefit of consumers and citizens. We are very keen to promote competition and to encourage investment and innovation. As part of our compliance with our citizen duties, we are very keen to ensure that new 4G services are available as widely as possible across the whole of the UK. We are proposing to achieve that through a combination of measures that promote competition and ensure good coverage.

**Next steps – 800MHz and 2.6GHz auction**
Where are we in the process? As I am sure you all know we have consulted repeatedly on this topic. Most recently we published a consultation in January. We are planning to publish our statement setting out our decisions on the auction design and the obligations that would be included in the licenses this summer potentially within the next few weeks, but it depends exactly on the timing of our governance processes to finalise those decisions.

Assuming we achieve that then the auction process itself should begin before the end of this calendar year. In particular we expect to invite applications from prospective bidders before the end of the calendar year.

The bidding itself, however, is unlikely to start until next calendar year. I can’t say exactly how long it will go on for, but I anticipate that will ideally complete within the first quarter of the next calendar year. We would then issue the licenses immediately after the end of that process.

Assuming we manage to hit that timeline then we expect mobile operators to start rolling out their 4G networks during next calendar year and, ideally, to be launching services before the end of next calendar year.

Quite how quickly they will roll out on a commercial basis is obviously up to them, but we proposed in January that we would include a roll-out, a coverage obligation, in one of the licenses and there was quite strong support for that. The proposal was that the obligation be met by no later than the end of 2017, so that gives you a sort of indication of the timescales that we expect to see widespread coverage of 4G services in the UK.

Next steps – 1800MHz liberalisations

Finally from me before questions, in parallel with that activity we have received a request from Everything Everywhere to vary their existing 2G 1800MHz licence to allow them to deploy 4G technology in those frequencies. We put out a notice earlier this year saying that we were minded to agree to that licence variation. We received some fairly strongly worded responses from some of the other mobile network operators, so we are now reviewing those responses and doing the analysis necessary to decide whether that is, in fact, the right decision, or if we should make a right decision. We are doing that as quickly as possible, but at this stage I can’t say exactly when the publication of that decision will be made.

With that I will hand over to Stuart, or shall I Chair questions?

Questions?
Matthew Howett (Ovum): On the 1800MHz liberalisation issue in the notice that you put out you largely dismissed possible remedies, such as regulated access for the other operators. Given the strongly worded feedback that you have had from the rest of the industry are those the sort of things that you are minded to reconsider?

Secondly, related to that, how does that affect the timing, particularly of the joint award as well? Can we expect that to coincide with a decision on the 1800 liberalisation?

Graham Louth: We have not ruled out any possible remedies, although our analysis of those remedies still holds. Certainly the request from the other mobile network operators was essentially not that there be some remedy imposed, but that we delay the liberalisation until a point in time where they have access to similar spectrum on which they can deliver 4G services. They weren’t asking for wholesale access, they were just asking for a delay. All options are still open at this stage.

In terms of timescales, we are not planning to link the two processes together in time. We want the auction to happen as soon as possible and so we are proceeding with the decisions on that independently of also wanting to decide on whether or not to allow 1800 liberalisation as quickly as possible. It may well be that the two things come out on similar sorts of timescales, but they are separate and independent processes.

Will Draper (Espirito Santo): Just a couple of things to probe where Ofcom stands on the 4G. Do you think it is likely that you will ring-fence any spectrum for a new entrant into the UK to try and promote competition? Also where do you stand on the issue of spectrum sharing: i.e. would you permit one group to buy spectrum and then go ahead and share that with another operator later?

Graham Louth: As per our consultation in January, we are certainly keen to ensure that we continue to have at least four operators in the UK and we are not ruling out the possibility that one of those four might be a new entrant rather than one of the existing operators. We weren’t at that stage proposing to reserve spectrum for a fifth player in the market, not least because we haven’t seen very much interest in being a fifth player in the market. I still haven’t seen very much interest in being a fifth player, so you can deduce from that that we are not minded to reserve spectrum for a fifth player.

Sorry, I have forgotten what the second question was about.

Will Draper: Spectrum sharing.
Graham Louth: We will look at any request on spectrum sharing to share spectrum on the merits at the time. Essentially it is a competition issue as to whether or not that brings benefits for consumers as against the potential costs in terms of reduced competition that might arise from spectrum sharing. It would be for the parties concerned to come to us and make the case to be allowed to do it essentially.

Steve Malcolm (Arete): Related to that should we view the O2 Vodafone network share as a deliberate, rather linked to their objections to the Everything Everywhere request to re-farm? Does that raise any regulatory issues for you in context of the re-farming and their request to share network in the UK going forward?

Secondly, should we assume that the existing licence rules, having suggested that the 900MHz licence would be repriced based on the 800 prices? Will that still be the case second time around, do you think? Thank you.

Graham Louth: I will answer the second one first and then David are you in a position to answer some questions on the joint venture? On the pricing we have a direction from Government that explicitly instructs us to amend the annual licence fees payable for 900MHz after the auction to reflect, “full market value”. We have no choice about that – we have been told by Government we must do it. Unless Government changes its mind and gives us a different direction that is what we will be doing after the auction.

On the network share arrangements between Vodafone and Telefónica, it is for them to make those sorts of decisions on a commercial basis. They have, I believe, commented that in part it is a reaction to the existence of Everything Everywhere and they need to do it in order to compete effectively with Everything Everywhere. Is it a response to ease variation? I don’t know. That is a matter for them. David, do you want to comment?

David Stewart: I work in the Competition Policy Programme. The first point to make is that there is no specific need for regulatory approval of a network sharing deal of the sort that we understand O2 and Vodafone to be considering. That said, as well as being the sector regulator, we are also a concurrent competition authority and we take a keen interest in understanding developments in the market. We, like other observers of the industry, are trying to understand the implications of network sharing, not just this deal, but other deals.

I would echo Graham’s comment that I don’t think we see those roles in relation to that issue or, say, 1800 liberalisation as being somehow interlinked. You need to look at each issue independently and on the merits. Obviously they happen in a wider context of
the industry working its way through a number of different strategic and commercial implications of various changes, but for us we have to look at each case on the merits.

Simon Weeden (Citigroup): Can I come back to the question of the 1800 4G dispensation? Two questions: one is if you were to permit this, would it automatically apply to the block owned by Everything Everywhere and the block they are going to sell, or would it necessarily just deal with their part?

The second question is can you elaborate a little bit more on the mechanism here? You mentioned a licence variation. In the opposition that you are seeing to this is there a question about whether you even have the legal power to vary the licence in that way, or is the opposition largely moral outrage and appealing to your broader role in terms of regulatory even-handedness, etcetera?

Graham Louth: I have now forgotten the first one – sorry, the two parts of 1800 of their existing licence and that would encompass not only the bit that they retain, but also the bit they have to divest. The moral outrage, as you put it, is predominantly focussed on the bit they retain, because the bit they will divest, they don't have to make that available to the acquirer for use until the end of September 2013, by which time, with any luck, the 2.6GHz spectrum will be available for use. There isn’t the same concern over competition advantage that might come from use of the divested spectrum.

In terms of vires, I don't believe there is any challenge to our vires to vary this licence, not least because, with the shoe on the other foot, Telefónica asked for a variation of their 900MHz licence to allow 3G use 18 months/two years ago and we made that variation. There is no challenge to our vires to make this variation. The challenge is over our position as set out in our notice that there would not be a sufficiently serious competition distortion as a result of the variation that would offset what we believe the consumer benefits would be from having 4G services available sooner rather than later. That is the issue that we are being challenged on by Vodafone, Telefónica and Hutchison. They basically claim that by allowing a one year lead start in the provision of 4G services will lead to a material distortion of competition that would be sufficiently harmful to consumers that we shouldn’t allow it to happen.

Stuart McIntosh: We are running out of time; I said we would take two questions; can you restrict it to one question each?
James Britton (Nomura): I wanted to remind myself why you think 4 wholesale national mobile providers is the right number for any market, but particularly the UK market, of essentially a fairly commoditised product? Then is that a view shared by your fellow regulators at the BEREC level?

Graham Louth: We are not taking the view that four is the right number. We would be quite happy with five/six or more. We do take the view that the UK market would be significantly less competitive if the number were to fall to three or two and we are not ruling out the possibility that on some timescale the UK market might consolidate to a smaller number of national wholesalers, but there are regulatory mechanisms, merger review, etcetera that allow competition authorities, whether it is us, or the OFT, or the European Commission to review that sort of consolidation and decide whether or not it is in the consumer interest, or whether any remedy is required in order to manage that process and ensure competition continues thereafter? We do not have the same levers to manage consolidation through the auction, so we want to make sure that at the outcome of the auction we have at least four players who have enough spectrum to be potential wholesalers, such that if there is then any subsequent consolidation process it can be managed through the usual regulatory process. It is about avoiding an accidental reduction in competition in the market.

To answer your second question we believe that, having said that at one level, the UK consumer enjoys considerably better services, certainly in terms of price and choice than almost any of their European counterparts. If you look at almost any other European market, the range of choice and the price of mobile services is not as good as it is in the UK. We believe that is because we have such a competitive wholesale market.

Do our fellow regulators see things likewise? Mixture. There are moves in some markets – France for example, to try and introduce new competition in the mobile sector. In other markets we are seeing consolidation. What I would point out is we are talking about having four wholesalers here. We are not saying, coming to an earlier point about sharing, there has to be four separate networks. We already only have three networks in the UK and if the Vodafone Telefónica deal works out the way they expect it to, then we might end up with only two. We are not ruling that out as being a possibility, but we would like there to be at least four wholesalers sitting on top of those networks.

Maurice Patrick (Barclays): You started off by saying you want or need to have at least four national wholesalers. There are obviously many potential scenarios for
the auction itself: who gets the higher coverage one; any minimum bids; all that sort of stuff. There is potentially a risk that Hutchison may say whether the options they’ve got are not what they want and won’t participate. You might find yourself going from four to three. What are you doing to ensure that Hutchison will be in a position that their portfolio is acceptable to it to ensure you get your wish that it is four players?

**Graham Louth:** I am not doing anything to make sure that Hutchison gets the four player portfolio. What we are doing is identifying portfolios that we think are good enough for a fourth player to be a credible national wholesaler. We are looking at what maximum reserve price, what will be an appropriate reserve price for those packages, such that an efficient fourth player would be able to afford them. But, we are not going to just give the spectrum away to Hutchison and say “Here it is; get on with it”.

**Stuart McIntosh:** Let’s move onto David, who is going to take a slightly longer-term perspective on spectrum requirements and options.

**UHF spectrum strategy**

**David Harrison**

**Strategy, Economics and Technology Group**

**Mobile data usage is growing rapidly**

One of the things we have learnt through history is that changing spectrum use typically takes a very long time, in particular when there is an incumbent user, or several incumbent users and international harmonisation is required.

What we have been doing with the UHF strategy project is deliberately trying to take a longer term view to scarce spectrum resources below 1GHz, what is known as the UHF frequency band.

There is a lot of challenge in that particular frequency band, because this is the band that is used to deliver digital terrestrial television services, but it is also a band that is of particular interest to mobile operators.

One of the important pieces of context for the UHF strategy consultation is the rapidly increasing demand for mobile data capacity. There are a number of contributors to that: there is the rapidly increasing growth in penetration and use of smartphones, 3G dongles and tablet PCs. What that is leading to is a doubling of the demand for mobile data capacity approximately every two years at the moment. If that trend was to persist until 2030 and that
is viewed as quite a conservative estimate at this point in time, that would lead to there being an 80 fold increase in demand for mobile data capacity by the time we reach 2030. That is a pretty tough call for mobile operators. We just saw some of the spectrum bands becoming available there in the 800/2.6GHz band. If you put that in that is a doubling of the amount of the capacity, just about, but it is nowhere near 80 times. There are going to have to be a lot of different approaches that mobile operators are going to have to take to meet that level of demand.

Ways to address increased demand

Spectrum is an important part of it and we anticipate that there might be a 7-13 fold increase in spectrum over the next 10-15 years, harmonised for mobile broadband. New more advanced LTE technologies, these are the 4G technologies that are evolving – we anticipate that could be between a 3-10 fold increase in data capacity that you could get through mobile networks using the same amount of spectrum.

Then there is always the option of building more sites, but there are practical limits there and there are cost constraints associated with how many extra sites you can build.

The key message is there is a big call here for both the UK and for other countries in trying to meet this mobile data capacity crunch. Spectrum is a very important part of it, but it is only one piece of the puzzle.

700MHz harmonisation for mobile broadband

The other thing that is really important to recognise about spectrum is there are only certain types of spectrum bands that are of interest to mobile operators and those are the ones that have been internationally harmonised. It is only through that international harmonisation process that you can create the economies of scale for handsets that reduce prices and increase the range of devices that people can choose when they go into shops.

One of the frequency bands that is particularly relevant for the UHF strategy consultation is the 700MHz band, shown on this slide. The 700MHz band was the focus of much of the debate at the World Radio Conference at this year, the WRC12 conference, where it was identified that, at the next WRC conference in 2015, this will become a globally harmonised band for mobile broadband services. It is already being used in the US and Asia to deploy 4G or LTE services, but it will become harmonised in Europe from 2015 onwards for mobile broadband services.

We can anticipate that will create a certain amount of momentum behind the desire to use that band, given the demand for mobile data capacity. The big challenge we have is that it is used for digital terrestrial TV services at the moment. If we take that spectrum away
from the digital terrestrial platform, it will be difficult to maintain the capacity of the platform and also its coverage.

**600MHz use for DTT could enable 700MHz release**

What we have been consulting on, and the consultation has just closed, is a longer-term approach. We don’t really think the 700MHz band will be usable after the harmonisation is complete at WRC15, there would have to be a re-plan of the frequencies used in the UHF frequency band agreed with our international partners, the French, the Dutch, anybody that borders with us. Those sorts of arrangements typically take at least three years to complete, so the very earliest we are looking at 2018 before the 700MHz band might be used for mobile broadband services.

If it were then, what we have been consulting on is that the 600MHz band, shown in green on the left-hand side of the slide, which was released through the digital switchover process, would be used for digital terrestrial services in the future. That would allow us to clear the 700MHz band and provide a sufficient amount of spectrum in aggregate for the DTT platform to continue to operate to deliver 6 multiplexes – the number that there is today with the level of coverage that they provide.

What we have had back from industry stakeholders is a lot of fundamental support; this feels like the right direction of travel. There is a lot more work to do to make these things happen, but the idea of trying to set a direction of travel now is very much recognising that these things do take a long time to complete. We are hoping to issue our statement on this in the autumn. The big output from that statement will be a position that the UK will adopt in the international negotiations over any future reshuffling of the UHF bands, because that will have to be done on an EU-wide basis.

**Questions?**

**Alex Wisch (S&P Capital IQ):** If I understand it right, the idea is to move the band to the 600, is that right? Then following up on that question is what would happen to the installed base of the DTT receivers in the UK? Would they have to be upgraded post 2015 and does it affect YouView?

**David Harrison:** That is a really good question. The plan is that the 600MHz band will be used for DTT. The DTT services would move out of the 700MHz band and into the 600MHz band. What that would mean for consumers is they would have to do a re-scan.
I don’t know if you have bought a digital set or box and you have to do the scan; you would have to do another one of those, because the frequencies would be in different places.

There are a small number of households that might have antennas, rooftop antennas that are dedicated to the 700MHz band; there are not many – most new antennas are wideband, they cover the whole of the frequency range, but those are the key changes.

YouView sits outside of this. YouView is quite an interesting context for thinking about how much capacity the DTT platform might need in the future, but it is an add-on rather than something integral to this.

**Stuart McIntosh:** Can it be that three years is beyond the financial time horizon of your stakeholders? This is fundamentally important for us, but an interesting contrast. Sorry, there is a question over here.

**James Britton (Nomura):** 700 versus 800 doesn't sound like a huge amount, but in relative terms it is 20% different. In terms of the economics of rolling out networks between different bands, is there any material difference here?

**David Harrison:** It comes back to the point I was making earlier, it is really about harmonisation of the handsets. That is what drives the attractiveness of the frequency band. The fact that it is juxtaposed to the 800MHz band is quite useful as well, because that gives you more flexibility over how you might deploy different frequency bands within a bigger chunk of spectrum for mobile broadband. The economics are broadly the same.

The lower you go in frequency, the better the propagation, the further the signals travel, so 700 is quite good for macro cells type deployments in suburban and rural areas, but it still has benefits in urban areas as well.

**Maurice Patrick (Barclays):** A bigger picture question on this one – at what point will you consider the relative benefits of the use of spectrum for DTT versus mobile broadband versus fixed broadband and think about bigger picture? Is it right that certain large amounts of spectrum should be dedicated towards DTT and in fact perhaps much of this capacity could be carried on an alternative media – that is obviously a different debate, but to what extent you are thinking about that, how and timescales to that?

**David Harrison:** That is a really good question as well. A really important part of the consultation was trying to get a long term view on both the demand for both the mobile broadband capacity and for DTT capacity. Clearly we have superfast broadband
deployment, the opportunity to deliver TV over the internet over a longer time frame. What really anchored us in thinking about trying to preserve a DTT platform for this particular exercise was that the 700MHz band could be cleared as early as 2018. 2018 is a long way away, but it is not that far away in terms of people swapping, getting rid of their DTT receivers and moving onto the internet to receive their telly. Over a much longer time frame there is another UHF strategy project, which is for 20 years rather than a 10 year timeframe. Those particular aspects about IPTV substitution become much more relevant.

**Guy Peddy (Macquarie):** Just a point of clarity – on your slide that shows way to address the increased demand, you highlight more spectrum; potentially seven to 13 times increase. Does that include the re-farming of the 600?

**David Harrison:** It does. It includes the re-farming of the existing mobile broadband to mobile broadband and the addition of new spectrum bands.

**Stuart McIntosh:** I will take one more question and then we will move on, because we are getting close to close.

**Matthew Howett (Ovum):** I’m wondering what the chances are of the 700MHz band being auctioned before the 800MHz band?

**Stuart McIntosh:** That is a rhetorical question.

**Current or planned Ofcom work**

In terms of stuff that is coming up a couple of things are not on here. As Gideon mentioned we do anticipate that we will put out the charge control for the lease line charge control. Our proposals in relation to that are most probably this week and also during the course of this month we hope to get out the Communications Market Report, which is, if you remember, our annual digest as to what is going on across all the sectors that we regulate. We normally put it out in August. We are trying to get in ahead of the Olympics, so you should see that.

Looking slightly longer term and this if focussed on telecoms, we are kicking off this next round of major market reviews which affect NGA, LLU, WBA, etcetera, towards the end of this year. That work has to be completed during the course of next year and where there
are charge controls in place all of those charge controls tend to expire the end of March 2014.

It might sound like it is a long time, but once you allow for consultations, certainly if you allow for appeals, you have to have quite a bit of lead time and quite a run up in order to get this work done on time. As many of you know, we have been doing quite a lot of work on non-geographic numbers: 0800, 0845. There is a programme of work that we will be rolling out during the course of the next several months which, if we follow through in our current proposals, will lead to quite substantial changes in the way that services are both provided and priced in that part of the market.

As I mentioned earlier, we anticipate consulting at some point over the next couple of months on regulatory reporting and a related issue about cost orientation and how do we apply that in practice?

As I also flagged earlier, on our work stack at the moment is looking again at our methodology in relation to the cost of capital.

Questions?

With that we have four or five minutes left.

**Nick Lyall (UBS):** Can I ask a couple please, just on the potential NGA review? A lot of the arguments don’t seem so much about price, but more about the product provided by Openreach; would you consider much tighter regulation of the product provided by Openreach for NGA?

Secondly on ULL how much do your current charge controls and your thinking take into account the principles coming from the EU about reduction in copper price? Is it quite large scope, like Maurice’s question earlier, for a bigger fall as you take those principles into account?

**Stuart McIntosh:** With regard to the product in the previous market review we put out a number of characteristics that we would expect the new product to have. By and large Openreach has progressed reasonably satisfactorily towards that. However, it has also been the case that some of the other major providers, like TalkTalk and Sky have said that they would like to see significant evolution of that product around self-install wires only, etcetera. Quite a lot of work is going in within the industry to do that away ahead of the next market review. I anticipate and hope that we will see some reasonably significant progress in respect of that.
Inevitably, given that we will have a lot more experience by the time we get to that market review, there will be quite a bit that we will need to consider with regard to the product and what we may or may not say regarding specification.

Was there a second thing? If there was it slipped my mind.

**Nick Lyall:** The MPF pricing.

**Stuart McIntosh:** I think I am correct in saying that when the EU put out its previous document it was for consultation and that they are considering their position once again. We have an established methodology for the way that we do these charge controls, which is to look at what we think are the relevant costs of providing the services in question, not to look at the cost of other services, which are potentially unrelated. We realise there is substitution, but at the moment we would stick with the methodology which we currently have.

The EU may come out with further guidance which we will have to take account of if they do.

**Steve Malcolm (Arete):** A slightly existential question for which I apologise, but looking at your overall responsibility for looking after consumers and the consequence of lowering copper prices, it seems to me that has not filtered through into lower retail prices. Generally prices are still nudging upwards. TalkTalk increased line rental in May. The companies themselves are increasing their margin targets – TalkTalk has raised its margin targets, Sky doesn’t cut prices, it holds them the same, but then uses that to underpin a rise in its dominant pay TV position. Do you think that your responsibilities in terms of SMP identification, charge controls are having the desired consequences? I know you wouldn’t want to regulate retail prices directly, or is there a broader competition issue here about the evolution of retail price that we need to think about?

**Stuart McIntosh:** Obviously we track what is going on both in the wholesale market and the retail market. You need to be very careful about jumping to conclusions about trends over a relatively short period of time. What we have seen in the UK over a fairly sustained period is that the value for money that people get in relation to pay TV, telephone and broadband services has increased consistently over time. That has also been associated in relation to telecoms and broadband, with quite steep declines in retail prices.
There is quite a lot of froth in the market at the moment; there is quite a lot going on terms of special offers; a little bit difficult to understand. At the moment I don’t think we are seeing things where we feel fundamentally concerned. We keep this under review, obviously.

Steve Malcolm: Do you consider in the round that falling call volumes and stuff like that, they are unregulated, when you think about the evolution of retail prices should we consider on that basis?

Stuart McIntosh: As you will see in our regular reviews and that should be in the Communications Market Report as well, we do look at the packages that people are buying, in addition to the individual elements. Increasingly the competition is moving towards competition around bundles and that is one of the things that we need to be thinking more about as we go into these various market reviews.

I will take one final question.

James Britton (Nomura): Is your upcoming review of costing methodologies likely to be aligned with the EC review of the same topic? Does this give you the opportunity to make those changes ahead of the next charge control next year?

Stuart McIntosh: Obviously we work within a legal framework, which is defined by Europe. We look to be aligned. They consult on different positions at different points in time so we may not necessarily be fully aligned with that because they haven’t yet decided what they are going to do. Where they articulate positions and those become recommendations – legally we are required to take utmost account of them. Yes, we would be aligned in relation to those sorts of questions.

With regard to timescales, those of you who know anything about regulatory accounts know that it is not simple and that it takes a long time. We will be consulting on issues that we see today in terms of how the current system works, what we see are potential areas that need to be addressed and the options, with a view to getting to a conclusion with regard to principles in relatively short order. We don’t yet have a view as to how quickly some of those things can be implemented, but I do anticipate that it would take two or three years; it is not something you can do overnight.

With that, we have overrun a little, so apologies for that, I hope that isn’t too much of a strain on your diaries. Thank you very much for coming and we look forward to you coming back again in the near future.
[Meeting concluded]