REVIEW OF THE WHOLESALE BROADBAND ACCESS MARKETS

EE Response to Call for Inputs dated 9 November 2012

2 January 2013

Non-confidential version

INTRODUCTION AND SUMMARY

As a substantial fixed provider, Everything Everywhere Limited ("EE") will be directly affected by Ofcom's ongoing reviews of the fixed electronic communications markets. We therefore welcome the opportunity to respond to this call for inputs ("CFI") regarding the review of the market for wholesale broadband access ("WBA") and note that we will be providing separate responses in relation to the related fixed market reviews, in particular in relation to Wholesale Local Access and Wholesale Fixed Analogue Exchange Lines.

EE broadly supports Ofcom's continuing use of the proposed analytical framework for this market review, which we understand is designed to:

(i) correctly assess the definition of the relevant economic markets (including delineation of sub-national geographic markets where divergences in competitive conditions are substantial enough to warrant this);

(ii) determine whether each market is prospectively competitive and whether any undertaking has significant market power ("SMP"); and

(iii) consider the necessity and appropriateness of any remedies imposed on operators with SMP, with the ultimate aim of giving the greatest benefits to consumers in terms of a mix of lower prices and faster innovation.

The key area where we consider Ofcom's existing policy requires refinement is in relation to the definition of the relevant markets and our comments below therefore focus on this topic. We reserve our position on making comments on other areas in response to the main consultation next year.

In summary, EE's position with respect to Ofcom's approach on market definition is that:

- we generally agree with Ofcom's definition of the WBA wholesale product market and do not consider that there have been significant changes which affect the existing parameters of the market. In this context, we would however note that the interpretation of the products that fall into the current SMP remedies in the WBA market should not continue to be limited to regulation of BT's IPStream Connect ("IPSC") product only, but <u>must be technology-neutral and be interpreted broadly enough to capture all wholesale broadband products</u> which currently exist, including Wholesale Broadband Connect ("WBC"), or which could be developed at some point during the charge control period;

- We believe that the SMP remedies imposed on BT in the WBA market (all geographic sub-markets) need to be strengthened, to ensure that BT fully complies with its non-discrimination obligations in the Wholesale Local Access Market. In particular, we believe that the current SMP Conditions which require BT to charge no more than the charge for the "Input Service" charged to it by Openreach in respect of BT's IPSC product in market 1 need to be extended to cover such "Input Services" into all WBA products supplied by BT in markets 1, 2 and 3;

- the approach on the geographic aspect of the market definition should be amended such that the key differentiating characteristic is whether a principal operator ("PO") other than BT is present in a particular exchange. We are of the view that the entry of a single PO apart from BT is sufficient to alter the market conditions to an appreciable extent and we would therefore suggest that there is no longer a need for the existence of a separate Market 2. Accordingly, the exchanges which currently fall within Market 2 should be re-defined, in most cases as falling into a new wider Market 3;
- since the 2010 WBA Review[1], there have been changes in the number of POs present at various exchanges which means that some exchanges are no longer in, or will soon need to be excluded from, Market 1 because they fall into markets with more competitive market conditions. We believe that there is a need for a mechanism to move these exchanges into the new wider Market 3 without the need to carry out a full market review so that the imposed remedies can reflect realities in the market on an on-going basis. Such additional flexibility would ensure that competition and innovation are promoted and not impeded by the necessary delays imposed by the market review cycle.

We deal with each of these points in turn below.

Product market definition should be technology-neutral

Between November 2006 and December 2010, BT had a voluntary commitment not to charge above a specified price ceiling for both its IPSC and WBC products[2].

When this voluntary commitment expired, following the 2010 WBA Review, in July 2011 Ofcom decided only to impose a mandatory charge control on the IPSC product in exchanges in Market 1 (where only BT was present).[3] At the time, 8Mbp/s was the maximum downstream speed available in Market 1 and IPSC was the only wholesale broadband product available from BT Wholesale in Market 1 and the main product used by end customers in Market1, so Ofcom concluded that charge controlling this product in Market 1 directly protected most consumers and constrained BT from excessive charging.

At the time of the 2010 WBA Review, when decisions in relation to the products that would fall into the relevant market definitions and SMP remedies were being made, there was limited penetration of BT Wholesale's faster WBC up-to-

[1]Ofcom, Review of the wholesale broadband access markets Statement on market definition, market power determinations and remedies, 3 December 2010 ("WBA Review").
[2] http://stakeholders.ofcom.org.uk/binaries/consultations/823069/summary/condoc.pdf at para 2.9
[3] Ofcom, WBA Charge Control Framework for WBA Market 1 Services, 20 July 2011 ("WBA Charge Control"), para 1.10

24 Mbit/s product in Market 3 only. WBC was not deployed in Markets 1 and 2,[4] with Ofcom further commenting that BT also had "no confirmed plans to deploy WBC in Market 1"[5]. Accordingly there was no need to consider whether WBC needed to be subject to any regulatory controls in market where BT had SMP.

The position has changed materially since the 2010 Review. BT has been involved in rolling out WBC to a very large number of exchanges,[6] some of which are in Market 1[7] where competition at the wholesale level is limited because BT is the only PO. In addition to this, EE understands that BT is now actively removing its IPSC offering from exchanges where WBC has been introduced and has stated an intention to stop supplying the IPSC product altogether and instead to only offer WBC.[8] This makes the position worse as the implication of such a strategy at these exchanges is that acquirers of wholesale broadband products like EE will be forced to deal with BT as the monopoly provider of one kind of wholesale broadband product which is not subject to price controls and in relation to which BT may choose to set excessive wholesale prices that are likely to ultimately be passed on to consumers.

Any arguments suggesting that the price control on IPSC can reasonably act as a market constraint on BT setting the price of WBC too high cannot be accepted as credible. This is because the 8 Mbit/s IPSC service does not adequately price constrain products with higher speeds, such as WBC, because it is not a full substitute for customers who have greater bandwidth requirements. In addition to this, such an assertion clearly does not hold true in exchanges where IPSC is no longer offered.

We also note that BT's original voluntary commitment referred to above, which was given on 10 November 2006 and expired on 31 December 2010, placed a floor and ceiling on the average revenue per user (ARPU) for wholesale broadband access which was set by use of a reference pricing model, which included both IPSC and WBC products. The purpose of the commitment was to provide price related protection for consumers in parts of the UK where wholesale broadband access competition was less likely to develop in the short term. BT clearly acknowledged in its commitment that the remedy is relevant to both products.[9]

The reason why price control is necessary in Market 1 is that BT is the only supplier of services in such exchanges and should therefore be subject to regulatory remedies to ensure that it does not set excessive prices. In our view,

[4] See 2010 WBA Review, at para 5.99.
[5] WBA Charge Control, at para 3.137.
[6] Around 1,400 exchanges, serving more than 18 million end users, have been enabled for WBC of up to 20Mbit/s service.
https://www.btwholesale.com/pages/static/Library/Network_Information/21CN_Broadband_Availibility/index.htm
[7] http://www.trefor.net/2011/07/27/latest-bt-adsl2-rollout-plans/
[8] As BT Wholesale expands the footprint for advanced copper broadband, as previously advised, it will gradually withdraw its legacy broadband products. For example, IPstream will be retired within the advanced copper broadband footprint by Spring 2014, as more and more customers are migrated onto more advanced services, see http://www.trefor.net/2011/07/27/latest-bt-adsl2-rollout-plans/
[9] See Ofcom Proposals for WBA charge control, Consultation document and draft notification of decisions on charge control in WBA Market 1, consultation on the WBA charge control, January 2011 at para 2.9.

regardless of the wholesale product that is being offered or the technical solution used in order to deliver that product, all products supplied from the exchanges that fall into the definition of Market 1 should be subject to remedies, including price controls.

The WBA Charge Control does not specifically refer to WBC as a product in relation to which regulatory remedies should apply, most likely because at the time the document was issued Ofcom was not aware of BT's deployment strategy in relation to WBC in Market 1. However, given that the characteristics of Market 1 are such that, absent regulation, BT will be able to set prices at potentially excessive levels, we believe that BT cannot be allowed to continue its strategy of pricing WBC products on the basis of unregulated commercial terms because this goes against the principles upon which the price controls were introduced in Market 1 in the first place. Indeed, to the extent that BT will be the only supplier of a service in a particular area, all wholesale broadband products should be regulated under the same principles regardless of what new technologies are introduced in the future.

Consistent with Ofcom's obligations under section 4(6) of the Communications Act 2003, the interpretation of the regulated products that fall into Market 1 must be technology-neutral and be interpreted broadly enough to capture all wholesale broadband products, without favouring one means of access over another.

Ensuring compliance with BT's non-discrimination obligations in the Wholesale Local Access Market

Currently, the charge control that Ofcom has set for BT's IPSC product in Market 1 provides an important protection against discrimination for CPs who consume that product, by obliging BT to charge no more than the charge for the "Input Service"10 charged to it by Openreach. Accordingly, when Ofcom mandates a change to the charges for these Input Services and/or when Openreach otherwise changes the prices for these Input Services, these changes automatically flow through to BT's downstream IPSC customers.

However, this is not the case in relation to BT's other WBA products – such as WBC. For example, there have recently been significant changes to Openreach's cease and connection charges for its Shared Metallic Path Facility ("SMPF") services, which have not been reflected in equivalent changes to the charges that BT passes on to its WBC customers for the very same Input Services. This situation in turn enables BT to discriminate in favour of BT Retail, to the detriment of BT's WBC customers. Given that BT has SMP in the supply of SMPF services throughout the UK (except in Hull), EE considers that this loophole needs to be addressed in the next set of SMP remedies imposed on BT in the WBA market. Specifically, EE believes that BT must be required to

[10] Any service provided by BT to itself and made available to other parties, which BT uses as a specific input into the IPSC product.

pass through to its WBA customers any changes in the prices charged to it by Openreach for BT's regulated upstream Input Services, in respect of all WBA products and in respect of all geographic sub-markets. EE considers that this change is necessary to achieve technology neutrality (e.g. no favouring of direct SMPF based competition over WBA based competition); that it will promote competition and the interests of end-user customers of CPs who consume BT's WBA products, and at the same time will be proportionate - as it should not be expected to entail any kind of undue burden for BT to implement.

No need for a separate Market 2

Ofcom's approach has been to separate exchanges into various sub-markets in order to reflect the differing levels of competitive conditions present in different geographic areas. We generally agree with this approach, but do not think that there is any longer a need to have a separate Market 2. This is because EE believes that it is sufficient to stimulate viable competition in the supply of wholesale broadband access services in a particular geographic sub-market for there to be at least two POs present (i.e. BT plus at least one other PO).

Ofcom acknowledged in the 2010 WBA Market Review that a "natural break" in competitive conditions occurs when two (or more) POs become present at an exchange, and that such exchanges can be regarded as different from those where BT is the only PO present[11]. Ofcom's conclusions in this respect followed from a detailed analysis in:

- patterns in PO coverage;
- market shares (including the potential for increases based on the migration of customers a PO supplies via WBA wholesale inputs in an exchange it has unbundled); and
- barriers to entry and the potential for future LLU rollout.[12]

EE considers that the entry of a single PO apart from BT is sufficient to alter the non-competitive market conditions in Market 1 to an appreciable extent, which would suggest that there is no longer a need for Ofcom to define a separate Market 2 (rather just Markets 1 and 3).[13].

[✂] [✂]

Finally, the reduction from three to two in the number of markets that are subject to different types of regulatory assessment is consistent with Ofcom's policy objective of reducing the burden of regulation, particularly where there is

---

[11] WBA Review, at para 3.86.
[12] WBA Review, at para 3.86.
[13] Such an approach is a consistent with the European Commission Recommendations on Next Generation Networks of 20 September 2010 (2010/572/EU). For example, in para 9 the Recommendations provide that "*NRAs should examine differences in conditions of competition in different geographical areas in order to determine whether the definition of sub-national geographic markets or the imposition of differentiated remedies are warranted. Where divergences in the conditions of competition are stable and substantial, NRAs should define sub-national geographic markets in accordance with Recommendation 2007/879/EC. In other cases, NRAs should monitor whether the deployment of NGA networks and the subsequent evolution of competitive conditions within a geographically defined market warrant the imposition of differentiated remedies*."

scope for effective competition. It also simplifies the approach with respect to the different remedies that need to be applied to these markets – it is simpler to monitor one set of remedies which apply to Market 1 than two sets of different remedies that apply to Markets 1 and 2

EE therefore considers that the exchanges which currently fall within Market 2 (a total of 660 exchanges) should be re-defined, most likely to fall into a new wider Market 3 because a minimum of at least 652 of these exchanges have both BT and at least one of TalkTalk, Virgin, O2 or Sky present.

Need to be able to move exchanges between various markets

A number of exchanges have been listed as falling into Markets 1, 2 and 3 in Appendices 1, 2 and 3 of the 2010 WBA Review. However, there have been changes in the number of POs present at a number of these exchanges, which means that some are no longer in Market 1, but fall into markets with more competitive market conditions.

EE has witnessed other operators moving into exchanges that are defined as Market 1 by the 2010 WBA Review. Out of a total of 3,389 exchanges in that geographic market, 569 now have at least one PO other than BT present (e.g. Sky, TalkTalk, Virgin or O2) and we believe that these need to be considered as belonging to a new wider Market 3 on the basis of the approach described above[14]. The remaining exchanges in Market 1 have only BT as present and should continue to be subject to a charge control.

In addition to this, EE is aware that other operators (principally TalkTalk) have ongoing plans to unbundle further exchanges, and once this occurs, we believe that there is a need for a mechanism to move these into the new wider Market 3 without the need to carry out a full market review, so that the imposed remedies can reflect realities in the market on an on-going basis. Otherwise regulation will lag behind the market, which is likely to impede investment and competition.

For example, we would suggest that a mechanism for changing the market designation of a particular exchange as more POs move in could include a requirement for either BT or the operator that unbundles a new exchange in Market 1 to notify Ofcom so that Ofcom can change the designation of the exchange accordingly. Once Ofcom has been made aware that another PO has unbundled a Market 1 exchange we do recognise that it would be appropriate to allow that operator a short grace period before the exchange was moved to Market 3. In our view this would assist in recouping capital expenditure, and should be expected to last no longer than 6 months.

[14] There are currently 1540 exchanges in Market 3 and we believe that all have at least one of Sky, TalkTalk, Virgin or O2 present and therefore should remain in Market 3.