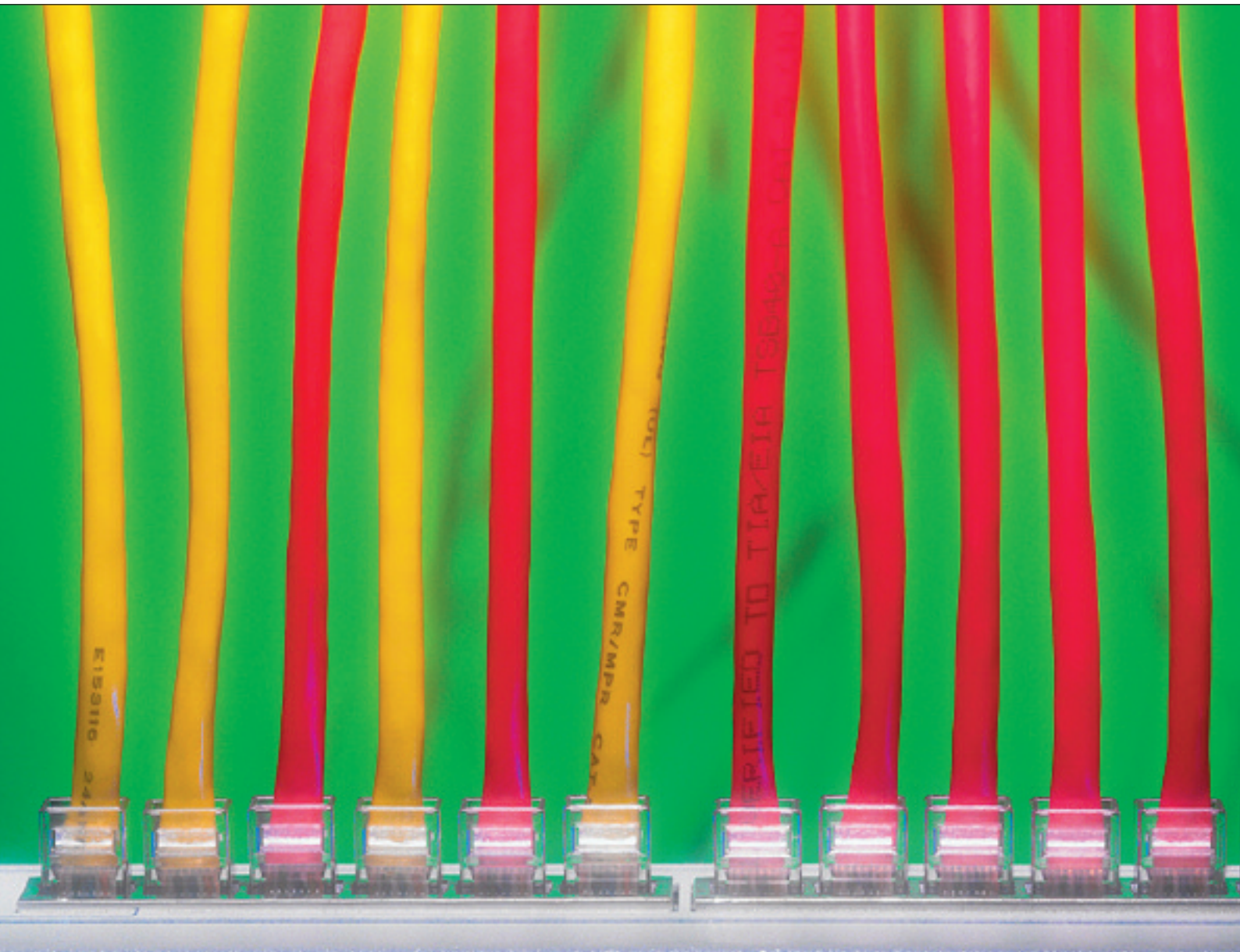




## Fixed Line Services and the Future



June 2010

# Fixed Line Services and the Future – An EPF Report

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## Executive Summary

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All three main parties committed in the UK General Election campaign to supporting the development of the country's digital economy. Like policy-makers in other countries, they identified ICT and broadband infrastructure as important for the economic recovery and as key to restructuring the economy away from an over-reliance on financial services. Moving from manifesto promises to agreed policy will be a critical development for the new coalition Government and Jeremy Hunt, the new Secretary of State for Culture, Media and Sport, confirmed this was his intention in his speech at the Hospital Club on 8<sup>th</sup> June.

Within the EU and wider throughout the OECD, Information and Communications Technologies (ICT) and the modern information services they deliver, have been identified as key to the economic recovery. UK policy can therefore be expected to be formulated within a general policy environment which is increasingly focussing on the promotion of broadband infrastructure as an enabler of global economic recovery..

In 2009, the EPF looked closely into the UK mobile telephony sector. It found a thriving competitive market in the UK but some mismatches in the analysis and expectations of mobile telephone operators and their regulator, Ofcom

In the light of the political interest in ICT and broadband policy, we felt that it would be helpful in 2010 to complement that study with a brief review of the fixed line sector. On mobile we were delighted to work together with Orange and it has been a pleasure to co-operate with BT in the preparation of this report.

This report presents the key facts about the UK broadband picture - from coverage and take-up to the degree of competition, relative to other major EU and OECD countries. It demonstrates a positive relative picture of extensive coverage, high take-up, effective use to support economic activity and a competitive market. A key enabler of competition was the functional separation of BT in 2006 – the creation of Openreach to provide equivalent access to key parts of the broadband network for BT and its competitors.

Broadband policy looks set to focus on two main objectives. The first will be to achieve almost universal UK access to broadband speeds of at least 2Mbits within the next couple of years. This universal service commitment was set in train under the previous Government and it's widely expected to continue in some form under the new coalition government. There is likely to be a debate about which areas should benefit from this funding and whether there can or should be a migration path allowing USC to be upgraded to much faster speeds. The second objective concerns public policy to support the longer-term provision of much faster broadband (often known as next generation or superfast broadband) delivered by fibre, beyond

the viable commercial footprint which is expected to reach around two-thirds of the UK population in the next 5 years.

After the last Government's proposal for a 50p per landline levy to pay for next generation broadband in rural areas, there will be renewed debate on whether this infrastructure upgrade can be left to the market and, if not, what the nature and timing of any public intervention might be. Against this background, a number of further regulatory measures to encourage broadband upgrades, including enabling the shared use of 'ducts and poles,' are in train, initiated by both the European Commission and by Ofcom.

This paper examines the different policy options faced by UK Ministers, and EU level policy makers including their likely costs and benefits. The UK's position close to the head of the European broadband pack can and should be maintained, provided that the new Government crafts a coherent combination of investment, policy and regulatory decisions in the months and years ahead.

## The Key Questions

This paper offers some empirical analysis of the following: consumer attitudes and expectations on the demand side; comparative wholesale and retail prices on the supply side; the state of competition in the UK market and how that compares with EU and other major economies. The aim is to examine the development of competition in the UK, and to use the analysis to make recommendations for public policy going forward, on new high speed networks.

Amongst the key questions we have sought to address are:

- How does the current telecoms and broadband service infrastructure and market structure compare with other developed countries?
- What are the key factors that will impact on demand for broadband and ICT services in the future?
- What are the key policy issues for the new Government in this area?

The paper also looks at the way in which EU public policy will shape longer-term regulatory and policy development in Member States going forward. Europe's telecoms regulators will co-ordinate their activities within BEREC, the Body of European Regulators for Electronic Communications, and this offers a new opportunity to develop more consistent regulation at European level and to drive a Digital Single Market.

# Market Structure and Supply Side issues

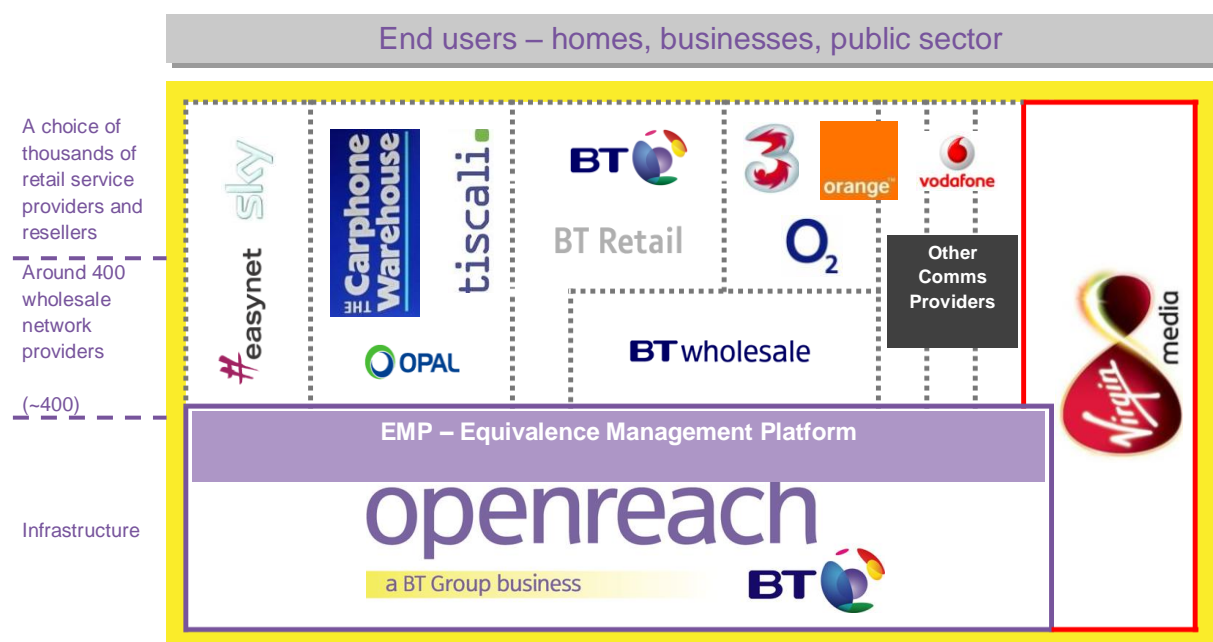
## The UK model of telecoms market structure

The most salient feature of the UK telecoms market which distinguishes it from markets in other developed economies, is the fact that BT's access network is run as an arm's-length organisation called Openreach. It manages BT's so-called 'access network', in a way which ensures it treats the rest of BT on an equal basis to other operators.

Openreach was set up in 2006 following Ofcom's Strategic Review of Telecommunications. The review had found that whereas competition between rival end-to-end infrastructures had proved to be effective and sustainable in the mobile market, this had not been the case in fixed telecoms. In fixed telecoms, Ofcom had concluded that there were enduring economic bottlenecks – parts of the network where effective and sustainable competition was unlikely in the short to medium term. The regulator concluded that in order for competition in fixed telecoms to be effective, BT needed to make such access available on the same terms as it made it available to itself: an approach Ofcom called equality of access.

The access network is the wiring connecting customers to their local telephone exchange, starting at the Main Distribution Frame (MDF) in the exchange and ending at the network termination point (NTP) at the end user's premises. Openreach also manages the connections between the MDF and the BT Wholesale/Local Loop Unbundling (LLU) termination points and equipment located in the exchange. An overview of this UK market structure including Openreach and the various wholesale and retail players including BT Retail and BT Global Services is shown in Figure 1.

Figure 1 – UK fixed line market structure



By 31 March 2010, Openreach calculated that there were 2,070 unbundled exchanges, which means that 85% of households in the UK were connected to an LLU exchange. Of these, 876 had six or more operators present with their own equipment in the exchange; 728 had two to five operators; and 466 had one operator in addition to BT using the exchange. By definition, since these exchanges all contain at least one operator in addition to BT they are all outside of Ofcom's market 1 areas.

In March 2010, there were some 6,619,933 unbundled lines on BT exchanges, or a quarter of UK households with an active LLU line: this offers significant market entry opportunities. The Wholesale Line Rental (WLR) and BT Wholesale's Carrier Pre-selection (CPS) services made available by BT to wholesale providers, in addition to the Openreach LLU services, provide further competitive opportunities by allowing resellers who are unable to invest in infrastructure themselves to resell BT network products under their own brand.

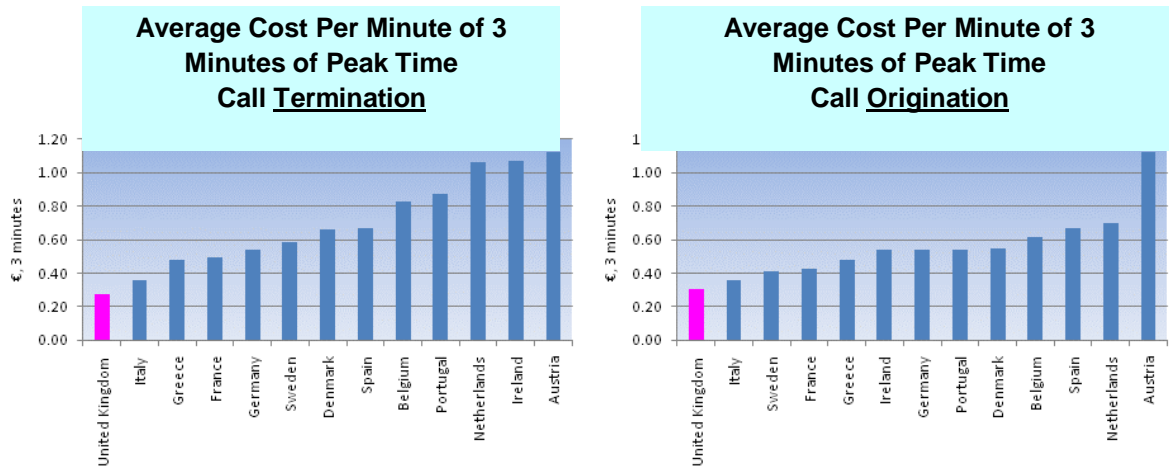
### **How market structure impacts wholesale prices**

To understand the impact of this structural regulatory intervention on market outcomes it is instructive to compare wholesale prices across EU economies. Here we look at wholesale products and prices across the market by considering traditional telephony based services, business focussed services via leased lines and broadband services.

As Figure 2 shows, UK call termination costs for traditional telephony services at wholesale level are the cheapest in Europe, with an average per minute cost of €0.30 compared with €0.45 in France and €0.50 in Germany. Some European markets have costs as high as €1.00 per minute. A broadly similar picture is shown for call origination.

Figure 2: Wholesale price comparison - 3 Minute call Key EU countries

## Wholesale price comparisons : interconnect



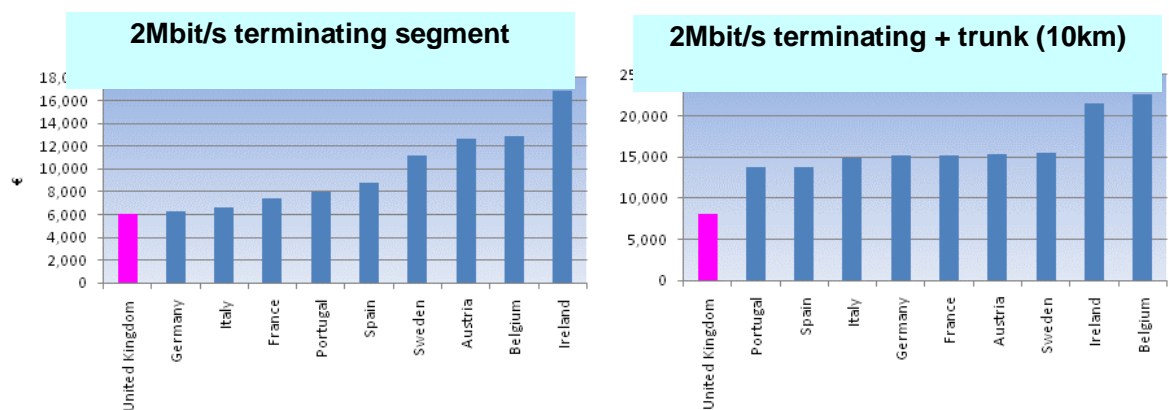
Cullen International Nov 2009; exchange rate at 25 January 2010, European Central Bank

- Wholesale prices for routing calls across the BT network – to either originate or terminate traffic - controlled by “Network Charge Control”

In terms of wholesale leased lines, that enable competitive provision of business services, Figure 3 shows the UK as cheapest in a range of European markets at €6.00 per 2Mb segment.

Figure 3: Comparison of Wholesale Leased Line Prices – Key EU countries

## Wholesale price comparisons: leased lines

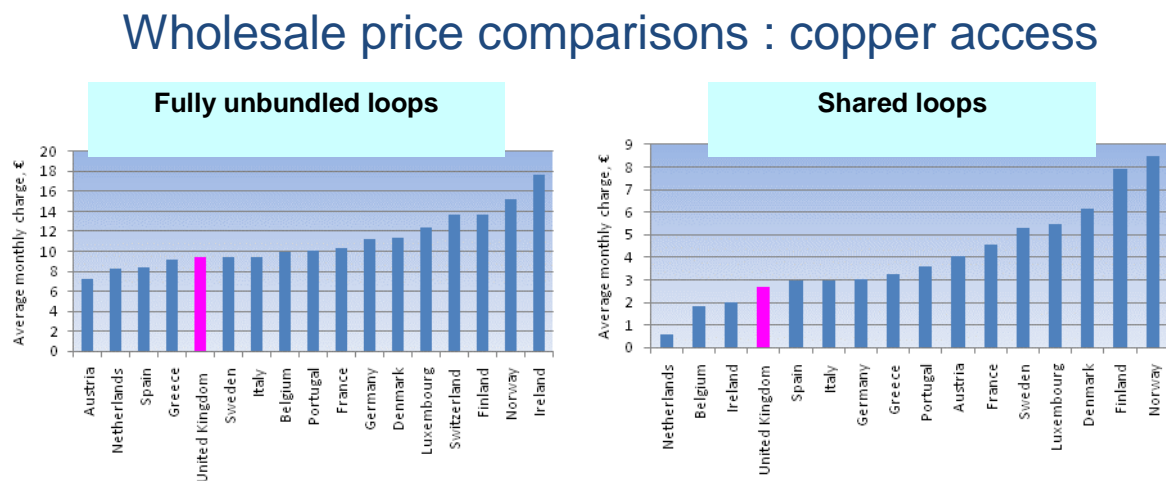


Deloitte, 8 Oct 2008; exchange rate at 25 January 2010, European Central Bank

- Wholesale leased lines enable BT’s competitors to provide dedicated access outside scope of their network build
- Charges based on 3 year contract

Turning to the costs of renting an unbundled (fully unbundled or shared) line to enable the provision of broadband services in the wholesale market, the average monthly charge in the UK, at slightly under €10.00 and slightly under €3 respectively, is again amongst the lowest in Europe (see Figure 4).

Figure 4: Wholesale copper line monthly rental prices – Key EU countries



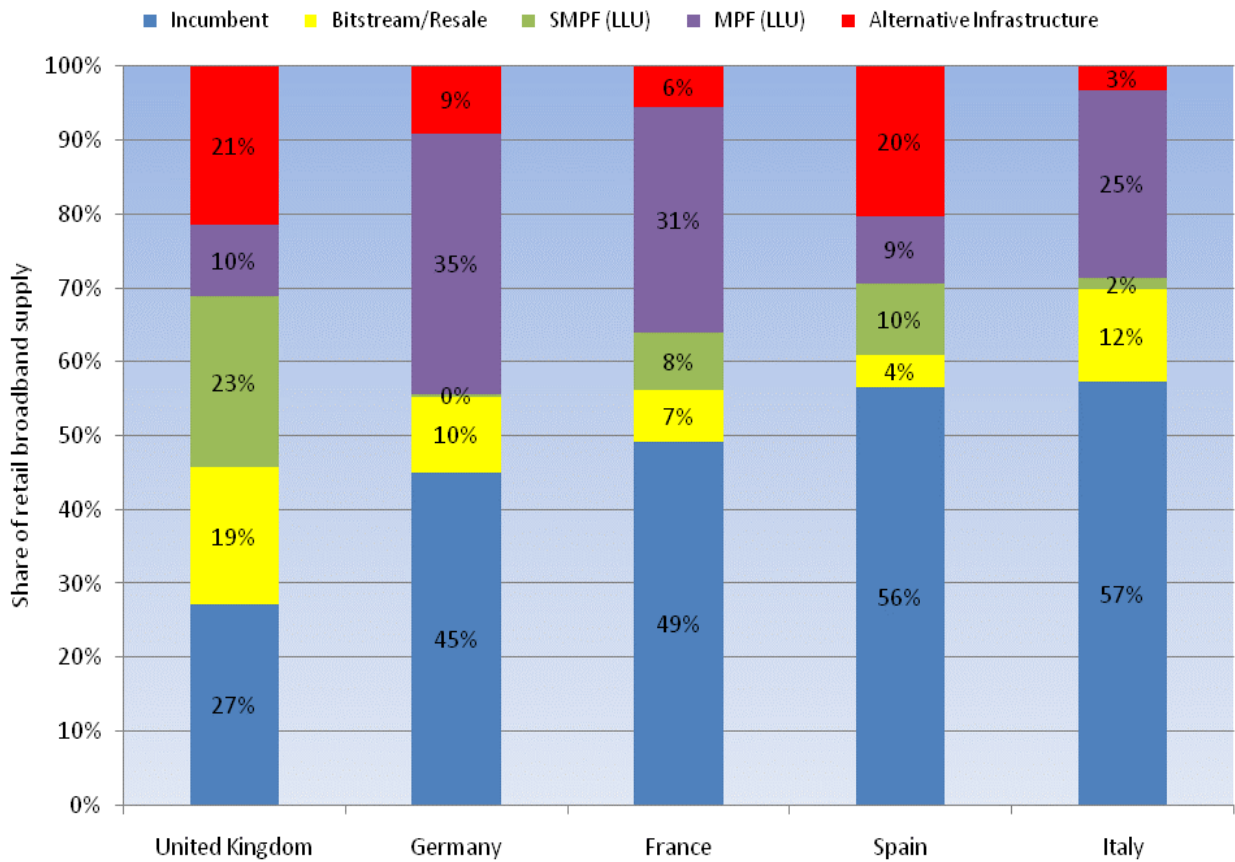
Cullen International Nov 2009; exchange rate at 25 January 2010, European Central Bank

These relatively low wholesale costs, for consumer and business services, have led to significant market growth and new entry. Openreach and BT Wholesale’s 700+ wholesale customers include fixed and mobile operators, internet service providers, broadcasters and other communications providers (CPs). Access to such products allows them to resell broadband and high speed data connectivity, interoperability and transmission services, as well as partial or fully managed network services and platforms. Such services mean that CPs can extend their network coverage beyond their direct network investment areas such as LLU exchanges, by making use of BT network investment and connections provided by BT Wholesale into the core network. Today, more than 4.2 million UK businesses and consumers are end customers of these competitive products. More than a third of the UK fixed telephony customers receive their telephony service from providers other than BT.

### Market entry as an indicator of competition

A further reflection of the impact of the UK telecoms market model is the competitiveness of the retail market. In the retail broadband market in September 2009, the UK incumbent (BT) had the lowest market share of any former incumbent in the major European economies with only just over a quarter of the market compared to typically half of the market for other major EU incumbents (figure 5):

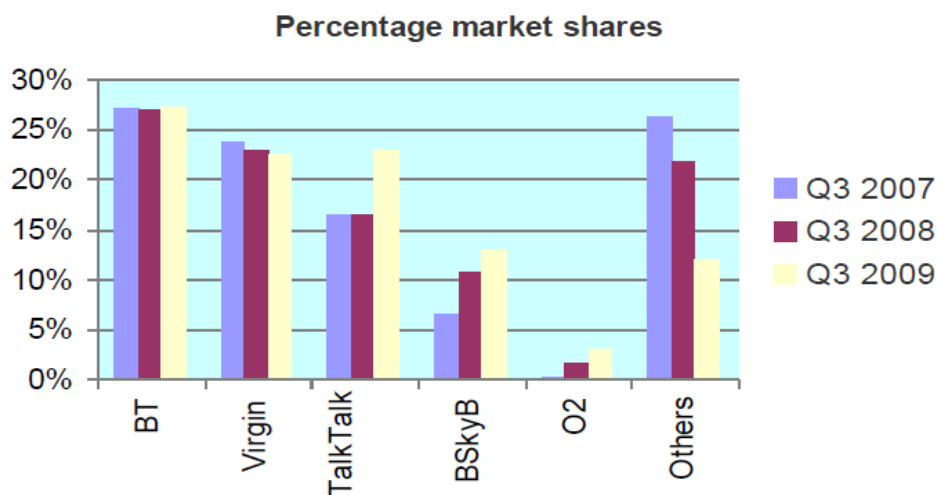
Figure 5 Relative share of Broadband supply – Key EU countries



Source: ECTA Broadband Scorecard, Sept 2009

Further detail on BT’s consumer broadband market share compared with its principal competitors is shown in Figure 6.

Figure 6 – Retail broadband market shares



Source: Enders Analysis

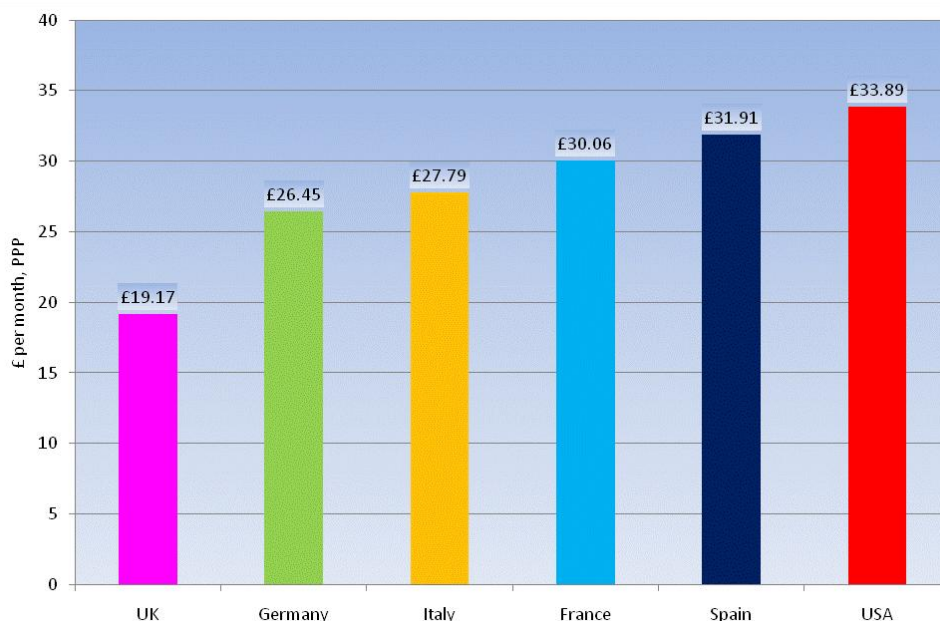
In respect of the traditional telephony market, in 2009 Ofcom decided that there was sufficient competition in the retail fixed line telephone market; that BT no longer had significant market power in most of those markets, and that those markets could be deregulated. At that point, competition mainly from Virgin Media, BSkyB and TalkTalk collectively served some 12 million UK households and businesses using a combination of their own network investment via LLU (with equivalent access, products and services provided by Openreach) and BT wholesale services in areas where they don't directly invest. In addition, competitive (substitutional, in some cases) pressure on fixed lines from mobile operators has grown further, to the extent that BT is no longer the largest operator in terms of number of retail voice customers. O2 now has more retail customers on its mobile network than BT has fixed customers.

### Lower retail prices

In 2006 Ofcom removed restrictions on how much BT could charge for landline voice calls, as a result of the strength of retail competition in this market, a decision vindicated by the cost of residential landline calls falling from an average of £25 per month to £21.60 in 2008.

In its most recent International Communications Market Review, Ofcom compared the best value tariff from each of the three largest operators by market share in six countries. This compares costs for a family of four who are cost conscious and use fixed line phones relatively heavily. As figure 7 shows, the UK cost of £19.17 compared favourably with the equivalent cost of £26.45 in Germany, £30.06 in France and £33.89 in the United States.

Figure 7 – Retail price for typical basket of calls in 6 developed economies



Source: International Communications Market, December 2009, Ofcom; weighted average of best-value tariff from each of the three largest operators by market share in each country, for 600 outbound minutes; July 2009; PPP adjusted. Based on a family of two parents and two children, who are cost conscious and favour using the fixed-line phone whenever possible, which gets fairly heavy use. Includes line rental and cost of purchasing enhanced tariffs that offer reduced prices.

## Conclusion

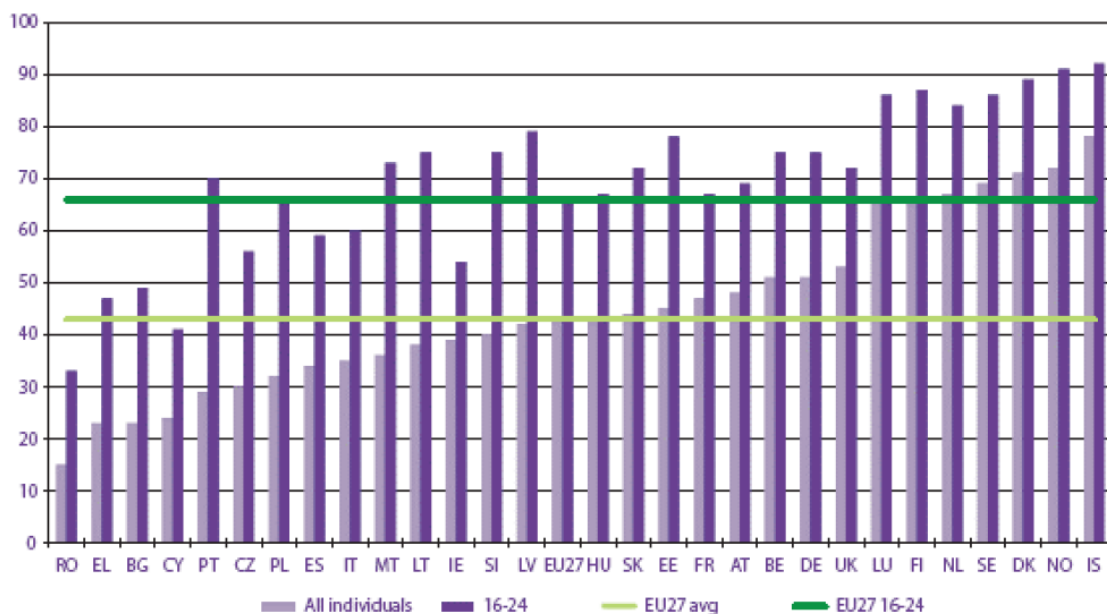
The picture on supply side impacts on the UK market is therefore encouraging. The combination of low wholesale and retail prices as well as the provision of equivalent access from Openreach has enabled competitive entry from a significant range of small and large providers across traditional and new services. It puts the UK in a very strong position particularly in comparison with its European peers.

## The Demand Side

### Take up of ICT services

Recent research by the European Commission shows that the UK performs well in terms of take-up of internet services. Figure 8 shows that although the Scandinavian countries tend to score ahead of the UK, the percentage of the population who use the internet every day or almost every day in the UK is higher than most member states including France and Germany and the EU average overall.

Figure 8 ICT usage in EU member states [2008]

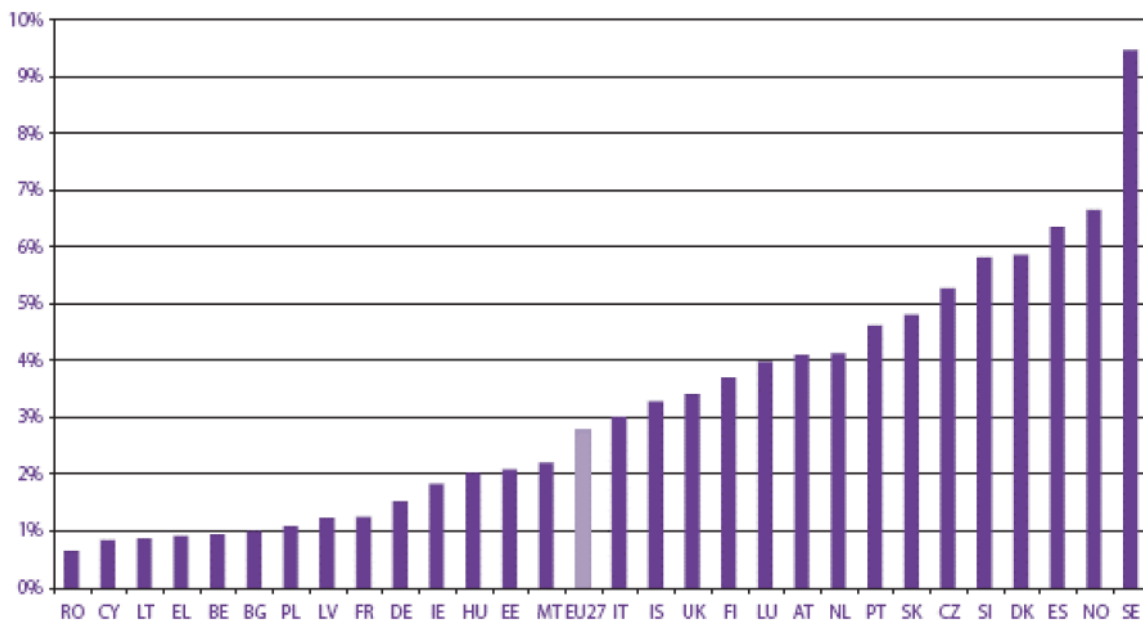


Source: Eurostat Community Survey on ICT Usage by Households and by individuals

It is important to note that people are making use of the internet for relatively basic services. While around half of the public in 2008 used the internet for email and finding information about goods and services, the proportion actually ordering goods online, reading online newspapers and magazines, and using internet banking was only between twenty and thirty per cent. Just one in ten people used the internet to make voice calls.

The more advanced services are being used mainly through fixed broadband connections – only three per cent of the EU adult population was using a third generation mobile phone to access the internet in 2008, according to Eurostat figures (see Figure 9). The percentage is higher in Scandinavian countries but nowhere did it exceed ten percent. Although the launch of devices such as the i-phone has led to significant increases in the number of people using 3G devices and consequent growth in broadband data the actual volumes are still very low compared to fixed lines. Customers find difficulties with mobile broadband in accessing sites, with lower access speeds, and differential pricing. This constrains take up even in comparison to current generation fixed networks. As fixed network speeds continue to increase, the ability of wireless broadband facilities ever to operate at very high bandwidths other than perhaps in central urban or other ‘hotspots’ will be an important factor.

Figure 9 Use of 3G mobiles to access the Internet [2008]

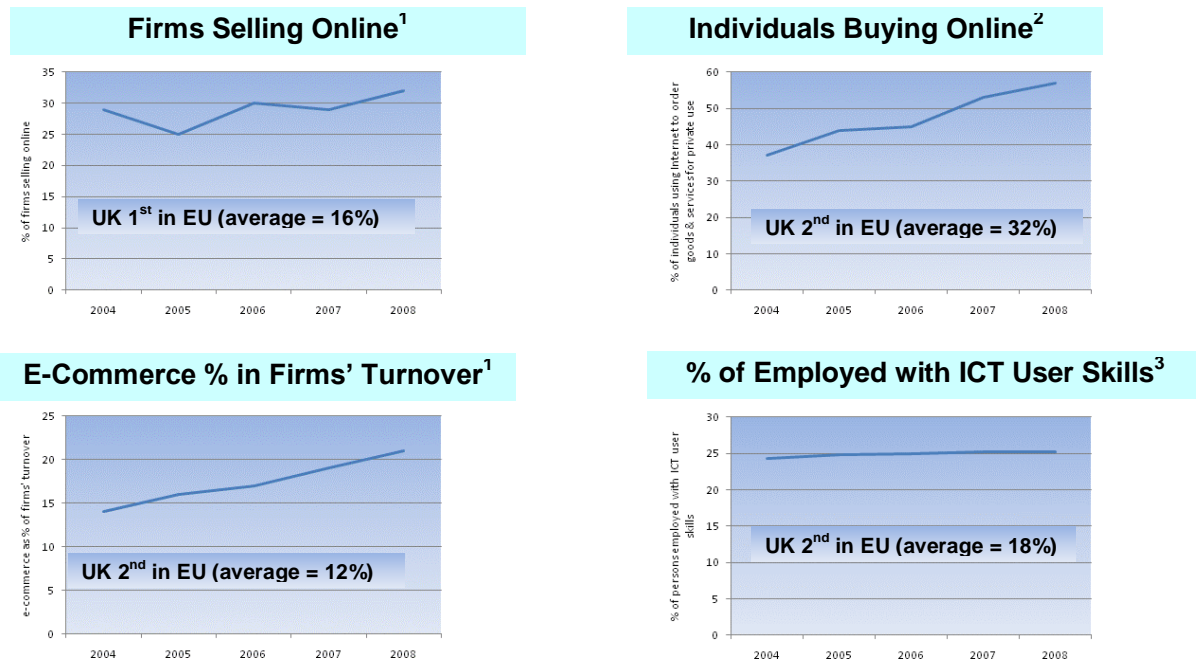


Source: Eurostat Community Survey on ICT Usage by Households and by individuals

Looking at the way the UK uses broadband the picture is encouraging with many key indicators well ahead of EU averages. Some of the key indicators are shown in figure 10 below.

In particular, the UK scores well for enterprises selling online and e-commerce, and is well up the league table for uploading self created content and buying and selling goods and services. It performs less well in the more sophisticated use of ICT for business purposes.

Figure 10 Key usage indicators for internet services



1. % of enterprises receiving orders/purchasing on the internet - Non financial enterprises. % of enterprises receiving orders/purchasing on the internet or via other external computer mediated network (in 2007). 10+ employees, excluding the financial sector. Source: Eurostat survey on ICT use by enterprises.

2 % of population using the internet to order goods & services in the last 3 months. Individuals aged 16-74. Source: Eurostat.

3. % of persons employed with ICT user skills - Based on the OECD definition of ICT user (basic + advanced) skills. Source: Eurostat Labour Force Survey.

## Consumer attitudes

UK consumers increasingly now see broadband access as essential or important to their lives. In 2009 the Communications Consumer Panel used Opinion Leader Research to survey some 2,000 consumers. The results show that of AB respondents, 82% believe that home broadband access is essential or important. Higher socio-economic groups tended to emphasise the importance of broadband, as did younger consumers, as the data in Figure 11 shows.

Figure 11 Consumer Preferences for broadband

Which statement best describes how you currently feel about having access to broadband internet at home?	Total	AB	C1	C2	DE	16-24	25-44	45-64	65+
It is essential/I couldn't be without it	42%	51%	46%	35%	31%	40%	45%	42%	28%
It is important/I value it highly	31%	30%	31%	27%	34%	42%	32%	26%	24%
It is nice to have but not vital	20%	13%	17%	30%	22%	14%	18%	22%	30%
It's not particularly important to me	5%	4%	5%	5%	8%	3%	3%	8%	9%
I don't value it at all	2%	2%	1%	2%	3%	1%	1%	2%	5%
Don't know	1%	0%	1%	1%	3%	1%	1%	0%	3%
Total - essential & Important	73%	82%	77%	62%	65%	82%	77%	68%	52%
Total - not particularly important & don't value it at all	7%	5%	5%	7%	11%	3%	4%	9%	14%

Source: Communications Consumer Panel 2009

Also in 2009, Ofcom carried out a substantial sampling exercise of consumers' experience of their current fixed line broadband performance, which involved installing hardware monitoring equipment in the homes of over 1,600 UK broadband users and running around 60 million tests in total.

While a large majority (83%) of panellists were satisfied overall with their broadband services, the single biggest cause of dissatisfaction among those who were dissatisfied was around speed.

- More than one in five consumers (21%) expressed dissatisfaction with broadband speeds, compared to 16% who were dissatisfied with value for money and 13% with the reliability of their connections.
- Over a quarter of consumers (26%) said that the speeds they received were not what they expected when they signed up to their broadband service.
- Consumers who receive lower actual speeds said that they were less satisfied overall with their broadband service.

On 23<sup>rd</sup> March 2010 the Broadband Stakeholder Group (BSG) and Value Partners launched a study designed to give a voice to companies and organisations that offer services and applications over the internet. (*Broadband Infrastructure: The Service and Application Providers' View.*) This White Paper provided insight into what companies and organisations that offer services and applications over the internet really think about the UK's broadband infrastructure today and how it might evolve in the future.

Dan Kirk, Partner at Value Partners London said: "To us, these interviews highlight a positive story of the state of the internet industry in the UK today. Current trends in usage and the anticipated rise in consumer dependence on performance critical rich

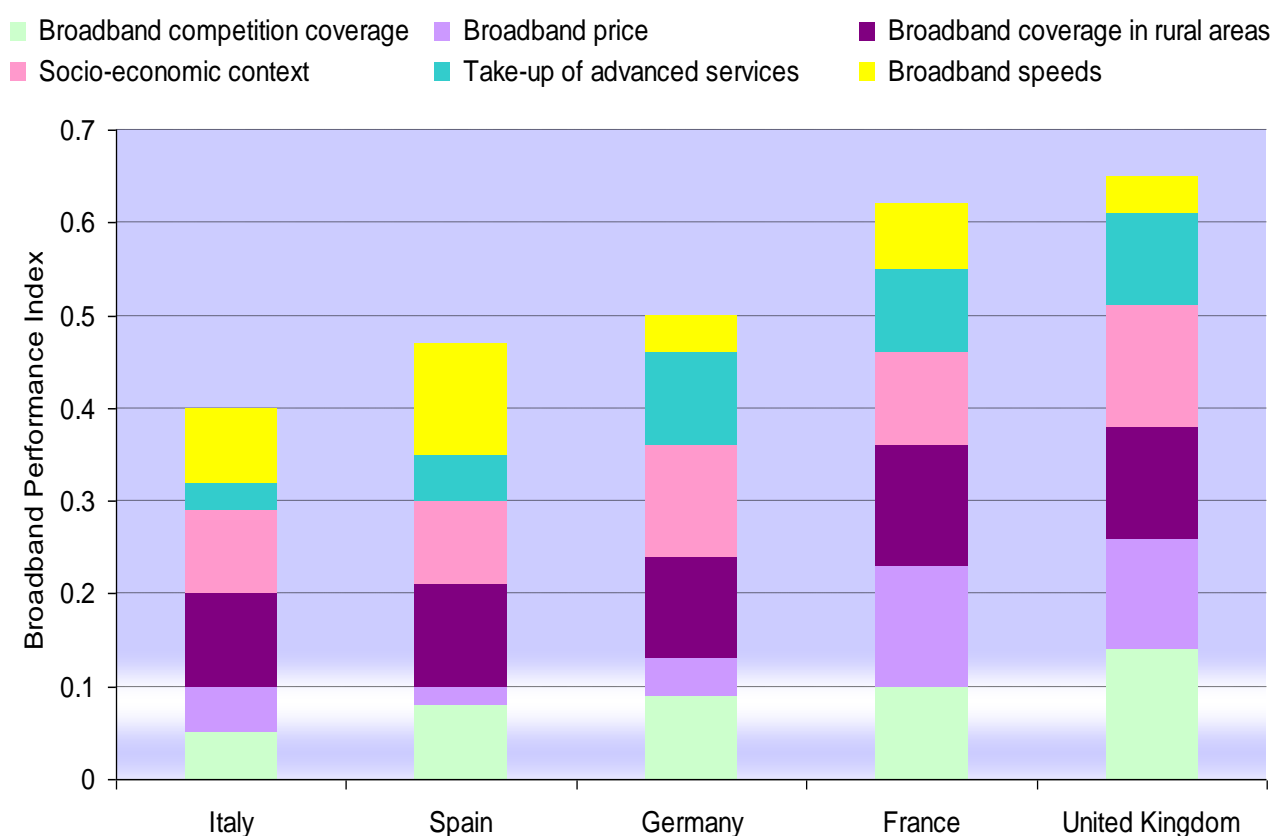
*media applications drive a strong case for investment in next generation broadband. That is not to say that this report shows any evidence of market failure as a result of a lack of next generation broadband deployment to date. But this report does suggest that innovation will drive further exciting and far-reaching developments when next generation broadband takes hold in the UK.”*

### **An overall broadband picture**

Although somewhat dated now, the EU’s attempt in September 2008 to synthesise a range of data about broadband into an overall Broadband Performance Index by which to benchmark member states is worth highlighting. The index attempts to measure overall broadband performance on a range of factors including speeds, rural coverage, affordability, innovation and other socio-economic factors.

The results of this exercise for the EU’s five largest economies are shown in Figure 10 below and, consistent with other data presented in this report, it shows the UK ahead of the pack. The UK’s particular areas of relative strength are the competitiveness of its market, broadband prices and the socio-economic context of positive consumer engagement in broadband services.

*Figure 12 EU broadband Indicator comparative Scores – Key EU countries*



**Source: EU broadband indicator, September 2008. The Broadband Performance Index (BPI) ranks the EU-27 countries plus Norway in terms of the supply and demand factors that affect**

the take-up and use of broadband. The BPI is represented by a value ranging from 0 to 1, higher values implying that a country performs better than others in terms of the various components.

## Fixed Line and Digital Economy Policy Issues

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Given this positive relative picture, why should broadband policy be a priority for the new UK Government? The answer is two-fold. First is the widespread policy maker conviction that broadband has the potential to deliver benefits (including significant operational savings) to many sectors in the wider economy, including public services. Second is the generally accepted view that some kind of public intervention will be needed to achieve superfast broadband speeds well beyond the expected commercially-viable footprint.

This conviction that investment in broadband services to the home would result in benefits to other sectors was spelt out in a report by the OECD Working Party on Communication Infrastructures and Services Policy in September 2009. This report stated that:

“High-speed communication networks are a platform supporting innovation throughout the economy today in much the same way electricity and transportation networks spurred innovation in the past. Future innovation in many sectors will be linked to the availability of high-speed, competitive data networks and new applications they support. The emergence of many of these innovative services tied to broadband is visible today in four key sectors: electricity, health, transportation and education. Broadband has become the leading delivery system for a wide range of content as witnessed by the transformation of the newspaper, music and video industries.”

In March 2010, the UK Department for Communities and Local Government published a report by Analysys Mason looking at gaps in broadband coverage. The report concluded that the UK ‘is very well served in terms of current generation broadband coverage, competition, take-up and price’. The report identified just over 4,000 (out of 42,000) areas that it considered at risk of not receiving next generation broadband this decade and that would face the highest negative impact on their community if they did not receive a rollout. The areas identified were almost all in Devon, Cornwall, Wales, the east coast of England, the north of England, Northern Ireland and the Scottish Highlands.

The then Digital Economy Minister, Stephen Timms, said in a statement that the report ‘makes clear that, without public intervention, some rural areas and less well off rural communities will be left behind and unable to reap the economic, health and education benefits super fast broadband offers’.

## Universal Service Commitment

The Digital Britain Review's Final Report published in June, 2009, stated: "More than one in 10 households today cannot enjoy a 2Mbps connection. We will correct this by providing universal service by 2012. As such, the UK's commitment leads Europe. It has a measure of future-proofing so that, as the market deploys next-generation broadband, we do not immediately face another problem of exclusion. The USC is also a necessary step if we are to move towards digital switchover in the delivery of more and more of our public services."

The report proposed using the underspend on the Digital Switchover Help Scheme (around £200m) to fund the USC. Generally speaking, these proposals were well received by all political parties. The Conservatives and Liberal Democrats both indicated their broad support for the USC, and the former have implied that this should be for higher speeds than 2 Mbps.

In the UK, therefore, the sense is of strong potential for a leap forward in broadband use, based on an already competitive international performance, but which would depend upon ensuring that a basic minimum capability was available to all and super fast speeds where they were needed. This was reflected in the House of Commons Business Select Committee's report on broadband (HC72, published on 23 February 2010). The Committee found a consensus in favour of the then government's proposals, referred to above, to introduce a universal service commitment for the delivery of a 2Mbps connection to virtually every household by 2012. The Committee believed that this should deliver a minimum of 2Mbps under normal circumstances to all users and considered this an achievable objective which would provide a greater range of services to all areas of the United Kingdom. In an interesting additional comment, the Committee noted that, where appropriate, next generation access would be used to deliver the upgrade, amounting to a significant single step forward for some 1.5 million households.

On 6 March 2010 the Government launched Broadband Delivery UK with the intention that it should allocate funds to achieve the USC. Whether the USC roll-out will proceed as envisaged by the last administration, which areas will benefit, and whether there could be a migration path allowing USC to be upgraded to much faster speeds remains to be seen.

Political pressure for increased speeds in rural areas was certainly building prior to the recent elections. For example, a number of organisations including Community Broadband Networks (CBN), the Independent Network Operators' Association (INCA) and the Country Land and Business Association (CLA) have been running campaigns to improve broadband coverage for UK rural users. The CLA believes that broadband is as essential to business as water, gas and electricity (though note no Universal Service Obligation exists in these sectors) and that around three per cent of rural areas cannot currently get a basic broadband service (under 512kbp/s),

holding back some 100,000 businesses. It notes that even rural districts of England's "Silicon Valley" (an area near Reading) and places close to the M25, have broadband access problems. Its campaign 'The Final Third First' is focused on the need for accelerated government intervention to ensure effective broadband access, say 2mbit/s and above, for the "final third" of the UK.

Jeremy Hunt as the new Secretary of State responsible for this area under the coalition government further confirmed, in a speech on the 8<sup>th</sup> June the commitment to help fund the USC deployment when he said - "...the government supports the commitment to ensure a universal service level of 2Mbps as the very minimum that should be available. We will use a proportion of the underspend on digital switchover to fund this.

### **Proposals for enabling superfast broadband in non-commercial areas**

Whilst there seems, therefore, to be a fair amount of political consensus about the need to use public funding to assist in the roll-out of services of up to 2Mbps to virtually the whole population, it is less clear that consensus exists in relation to the roll-out of superfast broadband beyond the expected commercial footprint.

BT announced in 2008 that it would be investing £1.5bn to provide fibre to 40% of UK homes (10 million) by the end of 2012, and will reach the first four million by the end of 2010. Seventy-five per cent of the homes they will provide with superfast broadband will be connected via "fibre to the cabinet" (FTTC), delivering speeds of up to 40Mb, potentially rising to 60Mb. A quarter of homes will get "fibre to the premises" (FTTP), delivering speeds of up to 100Mb. Speeds of 50Mbps and above are now available to all households covered by Virgin Media's national cable network: some 50% of UK homes. BT also announced, on 13 May 2010, a planned extension to this programme to invest an additional £1bn to provide superfast broadband services to two thirds of the UK by 2015 subject to there being a supportive investment environment.

Last year's Digital Britain report commented "The Government believes that the case is made for the desirability of such next generation networks being available to the large majority of the UK population. It is also persuaded that the economics of network deployment, whether fixed or next-generation mobile, mean that true superfast broadband will be concentrated in the first two thirds of the market in the next decade, leaving the 'final third' served only with current generation broadband. This would be undesirable. Equally, any subsidy scheme has to be carefully targeted to avoid distorting competition or subsidising activities which commercial operators would otherwise undertake."

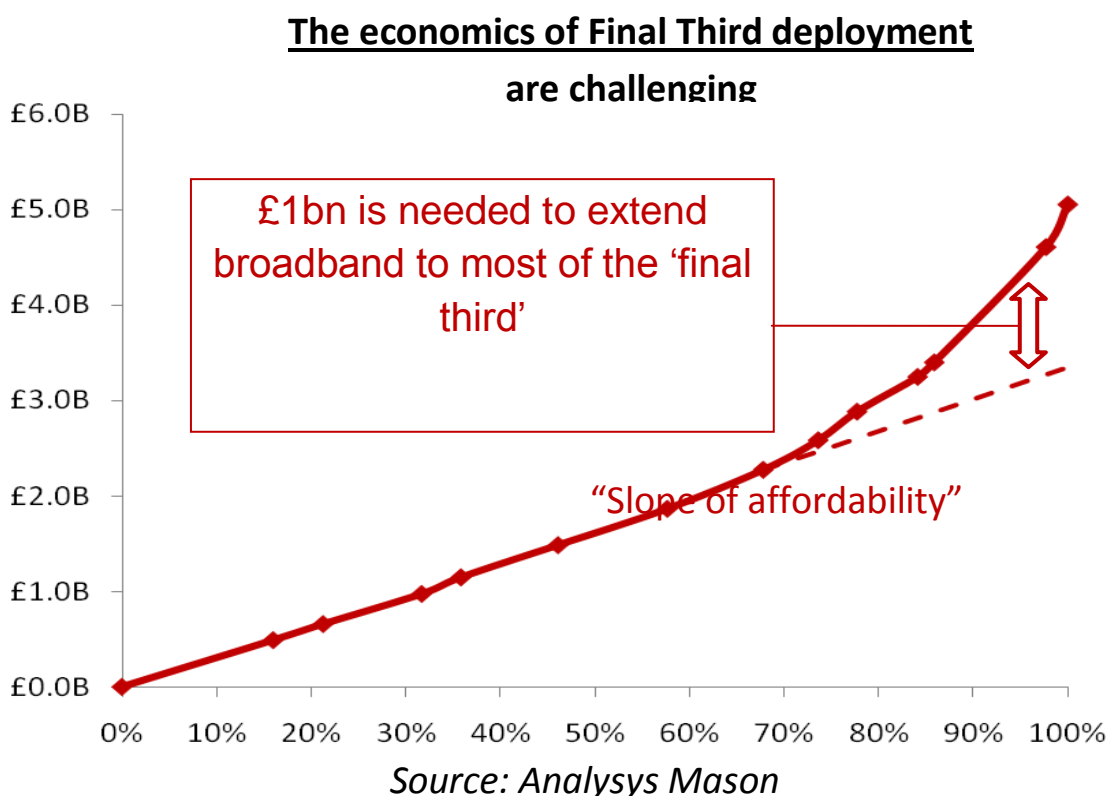
The previous Government planned to address this issue through a 50p levy placed on fixed telecommunication lines to fund extension of broadband reach – a proposal

contained in the 24 March 2010 Budget speech, but not included in the measures enacted before the General Election.

The Coalition Agreement says that the government “will seek to introduce superfast broadband in remote areas at the same time as in more populated areas. If necessary we will consider using the part of the TV licence fee that is supporting the digital switchover to fund broadband in areas that the market alone will not reach.” Jeremy Hunt further announced on the 8<sup>th</sup> June plans to create “3 market testing projects that will bring superfast broadband to rural and hard-to-reach areas..... that will provide us with vital information about how we can best target government intervention and make next generation broadband viable in even the most challenging areas.”

How much public money – whether from the licence fee or elsewhere – might be needed to achieve NGA in the ‘final third’? Research by Analysys Mason for the BSG implies that the essentially fixed costs of delivering NGA to the first 65% of the UK, if supplemented by an additional £1bn, could result in NGA being extended well into the final third and potentially to 95% plus of homes in the UK (see figure 13) significantly assisting with the completion of broadband coverage into areas where it is not commercially viable. Many people would consider funding of this scale (£1bn to essentially secure broadband Britain) pretty good value.

Figure 13 Potential impact of Government funding in non commercial areas.



## Facilities Sharing

The Conservative Party manifesto also indicated that they would “require BT and other infrastructure providers to allow the use of their assets to deliver superfast broadband across the country”. This policy is based upon the belief that requiring BT (and others) to allow competitors to share duct space would stimulate fibre rollout across the UK.

BT has said that it is keen to co-operate with other providers in helping develop a commercial market to deliver very high investment levels. This includes allowing access to Openreach ducts and poles where it will assist communications providers in the delivery of superfast broadband. Ofcom have, in any case, confirmed in recent consultations that they intend to require BT to offer duct and pole access.

Some commentators see this move to facilitate access as beneficial, but have made similar points about reciprocal opening of competitor ducts as well. For example, commenting on BT’s decision to open up its broadband ducts to competitors, the telecoms comparison site USwitch.com said this was a significant step towards creating a level playing field.

Steve Weller of USwitch said that:

“Competitors and ultimately consumers will benefit from the £1.5 billion BT is spending on its new fibre optic network, setting 100Mb broadband in the sights of forty per cent of homes. Once the deal is agreed, rival companies will have the opportunity to supply homes via their own fibre optic networks – but using BT’s ducts means that they won’t have to dig up any roads themselves. While they will have to rent the ducts from BT, any savings they make could ultimately be passed onto consumers. Firms will be in a stronger position to compete directly with BT Infinity, BT Retail’s new fibre optic broadband product which will be available to 4 million homes by the end of 2010 for £19.99 a month, capable of delivering speeds of up to 40Mb. However, this also begs the question of whether Virgin Media should also be taking steps to open up its cable networks for rival firms to use”.<sup>1</sup>

In the Queen’s speech on 25<sup>th</sup> May and the associated background note, the coalition government announced its support for investment in new high-speed broadband internet connections. The note stated: ‘The government believes that much of the cost of expanding broadband internet access comes from civil engineering, such as physically digging up roads, and that if these costs were reduced through sharing, commercial investment would be incentivised’.

In the government’s view, ‘allowing companies to use the infrastructure already in place, therefore, could allow NGA networks to spread more rapidly, particularly in

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<sup>1</sup> USwitch press release February 2010

rural areas. The extent to which this can be achieved through existing government powers, or will require new primary or secondary legislation, is uncertain’.

The Government has therefore announced an intention to do what can be achieved through existing powers and then to bring any new legislation required to Parliament “as soon as possible”.

Facility sharing is not, however, likely to be a “silver bullet” solution. In other parts of the EU, there are strong incumbent operators and little or no choice of wholesale or retail service provider for customers; in these circumstances, in certain areas (such as central Paris), duct sharing can give customers an alternative network choice.

BT, on the other hand, as well as agreeing to allow access to its ducts has proactively developed wholesale services available to everyone and utilised by competing service providers including Sky, TalkTalk and Orange, to deploy national services extending beyond any LLU infrastructure, in advance of any requirement to do so, and has the lowest incumbent retail broadband market share of any incumbent in Europe. It has also committed to offer “competitor ready” wholesale services over its fibre access investment at day one enabling CPs to take advantage of this new investment on equivalent terms. It is not clear that as things stand, sufficient incentives exist for investment in high-speed broadband in rural areas, even with the possibility of sharing existing facilities such as ducts and poles. The proposal, therefore, by Jeremy Hunt, to invite “*businesses interested in investing in superfast broadband to tell us how infrastructure sharing would impact on their plans. And asking infrastructure owners to tell me how we can best work together to make this happen*” appears to be a sensible and pragmatic approach.

## **UK regulation and Ofcom**

In the UK there has been some discussion about the role of Ofcom and its future structure e.g. that all economic regulators should be subject to ‘charter reviews’ in which their mission, functions and performance are reviewed from time to time in the context of the government’s policy agenda and current and planned legislative developments. Such measures have received a general welcome from economic regulators across the sectors.

It is notable that Ofcom has removed price controls from UK fixed line services at the retail level, and signalled an intention not to impose them for new generation broadband networks, but continues to implement a number of existing wholesale network price controls. Against the statistics and analysis of this report, it seems timely for Ofcom to review whether there is an opportunity to lift wholesale price controls. If UK customers are well served in terms of price and service, and this is reflected in very high levels of consumer satisfaction and competition, as evidenced

by research by Ofcom itself, then Ofcom's declared ambition to remove unnecessary regulation would merit action.

Where Ofcom does consider ongoing regulation of wholesale prices appropriate, it is important that those prices provide sufficient incentives for BT to continue to invest to improve overall service levels and maximise efficiency. Regulated prices should allow an efficiently run organisation to recover its ongoing costs of providing regulated services and to make reasonable returns on investment, reflecting the risks taken in various markets.

Ofcom's record of innovation in this area is to be commended, as is its wide ranging research, analysis and international networking functions. In today's conditions of fast moving technological change, globalisation and complex policy and regulatory interactions, a well informed regulator with highly skilled staff and the ability to capture the shape of the sector and help to design its future is a valuable asset to the UK.

## EU Dimension

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It is often forgotten that UK communications sector policy is conducted within the context of EU policy. Developments in the UK can sometimes anticipate, or sometimes follow what is happening at EU level. It is therefore important to consider how Britain's future fixed line telecoms environment will be affected by EU developments, and by the future of economic regulation in the UK. Some clues on this are already emerging.

**EU Broadband Policy** European Commission President Jose Manuel Barroso has identified ICT as one of the key policy 'flagships' in the 'EU2020' blueprint for economic recovery – the successor to the Lisbon Programme, and Commissioner Neelie Kroes has now published her blueprint for ICT and Broadband policy for the next few years – the "European Digital Agenda". At the EU Telecoms Council on 31 May 2010 the Spanish Presidency said that the EU aim is to have 100% broadband coverage across the EU by 2013 and 100% high speed or mega high speed broadband coverage by 2020.

The "Digital Agenda" is wide-ranging, covering online content, spectrum, interoperability, research, security, and digital inclusion. One of the main areas of focus is on fast and ultrafast internet access, with an emphasis on encouraging investment in open and competitive networks.

The most intensive periods of revision to the EU telecoms framework came to an end late in 2009 (for implementation in large part in 2011). In the meantime, however, the direction of policy development in Brussels can have a strong influence

on the thinking of policy makers and regulators in this country, and the EU agenda appears to be aligned with the general direction of the UK emerging policy.

In the context of broadband, the Commissioner plans an ambitious and comprehensive EU strategy which will be presented in a few months time. Mrs Kroes wants to encourage internet access and take-up for all, and has already proposed ambitious targets for roll-out and take-up of high speed networks.

During 2010 the Commission will finalise recommendations for national regulators on next generation access regulation - this need perhaps to be flexible in encouraging both active and passive methods to spur competition. A "one size fits all" approach would not work as the highly competitive service provision driven market in the UK is not the same as much of continental Europe. Investor confidence would be bolstered by a clear and flexible pro-competitive approach at a time when major investments are needed. Similarly, the Commission's guidelines on state aid for the new networks in more remote areas issued late in 2009 also helpfully support aid where due active and/or passive remedies and open network access are available.

The UK has opportunities to share the lessons of its functional separation debate with European colleagues. The role of larger urban and smaller communities will be an area discussed by MEPs, including against green agenda norms for energy efficiency.

Other items on Mrs Kroes' agenda in 2010 are the review of universal service obligation and net neutrality, where the Commission will report later in the year.

The Universal Service Obligation (USO) in telecoms was designed to prevent social exclusion, by ensuring the availability of a basic level of service in case the market did not provide this. Most of the assumptions underlying the original introduction of USO have since changed, in terms of technology, competition and consumer expectations. The deployment of new high-speed networks will change the picture even further, with substantially higher levels of public funding needed to bring these new networks to more remote regions. A wide-ranging review is therefore timely, bringing all these elements together in the broader, more strategic debate about 'Broadband for All' that the Commission is planning.

The EU debate will also engage the European Parliament. It is likely to be particularly interested in the role of universal service obligations across Europe and the Commission's consultation on this subject. Every country will be facing similar questions about what is the role of government and how are services best delivered, including via city or regional initiatives, albeit in such cases a focus on competition and interoperability are considerations.

All of these areas show the importance of the UK playing a full part in the EU's work agenda. Both BIS and Ofcom have experienced professional teams handling EU matters. The UK has traditionally had a prominent role in EU debates, including in

the past, the Chair of the European Regulators' Group, the predecessor of BEREC (see below). It will be important in 2010 for these efforts to be maintained. In part this is because experience from the UK will be relevant to a number of the issues on the European institutional agenda.

A number of UK MEPs have been active in EU legislative discussions, and the Internal Market Committee Chairman, Malcolm Harbour MEP, has played a key role.

## **BEREC**

A significant factor affecting the fixed line future in Europe is the development of EU and UK telecoms regulation, side by side. BEREC, the Body of European Regulators of Electronic Communications is now getting underway as a pan European group of regulators. Although its establishment was surrounded by much institutional discussion about the relative powers of the European Commission and national regulators if a regulator fell out of line with its peers – a discussion live in other sectors also – the agenda now looks rather different. The key challenges are for national regulators to exchange best practice and ideas about the issues preoccupying the European Commission and the European Parliament – incentives and structures for fast next generation roll out, measures to encourage investment and free up spectrum; and a clear Pan-European understanding about the role and limits of public support.

BEREC is off to a good start under the chairmanship of John Doherty, Head of the Chair regulator ComReg. It will have its own staff and budget. On 31 May the EU Telecoms Council announced that BEREC will be based in Riga in Latvia. This follows the announcement that the energy regulatory network ACER will be based in Ljubljana, Slovenia. Although sharing out agency headquarters among member states is a longstanding EU tradition these are bad decisions. BEREC, to be effective, needs to be in Brussels close to Council, Commission and Parliament members and staff.

BEREC will examine some of the key issues for fixed line future in 2010 including:

- next generation access roll out and multi-fibre networks
- regulatory aspect of open access, particularly in the context of the EC guidelines on state aid rules
- convergent services and whether and how these may be subject to regulation
- cross-border enforcement issues for consumers
- the new EU remedy of functional separation
- Net Neutrality

The combined body will consider market development and then whether the regulatory framework is fit for purpose to deal with these developments.

## Summary and Conclusions

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After a period of national agonising about broadband in Britain, the outlook now looks surprisingly positive. The coalition government is determined to ensure the rapid rollout of superfast broadband across the country, in remote areas as well as highly populated centres.

BT's announced extra £1bn investment and Virgin's fibre rollout should help to take the UK to two thirds superfast broadband coverage by 2015. The final third issue could be significantly addressed with approximately £1bn in public support. This is small when compared to major energy or transport infrastructure projects, is at least as environmentally-friendly, and would be good value to achieve 100% Broadband Britain.

Britain is already well to the fore in European broadband. Traditional fixed line wholesale phone costs are the cheapest in Europe, line rental costs among the lowest in Europe, and competitive market entry means that more than a third of fixed line telephone users receive their service from a non-BT competitive supplier. Ofcom research shows that a typical basket of monthly fixed line calls costs £19.17 in the UK compared with £26.45 in Germany, £30.06 in France and £33.89 in the USA.

Broadband customer satisfaction is high with 83% of customers satisfied overall according to the Communications Consumer Panel. The single biggest cause of dissatisfaction is around speed – showing the desirability of investment to speed up superfast broadband rollout. The Country Land and Business Association and other rural bodies are right to highlight the importance of this for rural communities and businesses.

Government, Ofcom and BT are of a similar view in supporting further market entry through access to BT ducts. But duct access is not a silver bullet. It is not clear that, without extra support, sufficient incentives exist for investment in high speed broadband in rural areas even with the possibility of sharing existing facilities such as ducts and poles.

It is timely now, given the competitive entry, low prices and high customer satisfaction in UK fixed telephone services, for Ofcom to review whether there is an opportunity to lift wholesale price controls. If UK customers are well served in terms of price and service, and this is reflected in very high levels of consumer satisfaction and competition, as evidenced by research by Ofcom and the Communications

Consumer Panel themselves, then Ofcom's declared ambition to remove unnecessary regulation would merit action.

UK telecoms policy is shaped within the EU single market. Britain is well placed to meet the newly announced EU targets of 100% broadband for all by 2013 and 100% high speed or mega high speed coverage by 2020. It remains key that the UK engages closely in the EU's work agenda and maintains the strength of the BIS and Ofcom teams leading in this field. Britain should also play a strong role in the telecoms regulatory network BEREC, the Body of European Regulators of Electronic Communications. Sadly the effectiveness of this body will not be helped by the EU Council decision to locate it in Riga, Latvia, far from its interlocutors in Brussels.



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