



Review of the wholesale fixed analogue exchange lines markets

Consultation on the proposed markets, market
power determinations and remedies

Consultation

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Section 1

Summary

Purpose of this document

- 1.1 This consultation examines the extent to which the competitive conditions operating in the wholesale fixed analogue exchange line markets have changed since late 2009, and how we see them developing in the period up to April 2014. In so doing, we set out our proposals on the definition of the relevant economic markets, the current and likely future competitive conditions operating in those markets and the regulatory remedies which we consider are needed to address the competition issues that we have identified.
- 1.2 In reviewing these markets we are seeking to establish whether there is sufficient competition in the supply of fixed analogue exchange lines at the wholesale level to enable us to remove the *ex ante* wholesale regulation we currently impose. Our ultimate goal is to protect consumers' interests by introducing appropriate regulation where our assessment shows that competition, by itself, is insufficient. This will help to ensure that consumers do not have to pay excessive prices for these services, and that they have more choice.

Background

- 1.3 Wholesale fixed analogue exchange lines are a key input to the fixed telephone services that are provided to residential and business consumers. This market review is therefore important to consumers as the cost and reliability of wholesale fixed analogue exchange lines will be reflected in the retail products provided to consumers.
- 1.4 We last concluded a review of this market in September 2009 in our Review of the fixed narrowband services wholesale markets ¹ ("the September 2009 Wholesale Review"). In that review we imposed a range of general network access and non-discrimination obligations on BT and KCOM, based on findings of significant market power ("SMP"). In addition to these general conditions, we also set a specific SMP obligation on BT to supply analogue wholesale line rental ("WLR") at a controlled charge. The current WLR charge control applying in this market expires at the end of March 2011 and we consider it necessary to review this market now in order to determine whether SMP regulation remains appropriate, and where we consider it is required what form it should take. This includes an assessment of whether a new WLR charge control is needed beyond March 2011.
- 1.5 In the September 2009 Wholesale Review, we also reviewed the wholesale narrowband call origination, call termination, conveyance, transit and ISDN2 exchange lines markets. However, this review is not considering any of these markets and is only concerned with the wholesale fixed analogue exchange line market.

¹http://stakeholders.ofcom.org.uk/binaries/consultations/wnmr_statement_consultation/summary/main.pdf

Summary of proposals

- 1.6 Since the September 2009 Wholesale Review there have only been a limited number of developments that have impacted competition in this market and we do not consider that these developments require us to reach a different conclusion to that reached previously.
- 1.7 We are proposing that the product and geographic market definitions remain the same. That is,
- Wholesale fixed analogue exchange lines in the UK (excluding the Hull area); and
 - Wholesale fixed analogue exchange lines in the Hull area.
- 1.8 We further propose to find that BT retains SMP in the UK (excluding the Hull area) and that KCOM retains SMP in the Hull area.
- 1.9 We propose to maintain the current remedies on BT and KCOM. We are also proposing to introduce a new obligation on KCOM to create a Statement of Requirements (“SOR”) process, which we consider will provide additional transparency for potential entrants into the Hull market.

Consultation

- 1.10 We invite comments from interested parties on the proposals in this document. The consultation period runs for one month, to 18 November 2010. Following consideration of responses to the consultation we would expect to publish our conclusions before the end of 2010.

Section 2

Introduction

Scope of this consultation

- 2.1 This consultation document considers the market for the provision of wholesale fixed analogue exchange line services in the UK in the three and a half year period to April 2014.
- 2.2 Analogue exchange lines provide a narrowband connection (typically a single 64 kbit/s channel) from a customer's premises to a local aggregation point (e.g. local exchange) in the access network. Wholesale fixed analogue exchange lines are intermediate products that are sold to communications providers ("CPs") to enable them to offer network access to residential and business retail consumers. In turn, this access service provides consumers with the capability to consume other narrowband services in the form of telephone calls, facsimile and dial-up internet access. The demand for wholesale analogue exchange line services is therefore derived from the demand from retail consumers for fixed narrowband analogue access.

Background

- 2.3 This review builds on, and is further to, the analyses that we carried out in the September 2009 Wholesale Review, which concluded that:
- BT had significant market power ("SMP") in the wholesale fixed analogue exchange lines market in the UK (excluding the Hull area); and
 - KCOM had SMP in the wholesale fixed analogue exchange lines market in the Hull area.
- 2.4 In order to remedy the identified SMP we imposed a range of general network access and non-discrimination obligations on BT and KCOM. In addition to these general SMP conditions, we also set a specific SMP obligation on BT to supply a wholesale line rental ("WLR") product that would be subject to a charge control.
- 2.5 The precise form, structure and term of the WLR charge control was subject to a separate consultation² and subsequent statements³. Specifically, in July 2009, we sought stakeholder views on our proposals:
- to replace the charge controls on Residential and Business WLR with a single control for a core WLR service (a slightly modified form of WLR Basic), and to introduce price controls for some related services, namely WLR line transfers and new connections; and

² *Charge controls for Wholesale Line Rental and related services*, Consultation, 3 July 2009, at <http://stakeholders.ofcom.org.uk/binaries/consultations/wlrcc/summary/wlrcc.pdf>

³ *Charge controls for Wholesale Line Rental and related services*, Statement and consultation, 26 October 2009, at <http://stakeholders.ofcom.org.uk/binaries/consultations/wlr/summary/wlrcondoc.pdf>, and, *Charge controls for Wholesale Line Rental – implementation and cost orientation*, second statement, 23 February 2010, at http://stakeholders.ofcom.org.uk/binaries/consultations/wlr/statement/wlr_statement.pdf

- to provide BT with the flexibility to offer higher service levels at an additional charge that are not subject to its cost orientation obligation.
- 2.6 In setting the WLR charge control we said that we considered it was appropriate to ensure consistency between the WLR and Local Loop Unbundling (“LLU”) (MPF and SMPF) charge controls, and to align them by setting a common start date and term. For those reasons we set an expiry date of the end of March 2011 for the current WLR charge control⁴, so that it would align with the LLU charge control expiry date. In reaching that decision we recognised that:
- in setting a control that is designed to end during the course of a market review forward look, we would need to consider setting a further appropriate control for the remainder of the review period; and
 - we would need to look again at the competitive conditions in the market before setting any new WLR charge control on BT, given that we could not predict with certainty how those conditions might change.⁵
- 2.7 In order to establish whether the competitive conditions have changed in the intervening period since the September 2009 Wholesale Review and whether they are likely to do so over the forecast period we have chosen to review the wholesale fixed analogue exchange lines market again. As our proposed findings are not substantively different to those reached in the September 2009 Wholesale Review, we consider that a one month period for consultation is appropriate.
- 2.8 When conducting this review, we have followed the standard analytical framework we use to define markets and assess whether any of the undertakings operating in the market have SMP. The details of the process that we have followed in defining the relevant market, assessing whether any undertaking has SMP on those markets, and identifying appropriate SMP remedies is set out in Annex 5. We have also detailed the regulatory framework that underpins the market review process in Annex 6.
- 2.9 The wholesale fixed analogue exchange lines market is not listed as one of the markets the European Commission identifies in its recommendation on markets (“the Recommendation on Markets”) for review by national regulatory authorities (“NRAs”). However, as in 2009, we consider it appropriate to review this market, given our provisional conclusions that:
- barriers to market entry remain high and non transitory. Since the source of those barriers remain (see paragraphs 4.7 to 4.9 and 4.17) we do not see the prospect for competition developing to any significant degree;
 - based on an assessment of the state of competition, behind the barriers to entry, the dynamics operating in the market suggest that there is no tendency towards effective competition within the relevant time horizon (see paragraph 4.27); and
 - it would not be sufficient to rely on competition law alone to address the competitive failures that arise where SMP is evident (see paragraph 5.5).

⁴ See paragraphs 3.62-3.66 and section 7 of *Charge controls for Wholesale Line Rental and related services*, Statement and consultation, 26 October 2009 at

<http://stakeholders.ofcom.org.uk/binaries/consultations/wlr/summary/wlrcondoc.pdf>

⁵ *Ibid*, paragraph, 8.81-8.81

- 2.10 For the reasons given above we believe that the three criteria test that the European Commission applies to markets that are susceptible to SMP regulation set out in the Recommendation on Markets have been met in the wholesale fixed analogue exchange lines market.
- 2.11 To assist us with this market review we sent formal information requests to BT, KCOM and a number of other CPs asking for information about their historic and forecast demand for wholesale analogue exchange line services. This provided the basis for our assessment of market shares, which provide a prima facie structural indicator of SMP. Our assessment has also been informed by our provisional and final conclusions in other relevant markets (the Review of wholesale local access markets (“WLA”),⁶ the Review of wholesale broadband access markets (“WBA”),⁷ and the Review of retail and wholesale ISDN30 markets (“the August 2010 ISDN30 Review”)⁸). We did not consider it necessary to conduct additional consumer research to inform our view of the retail fixed narrowband analogue access market, from which demand at the wholesale level is derived. Instead, we have relied on the research undertaken at the end of 2008 for our review of Fixed Narrowband Retail Services Markets (“the September 2009 Retail Review”),⁹ but have reassessed this research in light of subsequent market developments to ensure that the conclusions remain valid.
- 2.12 The period used for this forward look should reflect the specific characteristics of the market and the expected timing of the next review. In this market review, we have looked at potential developments over the next three and a half years. The forward look period that we have used allows for the possibility of the next review taking place within that timeframe. In determining when to undertake the next review, we will consider the new procedures and timeframes for conducting market reviews introduced by the amendments to the EU regulatory framework. Those requirements will apply in the UK from May 2011.

Impact assessment

- 2.13 We use impact assessments as a framework for assessing different options for regulation and determining which option should be preferred. They also provide a mechanism for assessing whether our proposals are likely to have a differential

⁶ *Review of the wholesale local access market: Consultation on market definition, market power determinations and remedies*, Consultation, 23 March 2010, at <http://stakeholders.ofcom.org.uk/binaries/consultations/wla/summary/wlacondoc.pdf>, and *Review of the wholesale local access market: Statement on market definition, market power determinations and remedies*, Statement, 7 October 2010, at <http://stakeholders.ofcom.org.uk/consultations/wla/statement>

⁷ *Review of the wholesale broadband access markets : Consultation on market definition, market power*, Consultation, 23 March 2010, at <http://stakeholders.ofcom.org.uk/binaries/consultations/wba/summary/wbacondoc.pdf> determinations and remedies <http://stakeholders.ofcom.org.uk/binaries/consultations/wba/summary/wbacondoc.pdf>

⁸ *Review of retail and wholesale ISDN30 markets: Statement on the markets, market power determinations and remedies*, Statement, 20 August 2010, at <http://stakeholders.ofcom.org.uk/binaries/consultations/isdn30/statement/statement.pdf>

⁹ *Consumer Preferences in Narrowband Communications, Research Report, Research Document*, 19 March 2009, at http://stakeholders.ofcom.org.uk/binaries/consultations/retail_markets/annexes/consprefs.pdf and *SME Preferences in Narrowband Communications, Research Report, Research Document*, 19 March 2009, at http://stakeholders.ofcom.org.uk/binaries/consultations/retail_markets/annexes/smeprefs.pdf

impact on one or more groups of business, consumers or citizens.¹⁰ As explained in Annex 6, the analysis presented in this document represents an impact assessment, as defined in Section 7 of the Communications Act.

Equality Impact Assessment

- 2.14 In addition to assessing the economic impact of our proposals, we have also considered whether our proposals might impact on race, disability and gender equality. This is to ensure that we meet our duty of furthering the interests of citizens and consumers regardless of their background or identity.
- 2.15 Having considered the potential distributional impact of our proposals, we have taken the provisional view that our proposals will not be to the detriment of any group within society. In particular, we do not consider that they will have a differential impact on consumers in different parts of the UK or on consumers with low incomes.
- 2.16 In addition, we do not believe that the policy proposals set out here, which primarily affect wholesale markets, would have a different impact in relation to people of different gender or ethnicity compared to consumers in general. As a result, we have not carried out separate assessments in relation to race or gender equality, or equality schemes under the Northern Ireland and Disability Equality Schemes.

¹⁰ http://www.ofcom.org.uk/consult/policy_making/guidelines.pdf

Section 3

Market definition

Introduction

3.1 The purpose of this section is to define the product and geographic boundaries of the market in which we need to assess whether any firm has SMP. This section is structured as follows:

- A summary of our proposals;
- A discussion of some of the key characteristics of the market;
- Our analysis of the relevant product markets; and
- Our analysis of the relevant geographic markets.

Our proposals

3.2 We are proposing to conclude that there are two separate wholesale fixed analogue exchange lines markets in the UK, distinguished by geography area. The two markets are:

- Wholesale fixed analogue exchange lines in the UK (excluding the Hull area); and
- Wholesale fixed analogue exchange lines in the Hull area.

3.3 This is the same market definition that we adopted in 2009. We are proposing to reach this conclusion having assessed the market taking into account key market developments that we have observed since we published the September 2009 Wholesale Review. These are:

- the increasing use of mobile-only access by retail consumers;
- the increasing use of LLU; and
- the deployment of NGA.

Key characteristics of the market

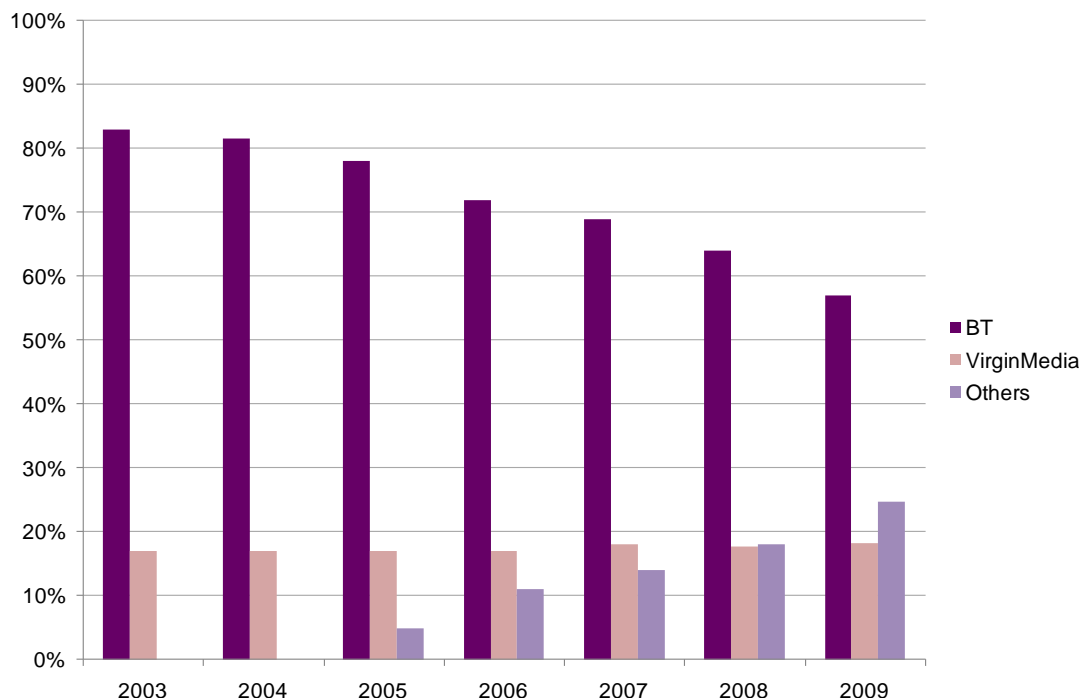
3.4 Analogue exchange lines are the most common type of access provided to residential and small business premises¹¹ in the UK and are delivered in the following ways:

¹¹ Although smaller business users share many of the characteristics of residential users, small and medium sized enterprises (SMEs) and larger business customers differ. These larger businesses often have a requirement for multiple lines across sites, with the exchange lines often needing to support advanced service features. They will often meet those needs using digital access (ISDN2 and ISDN30) solutions and with large and corporate customers using fibre based solutions.

- in the UK outside of Hull, BT provides analogue exchange lines via its copper access network. This network is also used to deliver broadband services;
- in the Hull area, KCOM provides analogue exchange lines via its copper access network. As with BT, the KCOM network is also used to deliver broadband services;
- in areas where Virgin Media has deployed its cable network, Virgin Media delivers analogue exchange lines using this network. This service is delivered using a copper based access network (as for BT and KCOM) which shares the same duct as the hybrid fibre/coaxial network used to deliver Virgin Media's cable TV and broadband services. Virgin Media's cable network is available to approximately 46% of UK premises;¹²
- in areas where LLU is in use, operators take over BT's copper loops and can provide analogue exchange lines directly to consumers. Providers offering both narrowband and broadband service via LLU cover approximately 84% of UK households.

3.5 In the September 2009 Retail Review we found that the delivery of those exchange lines to end customers was competitive. Furthermore, key in delivering competitive retail prices and choice to both residential and business customers was a package of effective regulatory measures operating at the wholesale level. As shown in Figure 3.1, BT's retail level market share has continued to reduce over time.

Figure 3.1: Market shares in the residential fixed narrowband analogue access market



Source: Ofcom/CPs

¹² See Figure 1.1 of our *Communications Market Report*, Research Document, 19 August 2010, pp. 16, at http://stakeholders.ofcom.org.uk/binaries/research/cmr/753567/CMR_2010_FINAL.pdf

Market definition

- 3.6 In this section we consider the wholesale fixed analogue exchange lines market. Included within this market is the wholesale input which is used by CPs in order to provide retail customers with line rental and access to other narrowband telephony services. This provides customers with the capability to access:
- voice calls;
 - facsimile services; and
 - dial-up data services (internet access with bandwidth capable of data transfer speeds of up to 56 kbit/s).
- 3.7 The market definition is formulated on the basis of the service provided and not the underlying technology used to deliver it. This means that the wholesale analogue exchange lines market is defined independently of whether the service is delivered over cable, the access networks of BT or KCOM (in the Hull area) including LLU, or any other fibre or wireless technology.
- 3.8 Before considering the wholesale level, we first consider the relevant retail market(s). We do this because the demand for wholesale services is derived from the demand for retail services. This market definition exercise is not an end in itself. Rather, it enables us to establish the product and geographic boundaries over which we can assess whether any firm has SMP. In formulating our proposals we have taken utmost account of the Recommendation on relevant product and services markets¹³ (“the Recommendation”)¹⁴, the Explanatory Memorandum¹⁵ and the SMP Guidelines¹⁶.

Retail market

- 3.9 For our retail market definition assessment, we have drawn on the analysis carried out for the September 2009 Wholesale and Retail Reviews. We then considered the

¹³ Commission Recommendation of 11 February 2003 on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communication networks and services, 2003/311/EC, OJ L114, 8.5.2003, p.45, at http://ec.europa.eu/information_society/topics/telecoms/regulatory/publicconsult/documents/relevant_markets/l_11420030508en00450049.pdf

¹⁴ Commission Recommendation of 17 December 2007 on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services, Official Journal of the European Communities, L 344, 28/12/2007, p. 65-9, at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:344:0065:0069:en:PDF>

¹⁵ Explanatory Memorandum to the Commission Recommendation of 17 December 2007 on relevant Product and Service Markets, Commission Staff Working Document, SEC(2007) 1483 final, Brussels, at

http://ec.europa.eu/information_society/policy/ecomm/doc/library/proposals/sec2007_1483_final.pdf

¹⁶ Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services, Official Journal of the European Communities, C165, 11/7/2002, p 6-31, at:

http://ec.europa.eu/information_society/topics/telecoms/regulatory/new_rf/documents/smp_guidelines/c_16520020711en00060031.pdf

extent to which this assessment should change in the light of market developments since 2009.

The September 2009 Retail Review

3.10 In the 2009 Retail Review we concluded that there were two separate product markets.

- Residential fixed narrowband analogue access; and
- Business fixed narrowband analogue access.

3.11 We also concluded that there were two separate geographic markets:

- The UK (excluding the Hull area); and
- The Hull area.

3.12 In reaching these conclusions, we considered that:

- **Mobile and fixed access are separate markets** – Our research evidence showed that 79% of consumers consider mobile and fixed line access to be largely complements, rather than substitutes. Furthermore, while 91% of consumers had a mobile phone the number choosing mobile-only access stood at 12% - having grown at around 1% each year since 2003. This relatively slow growth of mobile-only households was despite the fact that the estimated cost of mobile services declined by 45% over the period compared with a more modest decline in the price of fixed landline services of 18%. However, it was also evident that, were prices of mobile access and calls to fall significantly, a sizeable minority (33%) of residential consumers stated that they would be prepared to move to a mobile-only access solution. That was not the case however for business consumers, who reported greater reticence in moving to a mobile-only service. For that group only 24% said they would switch to a mobile-only solution, even if the price differential between fixed and mobile was eliminated.¹⁷
- **Alternative forms of network infrastructure used to offer fixed narrowband analogue access are in the same market** – Responses to our consumer research suggested that consumers considered alternative forms of fixed access provision such as the services provided using a cable network or LLU to be in the same market.¹⁸
- **Narrowband and broadband access services are in separate markets** – We found that while there are broadband only offers available from some suppliers (such as Virgin Media), customers viewed narrowband and broadband as complements rather than substitutes.¹⁹

¹⁷ *Consumer Preferences in Narrowband Communications: Research Report*, Research Document, 19 March 2009, at

http://stakeholders.ofcom.org.uk/binaries/consultations/retail_markets/annexes/consprefs.pdf and *SME Preferences in Narrowband Communications: Research Report*, Research Document, 19 March 2009, at http://stakeholders.ofcom.org.uk/binaries/consultations/retail_markets/annexes/smeprefs.pdf

¹⁸ http://stakeholders.ofcom.org.uk/binaries/consultations/retail_markets/annexes/consprefs.pdf

¹⁹ In particular, see the September 2009 Wholesale Review, paragraph 5.51, pp. 43.

- **Fixed narrowband access and calls are in separate markets** – Our research evidence indicated that, while in practice many residential and business customers buy access and calls together they often considered the two to be independent when making actual purchasing decisions.²⁰
- **Digital (ISDN2) and analogue access are in separate markets** – Our analysis indicated that there is limited consumer substitutability between retail analogue exchange lines and ISDN2. In particular consumers largely consider that the two forms of access offer different functional capabilities at distinct price points and therefore consider the two to be in separate product markets.²¹
- **The supply of residential analogue and business analogue access are in separate markets** – We observed that while the boundaries between residential and business tariffs were becoming blurred,²² CPs actively discriminate between those consumers on the basis of volume of calls (particularly for high usage customers) and the services provided.²³ We also took the view that supply-side substitution between the residential and business sectors was likely to be limited because of the relative high marketing costs needed to identify and sell to the relevant customer base. More generally, we found that the structure and nature of competition in the two sectors was different.
- **There is a single UK geographic market (excluding the Hull area) and a separate geographic market in the Hull area** – We recognised that on the demand-side customers are only able to choose between CPs that operate in their geographic area. Their ability to switch between different operators may therefore be limited particularly where a consumer lives in an area that is not served by cable or LLU. However, we noted that all operators have national uniform pricing policies and national marketing campaigns so competition on the

²⁰ Our 2008 residential survey indicates that in the majority of cases (88%) access and calls were purchased in combination but with a significant minority (38%) of customers who buy access or calls from BT considering the two to be separate purchase decisions, and 24% of consumers who buy both from rival suppliers of BT expressing the same view. These views were also reflected in consumer responses when questioned on how they would behave in response to a hypothesised 10% price rise in BT's access pricing. Similarly, our survey evidence indicated that while SME business customers make purchasing decision on the total cost of access and calls, the majority regard the two as separate products and are prepared to switch either access or calls products or both in response to changes in relative prices.

²¹ An analogue line provides a single line that can be used for voice, facsimile and narrowband data traffic, with only one service used at a time. In contrast, ISDN2 provides two digital 64kbit/s channels and a 16 kbit/s data channel. The ISDN2 service provides the capability for simultaneous internet access and voice telephony, supports a much wider range of supplementary services (e.g. Digital Select Services and DDI), and is necessary to support the function of many PBXs. The ISDN2 service can therefore be used for voice communications, at locations where a voice and a data channel is required, for some specific low bandwidth data applications where availability and reliability is essential and for providing management capabilities in higher bandwidth networks.

²² This was evident in tariffs such as 'BT Anytime', becoming increasingly similar in structure to lower-end business tariffs. This reflects the increasing trend of communications providers to offer a greater range of residential tariffs to appeal to different customer types. Similarly, BT and others, further expand the choice of tariffs by offering residential customers the opportunity to purchase some of the value-added services usually included in business packages, such as call-waiting, for an additional monthly fee.

²³ For example, any business making an occasional long duration call to a UK mobile or to an international landline is likely to be better off using the business tariff. A single 30 minute call to a UK mobile each month would cost £2.20 on BT Anytime compared to 25p on BT Business Plan. There are also potentially important quality differences e.g. the higher level of customer service offered.

supply-side of the market has a clear national dimension.²⁴ The exception is Hull, where the main UK based retailers, including BT, currently do not offer a competing residential retail service (there is no cable, LLU, or WLR). Cable and Wireless do however provide a competing indirect access service in the business market using leased lines. For the residents of Hull there is no effective demand-side substitution, while supply-side substitution from the rest of the UK is limited by the absence of alternative access infrastructure.

Our forward look out to 2013

3.13 In the September 2009 Retail Review we considered whether foreseeable technical and commercial developments might affect one or more aspects of the above assessment over the period until the end of 2013. In particular, we made the following observations.

In the UK area (excluding the Hull area):

- The number of mobile-only households is likely to continue to grow slowly, and fixed and mobile access will remain largely complementary;²⁵
- LLU and cable are likely to continue to offer recognised substitution possibilities for customers; and
- Given current deployments, NGA is unlikely to provide an effective substitute for access to traditional fixed networks during the period.

In the Hull area

- While many of the trends observable elsewhere in the UK apply equally to the Hull area, there currently appears to be limited appetite for competing CPs to enter the Hull area given the limited size of the market.

Our 2010 retail market definition

3.14 We now assess how the retail market has developed since the September 2009 Retail and Wholesale Reviews and how it is likely to develop in the period to April 2014.

Mobile and fixed access are in separate markets

3.15 The proportion of mobile-only households continues to grow at just over 1% per year and in Q1 2010 the proportion grew to 14% (from 12% in 2008). However, the overwhelming majority (78%) of UK households continue to purchase both fixed and mobile access.

²⁴ One caveat is that the Talk Talk Group (“TTG”) has certain tariffs which offer lower prices to customers who are able to be served by LLU.

²⁵ While the trend in mobile-only households (driven both by the demand for calls and improvements in broadband access performance) is likely to continue it is likely to remain a relatively small proportion of the access choices consumers make. We expected that fixed and mobile access would remain complementary, with the underlying demand drivers for retaining fixed to continue to be relatively strong (e.g. security, reliability and convenience). See Section 1.3 in, *Consumer Preferences in Narrowband Communications*, Research Document, 19 March 2009, at http://stakeholders.ofcom.org.uk/binaries/consultations/retail_markets/annexes/consprefs.pdf

- 3.16 The growth in the number of mobile-only households continues at the rate anticipated in the September 2009 Retail Review, with the clear majority of UK households still choosing to purchase both mobile and fixed access together. We expect to see the number of mobile-only households increase in the period to April 2014.²⁶ However, the case for many residential and business consumers to retain fixed access is likely to remain strong.²⁷ For these reasons we are proposing to find that fixed and mobile access are in separate markets.

Fixed access and calls are in separate markets

- 3.17 We are intending to reach the same conclusion as in the September 2009 Retail Review, that access and calls are in separate economic markets. While there is evidence that consumers are increasingly choosing to purchase bundles of communications services,²⁸ we believe that our previous consumer research, which indicated that consumers consider access and calls separately, remains valid.²⁹

Digital narrowband access services (ISDN2 and ISDN30³⁰) are in separate markets

- 3.18 We do not consider that any of the factors, e.g. price and technical characteristics, of ISDN2 have changed in a way that would cause us to alter our previous conclusion that fixed narrowband analogue access and ISDN2 access are in separate markets. In particular:

- BT's current retail ISDN2 price is £93.06 per quarter³¹ (compared to £90.78 per quarter in 2009). This price rise further increases the analogue/digital differential; and
- ISDN2 provides the same functional advantages³² over analogue access that we discussed in the September 2009 Retail Review.

²⁶ This trend is likely to be driven, in particular, by those residential consumers in the DE socio-economic grouping, who value the relative ease in obtaining network access, specific contract methods (allowing people to control their spending) and packages that are cheapest for people that make a limited number of calls. Furthermore, mobile access also offers consumers a broadband-like capability enabling them to access the internet. See, *Communications Market Report*, August 2010, p. 336-7, at http://stakeholders.ofcom.org.uk/binaries/research/cmr/753567/CMR_2010_FINAL.pdf, and *The consumer experience: Research Report, Research Document*, 9 December 2009, p. 20, at <http://stakeholders.ofcom.org.uk/binaries/research/consumer-experience/research09.pdf>, and

²⁷ In particular, although overall satisfaction with mobile telephony service remains high, satisfaction with access to the network (a key element in reliability of access) is lower than it is for the service in aggregate. See Figures 5.78 and 5.79, pp. 344-5, in http://stakeholders.ofcom.org.uk/binaries/research/cmr/753567/CMR_2010_FINAL.pdf. Historically, consumers have consistently reported greater satisfaction with the reliability of fixed than their ability to access the mobile network.

²⁸ *Communications Market Report*, Research Document, 19 August 2010, at http://stakeholders.ofcom.org.uk/binaries/research/cmr/753567/CMR_2010_FINAL.pdf, and *Strategic review of consumer switching: A consultation on switching processes in the UK communications sector*, Consultation, 10 September 2010, at <http://stakeholders.ofcom.org.uk/binaries/consultations/consumer-switching/summary/switching.pdf>

²⁹ We note that, even if the retail market were to be defined to include both access and calls, this would not fundamentally affect our wholesale market definition. Specifically, wholesale access is an essential input for providing a retail access product and a retail access and calls product.

³⁰ The August 2010 ISDN30 Review concluded that ISDN30 is a separate market at the retail level.

³¹ This is the price for BT's ISDN2e for premises with 2-8 channels (each channel being 64 Kbit/s) <http://business.bt.com/phone-services/phone-lines-and-calling-plans/isdn/pricing/>

- 3.19 While we did not conclude on the retail digital ISDN30 access market in the September 2009 Retail Review we did subsequently review that market (along with the ISDN30 wholesale market) in the August 2010 ISDN30 Review, where we concluded that a separate retail market exists for ISDN30.³³ Specifically, our analysis indicated that for a number of reasons, mainly the price and technical characteristics of the product,³⁴ analogue access services are not effective demand-side or supply-side substitutes for ISDN30. We do not consider it necessary to revisit that here as the market review concluded less than two months ago.

Alternative forms of network infrastructure used to offer fixed analogue exchange line access are in the same market (including current generation and next generation access)

- 3.20 We believe that consumers continue to consider fixed narrowband analogue access services to be substitutes, regardless of the underlying network technology. We would note that since the September 2009 Retail Review the cable operator, Virgin Media, has maintained its share of analogue exchange lines while LLU operators have significantly increased their share. We therefore consider that alternative forms of network infrastructure used to offer fixed narrowband analogue access services (e.g. cable and LLU) are in the same market.
- 3.21 The term NGA is commonly used to describe technological upgrades to current generation access (“CGA”) networks. These upgrades are predominantly intended to support higher speed broadband services. At the time of the September 2009 Retail Review Virgin Media had upgraded its entire cable access network to DOCSIS 3.0 and BT had announced plans to upgrade 40% of its network, using a combination of FTTC³⁵ and FTTP³⁶, by the end of 2012. Since the September 2009 Retail Review BT has deployed FTTC to about 2 million homes (approximately 7% of its network) and has announced an extension to its original plans – it now plans to upgrade 66% of its network by 2015³⁷.
- 3.22 As set out in the September 2009 Retail Review we do not expect these NGA deployments to have a significant effect on the market for narrowband analogue access services. This is because Virgin Media’s DOCSIS 3.0 upgrade and BT’s FTTC upgrade only affect their broadband services - the narrowband service is unaffected. In the case of BT’s FTTP upgrade, this is currently intended to be deployed as an overlay to its existing ‘copper’ network. Thus, customers can continue to purchase the current narrowband services. However, it is possible that the narrowband service could be delivered over the FTTP network, using an analogue terminal adaptor (“ATA”). Whilst the underlying technology would have changed the service presented to the end user would be broadly the same. In line with our technology neutral approach and given our conclusion that consumers consider fixed narrowband analogue access (which are technically identical or very

³² http://business.bt.com/asset-library/phone-services/ISDN2_pricing_extrafunctionality_v3_BB_040204.pdf

³³ *Review of retail and wholesale ISDN30 markets Statement on the markets, market power determinations and remedies*, Statement, 20 August 2010, at <http://stakeholders.ofcom.org.uk/binaries/consultations/isdn30/statement/statement.pdf>

³⁴ See paragraphs 4.20-4.25, 4.53-4.55 and 4.63-4.65 *Review of retail and wholesale ISDN30 markets: Consultation on the proposed markets, market power determinations and remedies*, Consultation, 4 May 2010, at <http://stakeholders.ofcom.org.uk/binaries/consultations/isdn30/summary/isbn30.pdf>

³⁵ Fibre-to-the-cabinet

³⁶ Fibre-to-the-premises

³⁷ BT expects 75% of its network upgrade to be based on FTTC with the remainder being based on FTTP.

similar) to be substitutes regardless of the underlying network we believe that any narrowband access services delivered over BT's FTTP network will fall within the scope of this market. We therefore do not expect these NGA deployments to affect the definition of the market for narrowband analogue access services.

The supply of residential analogue and business analogue access are in separate markets

- 3.23 Since the September 2009 Retail Review, BT has substantially revised and simplified its business access tariffs. This has closed the differential between business and residential access pricing and made customer comparisons between tariffs easier to make. With no customer restrictions on the usage of the business and residential products, narrowing the gap between the two tariffs has presented customers with more switching opportunities. However, supply-side substitution between residential and business sectors still appears to be limited by the costs associated with marketing multiple services. While some providers have been prepared to invest to address new market segments (TTG for example), we still observe a distinct structure of competition whereby business and residential services continue to be targeted at different customer segments. The business customers are addressed by more specialist CPs offering bespoke services, while the mass residential sector is predominantly addressed by larger retailers offering bundled services.
- 3.24 On balance, we consider that the residential and business markets continue to be separate at the retail level. We do however recognise that the two markets are closely linked. We also note that the conclusion we reach on this point does not affect our wholesale market definition, where we conclude that there is a single market comprising both customer segments.

There is a single UK geographic market (excluding the Hull area) and a separate geographic market in the Hull area

- 3.25 As we are concerned in this market review with an assessment of competition at the wholesale level our main area of focus in terms of geographic market definition is not at the retail level, but at the wholesale level. However, for completeness, we have considered the scope of the relevant geographic market at the retail level in order to inform our wholesale assessment (although we take the view that we do not need to conclude definitively on the precise scope).
- 3.26 In general, when assessing the geographic scope of communications markets the application of demand-side and supply-side substitution through the hypothetical monopolist test ("HMT") will lead to very narrow geographic market definitions due to the limited ability for substitution to take place. This is because end users are unlikely to move home to benefit from lower broadband prices and supply-side substitution requires significant sunk costs.
- 3.27 Instead of assessing substitution through an analysis of demand-side and supply-side substitution using the HMT, it is therefore more helpful to consider the presence of any common pricing constraints to indicate where the boundary of the geographic scope of the market may be. This is because to the extent that competitive pressure in one geographic area leads to a competitive response in another, the effect of that competitive pressure will be felt in both areas. For example, if there are two areas (A and B) and there is an increase in competitive pressure in the retail market in area A but this leads to prices falling in both area A and area B, (i.e. there is a common price constraint across area A and area B), then the geographic scope of the market could be defined as area A plus area B.

- 3.28 BT and KCOM continue to be subject to a Universal Service Obligation (“USO”) in defined geographic areas (the UK (excluding the Hull area) and the Hull area respectively), which underpins their uniform geographic pricing of narrowband access services.³⁸ We also observe predominantly uniform pricing and nationwide marketing campaigns used by competing LLU and cable based providers. Given this evidence, we consider that there is a common pricing constraint operating at the retail level in two distinct geographic areas for the supply of narrowband access services. We are therefore proposing to identify the following two geographic markets:
- The UK (excluding the Hull area) where BT is the incumbent operator and sets uniform prices in that area; and
 - The Hull area where KCOM is the incumbent operator and sets uniform prices in that area.

Impact of wholesale regulation of exchange lines on the retail market

- 3.29 For the purposes of defining the wholesale markets it is necessary to consider the retail markets without the presence of wholesale regulation.³⁹ Given that the narrowband analogue access markets rely on wholesale regulation, it is important to recognise how our market assessment may be impacted by the absence of such regulation.
- 3.30 In the absence of wholesale regulation, it is unlikely that a hypothetical monopolist would provide an analogue wholesale line rental product as this enables other providers to offer retail narrowband access services in direct competition with its own retail operations. We therefore consider the implications of the absence of a regulatory requirement to supply a wholesale exchange lines product for the retail markets discussed above.
- 3.31 Aspects of the retail markets that depend on common characteristics of the wholesale markets are unlikely to be affected in the absence of wholesale regulation. For example, whether business or residential analogue exchange lines are in the same market is unlikely to be affected since the prices and availability of both business and residential wholesale lines would be impacted in the same way in the absence of regulation. Retailers are also likely to continue to price discriminate between residential and business customers.
- 3.32 Technical features that differentiate products would also be unaffected. Therefore, even though in the absence of wholesale regulation competition may be different in analogue, ISDN2 and ISDN30 retail markets, it is unlikely that consumers would consider substituting between these products.
- 3.33 The absence of wholesale regulation is also unlikely to affect our assessment that access and calls are in separate markets.

³⁸ The USO ensures that all households in the UK are able to have access to a fixed line at a standard charge (although additional connection charges apply when a household is so remote that installation would cost the supplier over £3,400 to provide the line).

³⁹ As noted in *Hutchison 3G UK Limited v Office of Communications (Mobile Call Termination)*, Court of Appeal, Case No. C1 2008/1932, EWCA Civ 683, 16 July 2009 (http://www.catribunal.org.uk/files/CofA_Judgment_1083_H36_16.07.09.pdf) it is appropriate to apply the “modified Greenfield” in our assessment. Under this approach Ofcom does take into account for SMP assessment regulatory obligations that are unrelated to the assessment.

- 3.34 Therefore, while the absence of wholesale regulation would be likely to impact the retail markets in terms of price and the level of competition, we believe that it would not substantially affect the current product market definitions.

Summary of retail market

- 3.35 We have not found evidence that the retail markets identified in the September 2009 Retail Review have materially changed, or are likely to do so, in the period to April 2014. For this reason we are proposing to conclude that the retail markets for fixed narrowband analogue access remain the same as those defined in the September 2009 Retail Review.
- 3.36 We are therefore proposing that there are separate retail product markets for:
- Residential fixed narrowband analogue access; and
 - Business fixed narrowband analogue access.
- 3.37 For the retail product markets identified above we are proposing to define two separate geographic markets: the UK (excluding the Hull area) and the Hull area.

Wholesale market

- 3.38 Having defined the relevant retail product markets we now proceed to define the relevant markets at the wholesale level.

The wholesale market

- 3.39 Consistent with the specified approach (see Annex 5) we need to define the scope of the relevant market in the absence of existing SMP remedies i.e. we cannot assume the presence of analogue WLR in the market. It is, however, necessary to take any upstream regulation (e.g. LLU) into account when making this assessment. In considering this hypothesised world, it is likely that competition will only take place at the retail level between vertically integrated operators with an access network. This is on the basis that there are few examples of instances where vertically integrated operators have voluntarily offered access to potential competitors. In terms of fixed telecoms access, the relevant vertically integrated operators are BT, Virgin Media and the LLU operators.
- 3.40 In defining the wholesale market we begin by considering whether it would be profitable for a hypothetical monopolist supplier of the focal service (wholesale analogue exchange lines) to impose a 5-10% increase in price. For this purpose the focal service is narrowly defined, effectively as the provision of wholesale analogue exchange lines on BT or KCOM's network. The result of this SSNIP test is dependent on the extent of substitution possibilities for both wholesale customers (direct competitive constraints) and retail customers (indirect competitive constraints). If there is sufficient substitution to an alternative product to undermine the profitability of the SSNIP then this alternative product is included in the scope of the market.
- 3.41 Where the candidate substitute for the focal product (wholesale analogue exchange lines) is likely to impose a sufficiently strong constraint it is included within the scope of the market.
- 3.42 In defining markets at the wholesale level, indirect competitive constraints may prove more important than direct competitive constraints. For example, even if there are

limited wholesale substitutes, it may not be profitable for a hypothetical monopoly provider to raise the price of wholesale analogue exchange lines if, in doing so, this led to a large loss of retail end users who would switch to purchasing their exchange lines from Virgin Media or providers using LLU.

- 3.43 We first consider the indirect constraints that operate at the retail level before discussing direct constraints at the wholesale level.

Indirect Constraints

- 3.44 The demand for fixed wholesale exchange lines is ultimately derived from the demand for retail narrowband access. Even if a CP has no realistic alternative but to purchase exchange lines from a hypothetical monopoly provider, it may not necessarily be profitable for the hypothetical monopolist to raise prices above the competitive level if in doing so this leads to higher retail prices and a significant drop in the retail demand for its exchange lines. In particular, if the retail price of fixed narrowband analogue access based on the wholesale exchange line product (WLR) were to increase, some retail consumers may either:

- switch to another CP who either self-supplies analogue exchange lines or purchase them from a CP other than the hypothetical monopolist; or
- switch to a mobile based form of access (where they consider it to be a substitute).

- 3.45 To assess whether indirect competitive constraints in this hypothetical world without SMP regulation are sufficiently powerful to warrant inclusion in the relevant economic market we need to first assess the extent to which an increase in the wholesale charge feeds through into retail prices. In particular, whether the charge pass-through causes a sufficient number of consumers to switch to substitute retail products in order to render the hypothetical increase in wholesale charges unprofitable. We look at these issues in turn.

- 3.46 We believe, for the reasons explained below, that:

- Indirect constraints arising from the presence of vertically integrated CPs on alternative fixed networks (e.g. cable and LLU) may be effective in rendering a SSNIP by a hypothetical monopolist unprofitable; and
- Indirect constraints arising from mobile access would not be effective in rendering a SNIPP by a hypothetical monopolist unprofitable;

- 3.47 The proportion of any wholesale price increase that is passed on to retail consumers will be a key factor in the profitability of any SSNIP. The SSNIP is more likely to be profitable where:

- the proportion of the retail price of an exchange line that is accounted for by the wholesale input is low (“dilution effect”); and
- retail competition is more limited, allowing higher retail margins.

- 3.48 In order to understand the impact of a SSNIP at the wholesale level on retail prices, we have gathered wholesale and retail analogue prices detailed in Table 3.2 below.

Table 3.2: Wholesale and retail prices for a residential analogue exchange line

	Wholesale	Retail		
	BT	BT	TTG	Sky
Line rental (£/year including VAT)	121.82 ⁴⁰	131.88 ⁴¹	144.48 ⁴²	132.00 ⁴³

Source: Ofcom (retail prices from the listed CP's websites as at 7 October 2010)

- 3.49 Retail prices include both the wholesale exchange line cost and retail costs. This implies that, everything else being equal, a percentage increase in the wholesale input is unlikely to cause an equal percentage increase at the retail level unless retail costs are zero. As shown in Table 3.2 above, the wholesale exchange line cost typically accounts for approximately 90% of the retail price. On the assumption that 100% of any increase in the wholesale price is passed on by the resellers, this would imply that a 5-10% increase in the price of the wholesale input will lead to a price increase at the retail the level of approximately 4.5-9%.

Competition between fixed and mobile access

- 3.50 As we set out above, we found fixed and mobile access to be in separate markets at the retail level and for this reason we consider that there is limited substitution between these forms of access. So, despite the fact that a 10% increase in the wholesale charges could lead to as much as a 9% increase in retail narrowband access prices we do not consider this would be rendered unprofitable, because mobile access does not provide a sufficiently strong indirect constraint to fixed access.

Competition based on other fixed networks

- 3.51 We have set out above our view that a 10% increase in the price of wholesale exchange lines is likely to be fully passed on to retail prices. In addition evidence on how retail customers might respond to such a price increase is provided in the research supporting the September 2009 Retail Review. This indicated that a 10% increase in the retail price for line rental would result in 22% of consumers switching their landline provider.⁴⁴
- 3.52 The available evidence suggests that a 5-10% increase in the charge for wholesale analogue exchange lines may be rendered unprofitable as retail consumers are

⁴⁰ The BT Openreach wholesale price for WLR (Analogue) of £30.46 (inclusive of VAT) per quarter, effective from 1 April 2010, is for the Basic Line Rental product that is detailed at, <http://www.openreach.co.uk/orpg/pricing/loadProductPriceDetails.do?data=S54TzQgFOVXuwUgHKC I7L1Q14hLhaQkFGHrP9FQAI3yZrG2CsSujUDvDIXyfMBm!>

⁴¹ BT's full rate retail line price applicable (at £10.99 per month (inclusive of VAT)) when taking a BT Calling Plan. The details of the line rental charge can be found at, <http://www.productsandservices.bt.com/consumerProducts/displayTopic.do?topicId=25497>

⁴² TTG's retail line rental price applicable (at £12.04 per month (inclusive of VAT)) when taking either its Talk UK Anytime or its Talk UK Evening and Weekend packages. The details of the line rental charge can be found at, <http://broadband.talktalk.co.uk/pricing/ew>.

⁴³ Sky's retail Sky Talk Line Rental price (at £11 per month (inclusive of VAT)) applicable when taking Sky Talk calls package. The details of the line rental charge can be found at, <http://www.sky.com/shop/broadband-talk/talk-linerental/>.

⁴⁴ While this number is likely to overstate actual switching activity in the hypothesised case where there is no SMP regulation requiring the provision of WLR, we consider that it provides us with a useful proxy for switching in that notional world. Specifically, consumers stated preferences relate to the exchange line service being offered and not the underlying technology used to deliver that product.

willing to move to providers supplying exchange lines over LLU or cable. The fact that cable and LLU-based access might provide a sufficient constraint on the hypothetical monopolist suggests that we should broaden the product market to include the supply of wholesale exchange lines using LLU and cable.⁴⁵

- 3.53 Therefore, on the basis of indirect constraints, the above assessment would suggest that the effective indirect competitive constraints are limited to customers switching between alternative forms of fixed networks (e.g. cable and LLU) and the provision of wholesale fixed analogue exchange lines using these alternative networks should therefore be included in the relevant market.

Direct Constraints

Competition between wholesale provision of fixed and mobile access

- 3.54 We do not consider that mobile and fixed line access are direct substitutes at the wholesale level and as such the availability of mobile access is unlikely to undermine the profitability of a SSNIP. As we noted in paragraph 3.50, limited substitution is likely to occur indirectly in the retail market.

Competition between alternative providers of fixed networks

- 3.55 If a hypothetical monopolist were to attempt to increase the price of wholesale exchange lines by 5-10% above the competitive level the only direct fixed substitution possibilities available to a CP requiring wholesale exchange lines would be either to:

- purchase a wholesale product from a competing wholesale provider;
- invest in either cable-based or LLU-based self supply; or
- invest in a NGA fibre based network.

- 3.56 The main providers of fixed analogue exchange line in the UK are BT, KCOM, Virgin Media, TTG, Cable & Wireless and Sky. Below we consider whether these providers can act as effective direct constraints in the provision of wholesale fixed analogue exchange lines.

- 3.57 BT is currently the main provider of wholesale analogue exchange lines in the UK, and KCOM in the Hull area.⁴⁶ The other CPs that supply exchange lines in the UK (excluding the Hull area) tend to provide them for the exclusive use of their retail division.⁴⁷ Currently, provision of wholesale exchange lines by other CPs is limited. C&W provides wholesale exchange lines via its LLU deployment (with small volumes in comparison to the whole market). TTG and Sky offer retail narrowband services over LLU.

⁴⁵ In our September 2009 Wholesale Review we recognised that there might be arguments for not including either LLU or cable-based infrastructure in the market definition. Importantly, we concluded in that review that it was not necessary to reach a definitive conclusion on the issue because even if the market were defined more narrowly to exclude cable and LLU then this would only serve to strengthen the SMP finding rather than to weaken it.

⁴⁶ As previously noted, it is unclear that in the absence of wholesale regulation either BT or KCOM would have the incentive to provide a wholesale analogue exchange lines product.

⁴⁷ In the Hull area, there is no direct constraint operating on KCOM because there are no wholesale demand side substitution possibilities and the cost of the supply side options is prohibitive. Specifically, provision of a wholesale substitute would require significant investment in a prohibitively short time period.

- 3.58 If a hypothetical monopolist of wholesale fixed analogue exchange lines increased its prices by 5-10%, LLU operators (other than C&W which already has a wholesale offer) could provide wholesale exchange lines in areas where they are active if they believe it profitable to do so. Since the infrastructure to support exchange lines is in place to support their retail businesses, significant additional investment is unlikely to be needed to develop a wholesale product. On the other hand, LLU providers (with limited exceptions) do not currently wholesale to third party resellers as they are concentrating on their own retail sales.
- 3.59 Moreover, new entry based on investment in cable infrastructure, LLU deployment or NGA deployment is unlikely. This is because such investment entails a substantial sunk cost and would require a roll-out in a prohibitively short time period.
- 3.60 This analysis suggests that the direct constraints arising as a result of competition from alternative fixed network operators are limited and, by themselves, would be unlikely to render a SSNIP unprofitable. However, as noted above, we consider that the indirect constraints imposed by competition from these providers are sufficient to justify the inclusion of their services in the market.

Competition from wholesale suppliers of business and residential customers

- 3.61 As discussed above we believe that there are separate residential and business markets at the retail level. However, at the wholesale level we considered in the September 2009 Wholesale Review that the analogue exchange line services used to support residential and business retail services are sufficiently interchangeable as to be viewed by customers as effective substitutes. The key differentiating factor between residential and business services is the service levels and wrap provided alongside the access product. In that review we therefore concluded that residential and business services were in the same market.
- 3.62 We believe that the assessment in the September 2009 Wholesale Review remains valid and accordingly we are proposing to find that residential and business wholesale analogue exchange lines are in the same market.

Competition from wholesale digital fixed exchange lines

- 3.63 As discussed above we believe that there are separate analogue and digital markets at the retail level. At the wholesale level we do not consider that there is any possibility of significant demand-side substitution between analogue and digital services. This is based on our retail assessment and given the fact that wholesale demand is derived from retail demand.
- 3.64 In theory it may be possible for a hypothetical monopolist of fixed digital exchange lines to start offering fixed analogue exchange lines in response to a SSNIP. This would open up the possibility of supply-side substitution between analogue and digital services at the wholesale level. However, in practice there are no network operators that only provide fixed digital exchange lines and as such this theoretical supply-side substitution would not bring any new players into the market. We therefore need to decide whether analogue and digital services should be included in the same market for the purpose of our market assessments.
- 3.65 Given that on the demand side analogue and digital services are in separate markets and that consumers of these services have very different requirements we believe that separate wholesale markets should be maintained. We therefore propose to find

that wholesale analogue exchange lines and wholesale digital exchange lines are in separate markets.

Interplay between product and geographic market definition

3.66 We are aware that cable and LLU based services are not available in all parts of the UK. However, when assessing the product market we do not consider the geographic availability of the potential substitute services and networks. Rather, we consider this within the geographic market assessment, in paragraphs 3.81 to 3.87. It is also taken into account in the market power assessment.

Forward look

3.67 In defining these wholesale markets, we have considered the likelihood of relevant competitive and technical developments that might affect these market definitions. These concern mainly:

- the deployment of NGA
- increased fixed/mobile convergence (“FMC”);
- Voice over Internet Protocol (“VoIP”); and
- the likely development of existing technologies.

NGA

3.68 We have discussed NGA deployments and their likely impact on the retail narrowband analogue access services market in paragraphs 3.21 to 3.22. Consistent with our conclusion at the retail level we do not expect the known NGA deployments to have a significant effect on the market for wholesale analogue exchange line services.

3.69 In particular, Virgin Media’s DOCSIS 3.0 upgrade and BT’s FTTC upgrade only affect their broadband services, the narrowband service is unaffected. In the case of BT’s FTTP upgrade, this is currently intended to be deployed as an overlay to its existing ‘copper’ network. Thus, customers can continue to purchase the current narrowband services. However, to the extent that a narrowband analogue exchange line service is provided over a NGA network, e.g. BT’s FTTP network, these services will fall within the scope of this market and do not affect the market definition.

Fixed-to-mobile convergence

3.70 As previously stated, our market research indicates that, for access, retail customers consider fixed and mobile access to be complements rather than substitutes. The primary reasons are security and the requirement to have a fixed line to support fixed broadband.⁴⁸ We expect that over the next few years, consumers will attain higher broadband speeds via fixed access than those achievable via mobile networks. Our research also indicates that mobile-only households have chosen not to have a fixed line for reasons that are only to a limited extent affected by the relative prices of a fixed line and a mobile phone line (e.g., live in rented accommodation, students, etc.).

⁴⁸ See footnoted 26 above.

- 3.71 There is the possibility that in the future fixed and mobile services may converge (Fixed-Mobile Convergence). In particular, deployment of in-house (or in-office) mobile technology such as femtocells and Generic Access Network (GAN) solutions may lead to greater use of mobile devices in locations where consumers have traditionally used fixed services. However, both of these technologies provide access in the home/office via fixed broadband access. Therefore, these types of convergence drive use of fixed broadband access – it is therefore not obvious that this will lead to the removal of the fixed narrowband access, as the cost of maintaining it is likely to be low and it may be seen as providing a secure/reliable additional telephone service. Whilst these services may develop over the next three and a half years, we do not expect this development to drive a significant reduction in the demand for fixed narrowband access in the near term. More broadly, whilst there may be some increase in substitutability between fixed and mobile narrowband access, we would not expect this to develop, over the period covered by this review, to an extent that would justify their inclusion in the same market.

VoIP

- 3.72 Consumers may also increasingly use VoIP technology. This could either be a managed service (such as BT's Broadband Talk package) or a service that uses the Internet (such as Skype). In both cases the consumer will need a broadband connection to access the service.
- 3.73 VOIP services provide consumers with an alternative way of making and receiving calls. As such, they may potentially become candidates for inclusion in the same market as calls made over the public switched telephone network – they are not an alternative method of access.
- 3.74 However, as VOIP services are accessed using broadband connections, an increase in their usage could raise a question as to whether narrowband and broadband access should be considered to be in the same market. In our view, that is not the case, as broadband connections can be used to access a far wider range of services than narrowband connections, and are not regarded by consumers as close substitutes.
- 3.75 In addition, it is relevant to note that, at the current time nearly all fixed broadband services are only made available after the customer has already purchased a fixed narrowband access service. To our knowledge Virgin Media is the only network operator who is currently offering a broadband service without requiring the customer to also purchase a narrowband access service⁴⁹. However, take-up of Virgin Media's 'broadband-only' service has been very low and we believe that this is directly related to the pricing structure. For example, Virgin Media's 20Mbit/s broadband service is available for £20 per month if purchased in addition to narrowband access, which is priced at £11.99 per month. However, the price for a 20Mbit/s broadband-only service is £30 per month⁵⁰. Thus, the saving is only £1.99 per month and to get this saving the customer has to give-up their existing telephone service. Faced with such a choice, even consumers who intend to use VoIP for their calls generally continue to purchase fixed narrowband access as it provides a secure/reliable additional telephone service.

⁴⁹ We are aware that there are a number of providers who only provide broadband services, however, the end user is still required to purchase a narrowband access product, albeit from a different provider.

⁵⁰ Prices from Virgin Media's web site as at 8 October 2010

- 3.76 Further, we do not believe that Virgin Media's pricing structure is necessarily artificially distorting consumers' decisions. Rather, it is likely to broadly reflect the economics of deploying and operating a fixed access network. That is, the incremental cost of adding narrowband access (i.e. to allow the consumer to make calls) to the fixed access connection is likely to be quite low. Indeed, we consider that this is likely to be the reason why no other provider is offering broadband-only services.
- 3.77 In the light of the above, we do not believe that VoIP is a substitute for narrowband access, or that the prospective growth in VOIP usage has any direct implications for our market definition.

Development of existing technologies

- 3.78 Regarding existing technologies, we think that there could be an increase in the number of wholesale offers available if operators who are currently using LLU move into this market.
- 3.79 However, we do not think that any such developments will materially affect our proposed product market definition during the period covered by the review.

Conclusions on product market definition

- 3.80 Based on the analysis above we are therefore proposing that the relevant product market definition is:
- Wholesale fixed analogue exchange lines.

Geographic markets

- 3.81 In theory the HMT can be used to assess the geographic scope of the market. However, it is clear that applying this test would lead us to potentially very narrow geographic markets. For this reason we considered it more appropriate to assess other features of the market, in particular whether a common pricing constraint exists. Where such a constraint is found it would not be necessary to conduct a detailed analysis of the competitive conditions by locality to establish whether there are areas with sufficient similar competitive conditions.

Common pricing constraint

- 3.82 As identified above there are currently a number of providers who are operating at the wholesale level for analogue exchange lines. These are:
- BT, which is able to provide services everywhere in the UK (excluding the Hull area);
 - KCOM, which is able to provide services only in the Hull area;
 - Virgin Media, which is able to provide services to approximately 46% of premises in the UK (none of which is in the Hull area); and
 - LLU operators, which are able to provide services to differing amounts of UK premises, up to approximately 84% (none of which are in the Hull area).

- 3.83 While deployments of cable and LLU have occurred in discrete geographic areas that does not necessarily imply the existence of sub-national geographic markets.
- 3.84 As discussed above, when assessing the retail market, BT is subject to a USO obligation when providing narrowband services (see paragraph 3.28) and this supports our view that the geographic market could be extended to the area covered by BT's network due to the existence of a common pricing constraint. Given the existence of a common pricing constraint at the retail level, supported by the USO, we consider that the same logic applies at the wholesale level. This is because if BT did provide a wholesale product (absent regulation) then it is likely to set a common price. To do otherwise would create unsustainable geographic arbitrage opportunities between the wholesale charge and the retail price.
- 3.85 In addition to the logic that suggests the presence of a common pricing constraint at the wholesale level supported by BT's retail USO obligation, there are additional commercial drivers to suggest that in the absence of SMP remedies, uniform wholesale charges would still be adopted. Specifically:
- there are costs associated with setting an alternative menu of costs through tailored marketing activity;
 - we observe uniform pricing in the retail fixed narrowband analogue access market, even where cable and LLU networks have been deployed.

Conclusions on geographic market definition

- 3.86 We consider that that there are sound economic reasons to take the proposed view that a common pricing constraint exists in the wholesale fixed analogue exchange lines market and that a national market (excluding the Hull area) can be defined on this basis. Consequently we do not consider that it is necessary for us to conduct a detailed geographic analysis based on identifying areas of sufficiently similar competitive conditions.
- 3.87 Based on the above analysis we proposed to define the following geographic markets for wholesale fixed analogue exchange lines:
- the UK (excluding the Hull area); and
 - the Hull area.

Conclusions

- 3.88 Based on the above assessment we are proposing to find that the relevant markets are:
- Wholesale fixed analogue exchange line services in the UK (excluding the Hull area); and
 - Wholesale fixed analogue exchange line services in the Hull area.
- 3.89 Specifically, we are proposing to find that these markets include both residential and business services. However, we are proposing to exclude mobile access, fixed digital access, broadband and calls from these markets.

- 3.90 We consider that these wholesale markets are the relevant markets in which to consider whether any firm has SMP.

Question 1: *Do you agree with Ofcom's proposed wholesale market definition? If not, please explain why.*

Section 4

Market power assessment

Introduction

- 4.1 Market definition is not an end in itself. The definition of the scope of the relevant economic market is carried out in order to identify the products and the geographic area over which an assessment can be made of operators' ability to act to an appreciable extent independently of competitors, customers and consumers, i.e., whether there are any operators that hold a position of SMP within a particular market.
- 4.2 In this section we set out our conclusions on the market position of CPs in each of the relevant product markets.

Assessment of SMP in the UK excluding the Hull area

Market share analysis

- 4.3 We now assess market share information for the wholesale fixed analogue exchange line market in the UK excluding the Hull area.
- 4.4 Market shares are presented in Table 4.1 below.

Table 4.1: Market shares in the UK (excluding the Hull area)

	2003	2004	2005	2006	2007	2008	2009	2010
BT	85%	85%	85%	84%	81%	80%	78%	73%
Virgin Media	15%	15%	15%	15%	15%	16%	16%	17%
LLU (MPF ⁵¹)	0%	0%	0%	1%	4%	4%	6%	11%

Source: Ofcom (based on data supplied by CPs)

- 4.5 Table 4.1 indicates that while BT's market share of wholesale analogue exchange lines has declined slowly, its share has remained persistently high with BT still providing nearly three quarters of all lines. The growth in the use of LLU (MPF) has been the key driver in reducing BT's market share, with provision of LLU-based exchange lines totalling approximately 2.9 million in April 2010. Virgin Media's market share has risen marginally since the last review, against a trend that has remained broadly flat.
- 4.6 The market share data set out in Table 4.1 provides us with a presumption of dominance in the market. Furthermore, the structure of competition indicates that to date, despite competing with BT for a number of years, alternative suppliers have managed to only take limited market share from BT. While important, market shares only provide an indicator of the competitive outcomes. In the following sub-sections, we consider the key factors that are driving the competitive outcome in this market. It is this competitive assessment that is central to our consideration of whether SMP exists.

⁵¹ We have only included LLU Metallic Path Facility (MPF) lines as these are the only LLU lines that independently support narrowband service.

Barriers to entry

- 4.7 The considerable investment required to deploy an access network presents a substantial barrier to entry in the market for the wholesale supply of analogue exchange lines. LLU was imposed as a remedy in the upstream wholesale local access (WLA) market to provide access to BT's access network for providers of narrowband and broadband services.⁵²
- 4.8 However, while LLU reduces the barriers to entry it is unlikely that significant additional entry will occur based on LLU, in the next few years. This is because LLU requires CPs to make a sizeable fixed investment in each local exchange and there are 5,587 local exchanges in BT's network. In order to be able to recover the investment costs an LLU operator needs to secure a significant group of customers in each local exchange. This has two consequences:
- i) LLU will in general not be used in small exchanges (i.e., exchanges that do not serve many customers). This is demonstrated by the fact that LLU is currently in use in about 2,000 exchanges, which cover approximately 85% of premises. LLU is not, however, in use in the remaining 3,500 or so exchanges, which cover approximately 15% of premises.
 - ii) The number of LLU operators that can achieve the required scale will be inherently limited. This is demonstrated by the fact that, even in the exchanges where LLU has been used, there are currently only four main LLU operators (C&W, O2, Sky and TTG). We would also note that 18 months ago there were six main LLU operators. Since then, however, Tiscali has been acquired by TTG and Orange has decided to use BT wholesale products rather than LLU.
- 4.9 Therefore, while it is possible that CPs who have already invested in LLU may try to leverage that investment further in this market it seems unlikely that additional CPs will enter this market based on LLU.

Economies of scale and scope

- 4.10 There are significant economies of scale⁵³ associated with deploying and operating a network to provide wholesale fixed analogue exchange lines in any given area. If a CP builds its own network then any build costs will need to be spread over many customers in order to reduce the per end user cost to a competitive level.
- 4.11 Economies of scope⁵⁴ are also important in the provision of exchange lines. Specifically, BT has significant economies of scope in the provision of wholesale fixed analogue exchange lines due mainly to its access infrastructure, which is able to support a range of other communication services. The same is true for Virgin Media and the LLU providers who can supply both narrowband and broadband services.

⁵² *Review of the wholesale local access market: Identification and analysis of markets, determination of market power and setting of SMP conditions - Explanatory statement and notification*, 26 August 2004, at <http://stakeholders.ofcom.org.uk/binaries/consultations/rwlam/summary/rwlam2.pdf>.

⁵³ Economies of scale exist where average costs fall as output increases. See note 18, p. 18, *The Competition Act 1998, The Application in the Telecommunications Sector*, OFT 417, March 2000, at http://www.ofg.gov.uk/shared_ofg/business_leaflets/ca98_guidelines/ofg417.pdf

⁵⁴ Economies of scope exist where average costs fall as more services are offered. See note 18, p. 18, *Ibid*

Countervailing buyer power

- 4.12 Potential future purchasers of BT's wholesale fixed analogue exchange line services are unlikely to possess sufficient countervailing buyer power to undermine BT's market power given the limited availability of alternative wholesale suppliers.

Pricing and profitability

- 4.13 BT's charges for wholesale fixed analogue exchange lines are currently set by regulation which requires them to be cost oriented and to comply with a charge ceiling. The current regulated price for the supply of the Analogue Core WLR Rental Service is £121.82 per annum (£30.46 per quarter).⁵⁵ This product is made available to resellers targeting both residential and business customers.
- 4.14 BT has so far set its analogue WLR charge to the maximum level permitted by the charge control. While this behaviour does not conclusively support a finding of SMP, neither does it contradict the other economic factors that suggest a finding that BT has SMP.

Summary of assessment of SMP in the UK excluding the Hull area

- 4.15 Based on the analysis above, in particular BT's high market share, the high barriers to entry and lack of countervailing buyer power, we propose to find that BT has SMP in the UK (excluding the Hull area) in the market for wholesale fixed analogue exchange lines.

Assessment of SMP in the Hull area

Market shares

- 4.16 KCOM has historically had a 100% share of the retail and corresponding wholesale markets for the provision of fixed analogue exchange lines in the Hull area. However, recent entry by Nexus Telecommunications ("Nexus") into the retail market, based on a regulated wholesale product supplied by KCOM, has resulted in KCOM's retail market share dropping marginally, to approximately 98%. KCOM does however retain 100% market share at the wholesale level. This creates a clear presumption of dominance.

Barriers to entry

- 4.17 The barriers to entry in the wholesale fixed analogue exchange lines market in the Hull area are similar to those discussed above in relation to the rest of the UK. Specifically, to enter the market in the Hull area in any significant way a CP would need either to build a network to premises in the Hull area, or to deploy a solution based on LLU within the Hull area. Both solutions would require a provider to make a significant investment. To date, no supplier has chosen to build a direct access network, or has approached KCOM to request LLU.

⁵⁵ Wholesale charges are given inclusive of VAT.

<http://www.openreach.co.uk/org/pricing/loadProductPriceDetails.do?data=S54TzQgFOVXuwUgHKC I7L1Q14hLhaQkFGHrP9FQAI3yZrG2CsSujUDvDIXyfMBml>

Other criteria

- 4.18 While the relevant wholesale fixed analogue exchange line market in the Hull area is much smaller than in the rest of the UK, the assessment of the other SMP criteria as applied above to BT in the rest of the UK apply equally to KCOM and the Hull area. This suggests that KCOM would not be constrained in its pricing of this service.

Summary of assessment of SMP in the Hull area

- 4.19 Based on the analysis above, we are proposing to find that KCOM has SMP in the Hull area in the market for wholesale fixed analogue exchange lines.

Forward look

- 4.20 As we set out in our assessment of the forward look in the market definition section, we consider there to be a limited number of developments that could affect competition conditions in the wholesale fixed exchange line markets. We consider each of these in turn below:

NGA

- 4.21 As discussed in Section 3 Virgin Media has already upgraded its broadband access network and the main known NGA future deployment is BT's access network upgrade. Thus, this will not bring any new players into the market that could undermine BT's SMP.
- 4.22 We have recently published our WLA statement⁵⁶ and in the context of NGA this has introduced two new access remedies; virtual unbundled local access ("VULA") and physical infrastructure access ("PIA"). VULA allows other CPs to use BT's NGA network where deployed and PIA allows CPs to use BT's ducts and poles for the purpose of deploying their own NGA network. It is possible that these upstream remedies could provide a competitive constraint in this market in the future, in the same way that LLU has. However, it is too early to assess what the impact of these new remedies is likely to be in this market.

Fixed-to-mobile convergence

- 4.23 As discussed in Section 3 we believe that the majority of consumers will continue to consider fixed and mobile access to be complements rather than substitutes over the next four years. Therefore, we do not believe that mobile access will offer a significantly strong constraint on the pricing of wholesale fixed analogue exchange lines.
- 4.24 Further, fixed-to-mobile convergence (FMC), e.g. deployment of in-house (or in-office) mobile technology such as femtocells and Generic Access Network (GAN), generally rely on both the fixed and mobile access networks. Although the fixed access service required in this situation is likely to be broadband, instead of narrowband, as explained in paragraphs 3.73 to 3.77 it is highly likely that the availability of the fixed broadband service will be contingent on fixed narrowband access. Therefore, we do not believe that FMC will significantly affect the existence

⁵⁶ *Review of the wholesale local access market, Statement on market definition, market power determinations and remedies*, Statement, 7 October 2010, at http://stakeholders.ofcom.org.uk/binaries/consultations/wla/statement/WLA_statement.pdf

of SMP in the wholesale fixed analogue exchange line market over the next three and a half years.

Development of existing technologies

- 4.25 In the last five years LLU (MPF) based wholesale fixed analogue exchange lines have grown significantly, from a zero base to 11% of the wholesale market. In particular, these services have increased their share by 5% in the last year. Whilst we expect to see further growth in these services we do not believe that they are likely to significantly undermine BT's SMP in this market over the next three and a half years. This is because most of the LLU (MPF) growth is attributed to TTG growing its customer base for voice and broadband services, and more recently Sky up-selling its existing broadband customers to voice and broadband. The current growth rate is therefore not sustainable. Rather, the maximum volume of LLU (MPF) based wholesale fixed analogue exchange lines is likely to be limited by the number of LLU based broadband customers. The growth rate of LLU based broadband, whilst positive, is much slower than the recently seen growth rate in LLU (MPF) based wholesale fixed analogue exchange lines. Further, even if all the current LLU based broadband customers were to convert to LLU (MPF) based voice and broadband this would only change the current wholesale fixed analogue exchange lines market shares by about 12%. LLU would go up to about 23% and BT's share would come down to about 61%. Therefore, we do not believe that LLU will significantly affect the existence of SMP in the wholesale fixed analogue exchange line market over the next three and a half years.
- 4.26 After considering these possible future developments we believe that our assessment of market power and the findings of SMP in the relevant markets is unlikely to change in the period covered by the review, given BT's and KCOM's high market share and the slow rate of deployment of alternative infrastructure solutions.

Question 2: *Do you agree with Ofcom's proposed assessment that BT has SMP in the wholesale fixed analogue exchange lines market in the UK (excluding the Hull area), and KCOM has SMP in the same product market in the Hull area? If not, please explain why.*

Question 3: *Do you agree with Ofcom's analysis of future developments that may affect these assessments? If not, please explain why.*

Section 5

SMP remedies for BT and KCOM

Introduction

5.1 In this section we examine which remedies we consider will be most effective in addressing BT's and KCOM's SMP in the wholesale fixed analogue exchange lines markets. The section is structured as follows:

- Our proposals;
- Remedies considered – BT
- Remedies considered – KCOM
- Proposed SMP conditions – BT and KCOM
- Cost accounting; and
- Accounting separation
- Consultation questions

5.2 The details of the proposed product-specific SMP remedies are set out separately in Sections 6 and 7.

Our proposals

5.3 Given our proposed finding that BT holds SMP in the wholesale fixed analogue exchange lines market in the UK (excluding the Hull area) for the reasons given below we consider it appropriate to re-impose the same set of general and specific SMP remedies that are currently in place (see Table 5.1 below).

5.4 Similarly, given our proposed finding that KCOM holds SMP in the wholesale fixed analogue exchange lines market in the Hull area, for the reasons given below we consider it appropriate to re-impose the same set of general SMP remedies that are currently in place. We are also proposing to add a new access related condition that requires KCOM to introduce an SOR process for prospective customers – a requirement that formalises KCOM's current commercial practice and which mirrors the historic and proposed requirement placed on BT (see Table 5.1 below).

5.5 Specifically we are proposing these remedies as we consider that:

- the underlying sources of BT's and KCOM's SMP have not changed since the time of our last review (see paragraphs 4.17 to 4.19);
- our proposals are proportionate and appropriate to address the competition concerns identified. In particular the set of proposed wholesale SMP remedies:
 - on BT form part of a set of complementary regulatory measures that continue to be needed to promote effective competition both in the intermediate and retail markets; and

- on KCOM will support the nascent development of retail competition;
- there is no other mix of SMP remedies more appropriate; and
- they are required because competition law does not provide an appropriate remedy in the identified wholesale fixed analogue exchange lines markets. While competition law is sufficient to deal with any competition abuses that may arise in an effectively competitive market, where competition is lacking the imposition of *ex ante* regulation is needed to promote competition.

Table 5.1: Summary of our proposed remedies in wholesale fixed analogue exchange lines markets

Market	BT Obligation	KCOM Obligation
Wholesale fixed analogue exchange lines	Requirement to provide Network Access on reasonable request	Requirement to provide Network Access on reasonable request
	Requests for new Network Access	Requests for new Network Access
	Requirement not to unduly discriminate	Requirement not to unduly discriminate
	Basis of charges	Basis of charges
	Requirement to publish a reference offer	Requirement to publish a reference offer
	Requirement to notify charges	Requirement to notify charges
	Requirement to notify technical information	Requirement to notify technical information
	Cost accounting	Cost accounting
	Accounting separation	Accounting separation
	Transparency as to quality of service	
	Obligation to provide WLR	
Charge control		

- 5.6 The draft Notifications that we set out in Annex 7 to this document set out our detailed SMP condition proposals.
- 5.7 For the avoidance of doubt, the proposed revocation and imposition of new SMP conditions that we set out in Annex 7 does not affect any other operative SMP conditions in other wholesale exchange lines markets e.g. wholesale digital exchange lines (ISDN2 or ISDN30) (or indeed any other services outside the wholesale exchange lines market). The details of the SMP Conditions that we have placed on BT in those wholesale digital exchange lines markets can be found in the September 2009 Wholesale Review (ISDN2), and the August 2010 ISDN30 Review.
- 5.8 Annex 6 provides a detailed outline of the legal framework for this review including the legal tests that we must satisfy in order to impose the proposed SMP conditions.

In this section we have explained the approach that we have taken in considering each possible remedy and set out the reasons why we think that the legal tests have been met.

Remedies considered - BT

5.9 In this section we set out our proposals for remedies to be imposed on BT in order to address its SMP. We start by discussing three general options for remedies:

- **Option 1:** no remedies (i.e. the removal of existing remedies);
- **Option 2:** general SMP remedies and product-specific remedy (WLR); and
- **Option 3:** pricing remedies (in addition to Option 2).

5.10 In assessing these options, we have taken account of the effectiveness of the remedies which currently exist in this market.

Option 1 (no regulation)

5.11 In the absence of *ex ante* regulation, BT would be able to exploit its market power in a way that would be damaging to markets and the interests of citizens and consumers. For example, if SMP regulation was absent BT would be able to withhold access and were it to decide to supply a wholesale product then it would be able to set charges above the competitive level.

5.12 Further, paragraphs 21 and 114 of the SMP Guidelines state that NRAs must impose one or more SMP service conditions on a dominant provider, and it would be inconsistent with the objectives of the Framework Directive not to impose any SMP service conditions on an undertaking which has SMP (see Annex 6).

5.13 As we explain below, BT is currently subject to general access, no undue discrimination and transparency requirements in this market, as well as the requirement to supply WLR at a regulated rate. These remedies have been successful in enabling an increasingly competitive supply of narrowband analogue access in downstream markets. Given our provisional finding of SMP, we consider that there is a continued need for wholesale SMP regulation to support effective competition in the downstream narrowband access market.

Option 2 (general SMP remedies and product-specific remedy (WLR))

5.14 In order to promote competition in the provision of downstream analogue narrowband access services, a set of regulatory remedies is required. Specifically, remedies are needed to ensure that BT provides access to its network on non-discriminatory terms, and makes available a wholesale line rental product to other CPs. These remedies would take the same form and operate in the same way as the current SMP provisions in this market.

5.15 Requiring BT to meet reasonable requests for Network Access would enable CPs to compete in the downstream retail market for fixed narrowband analogue access services by enabling them to access the wholesale products that they need, but cannot easily replicate themselves. This is because for a competing CP to supply its own analogue access product it would need to make a substantial investment in deploying a competing network.

- 5.16 Relying solely on a Network Access requirement provides BT with the option to discriminate in favour of its own retail divisions, by setting excessive prices for the externally supplied wholesale product, or making it inferior quality (e.g. degrading the terms of supply or the availability or functionality). Such discrimination would restrict the ability of other CPs to compete effectively with BT in the downstream markets.
- 5.17 Therefore, an obligation to provide Network Access is only likely to be effective if supported by an obligation not to discriminate unduly. Currently, BT is subject to an obligation not to discriminate unduly in the provision of wholesale fixed analogue exchange lines and we propose to retain this requirement.
- 5.18 However, in order to ensure that BT complies with the requirement to supply Network Access and not to discriminate unduly, additional obligations related to transparency are also required. Transparency obligations would provide CPs with access to the information they need to make informed decisions about purchasing BT's wholesale fixed analogue exchange lines products. Without these obligations, not only would it be difficult for third parties to assess whether BT was meeting its obligations to provide Network Access and to not discriminate unduly, it may also be the case that third parties would not have sufficient information to decide whether, or how, to enter the market. This could ultimately result in fewer CPs competing in the retail market, and therefore less choice for consumers.
- 5.19 Obligations requiring transparency already exist in this market and have worked well. Currently, BT is required to publish a reference offer, notify charges, notify technical information, and provide transparency as to quality of service. We propose to retain these obligations. Given that BT holds a position of SMP in this market, in the absence of regulation it would have no economic incentive to provide products on the same terms to competitors.
- 5.20 Finally, to dissuade BT from setting excessive wholesale charges and, by extension, impacting effective competition at the retail level, both cost accounting and accounting separation obligations are needed. The former requires BT to demonstrate how the requisite cost orientation obligation is being met. The latter requires the separation of internally and externally supplied products and thus enables Ofcom and other interested parties to monitor for discrimination. It also provides transparency in the way that BT is treating, in accounting terms, its downstream businesses and other wholesale buyers.
- 5.21 Therefore, we have provisionally concluded that the existing framework of supply, non-discrimination, and transparency obligations is necessary going forward to support fair and effective competition in the downstream retail market.

Option 3 (pricing remedies (in addition to Option 2))

- 5.22 In a competitive market, the charges for services would be set on the basis of the commercial judgements of individual companies and would be expected to tend towards the cost of provision. However, where competition cannot be expected to provide an effective constraint, *ex ante* regulation may be needed to prevent charges from being set at an excessive level. Such intervention could also have as its objective the aim of promoting efficiency and of allowing the development of effective competition in downstream markets.
- 5.23 There are three possible approaches to the regulation of wholesale charges, which are examined in turn below. The three approaches are:

- no specific charging obligations;
- a basis of charges (cost orientation) obligation; and
- a charge control.

No specific charging obligations

- 5.24 In the absence of specific charging obligations, BT may be constrained by other SMP conditions imposed within the market. The requirement to provide Network Access and the obligation not to discriminate unduly would mean that BT would be required to provide access on fair and reasonable terms, conditions and charges. Additionally, it would not be permitted to discriminate unduly between customers and this would restrict its ability to set different charges. Regulation set on this basis may be considered to provide a light touch approach and could be sufficient in certain circumstances, for example when we consider a market is moving towards being competitive or there is a risk that specific charge regulation could deter investment. BT would also be subject to the requirements of the EU and UK competition law.
- 5.25 In this market, we are proposing to find that BT holds SMP and therefore has the ability to maintain charges that are excessive. We also consider that the position of SMP held by BT is enduring and that the market will not move towards becoming effectively competitive over the period of this review.
- 5.26 Therefore, we are of the view that wholesale charging obligations are required to address BT's SMP. The options we consider below would to differing degrees constrain BT's ability to set excessive charges.

Basis of charges (cost orientation)

- 5.27 As discussed above, we believe that, without some additional constraint on wholesale charges, BT would have the ability to set excessive charges in order to maximise profits. Excessive charges at the wholesale level are likely to result in high retail prices.
- 5.28 A cost orientation obligation would require BT to set charges based on the long run incremental costs ("LRIC") plus an appropriate mark-up for costs which are common across products, and for recovery of the cost of capital in providing wholesale fixed analogue exchange lines.
- 5.29 We could choose to limit the pricing remedy to the imposition of a cost orientation obligation. However, given BT's position in the market it is likely to be able to exploit the pricing freedom available under a cost orientation requirement by setting charges at the higher end of the range permitted. While this may meet the first order test for cost orientation, it might still result in charges being set higher than the competitive level. A cost orientation obligation on its own might not therefore be sufficient to adequately protect consumers and citizens.

Charge Control

- 5.30 Where there is a risk of a firm setting excessive charges due to a lack of competition in the market, a charge control with transparent and easy to monitor compliance conditions can ensure that a dominant firm is not able to abuse its position.

- 5.31 As discussed above, while a cost orientation obligation would provide some constraint on charge levels, it would not necessarily require charges to be set at the competitive level. However, a charge control sets the maximum price that the firm is allowed to charge over a given period and can be designed to mimic the constraints that would apply in an effectively competitive market. Further, if the firm can reduce its costs below the level expected when the charge control was set, then it can make higher profits, at least for the period the control is in place, and this can act as an incentive for the firm to be efficient.
- 5.32 Generally, there are significant economies of scope in the supply of telecommunications services. Thus, in the situation where a single firm supplies multiple services there are likely to be significant common costs that cannot be attributed to the provision of any one service. In these cases it may be difficult to determine if prices are excessive in one market, without understanding the recovery of costs from related markets. A charge control will generally include an allocation of common costs to the regulated services.
- 5.33 A charge control would result in charges being based on a forward-looking view of the costs related to the provision of wholesale fixed analogue exchange line services over the charge control period. The charge control would provide certainty for CPs in that the maximum charge for wholesale fixed analogue exchange lines (WLR) would be known and it would also allow BT to make a reasonable return.
- 5.34 A charge control, however, can also carry some risk of negative effects. In particular, if the level of the charge control is set too low, this could deter inefficient investment and distort competition.

Conclusion on *ex ante* charging obligations

- 5.35 We propose that generally BT's charges for services in this market should be subject to a cost orientation obligation. Additionally, we propose to introduce a charge control on BT's WLR service, because we do not consider that a cost orientation obligation would, by itself, be sufficient to constrain charges to the level that would prevail in an effectively competitive market.
- 5.36 We propose to consult separately on the detail of the charge control.

Proposed conditions for BT

- 5.37 Based on the above, we propose to retain the obligations which currently apply and that are set out in summary in Table 5.1.
- 5.38 We discuss each of these conditions later in this section, specifically in relation to how they address our competition concerns in the market. We also deal with the product-specific proposals for WLR and the associated charge control on BT in Section 7.

Remedies considered – KCOM

- 5.39 In this section we set out our proposals for remedies to be imposed on KCOM in order to address its SMP. We start by discussing three general options for remedies:
- **Option 1:** no remedies (i.e. the removal of current remedies);
 - **Option 2:** general SMP remedies; and

- **Option 3:** pricing remedies (in addition to Option 2).

5.40 In assessing these options, we have taken account of the effectiveness of the remedies which currently exist in this market.

Option 1 (no regulation)

5.41 In the absence of *ex ante* regulation, KCOM would be able to exploit its market power in a way that could be damaging to the interests of citizens and consumers. For example, if SMP regulation was absent KCOM would be able to withhold access and where it chose to supply a wholesale product then it would be able to set charges above the competitive level.

5.42 Further, paragraphs 21 and 114 of SMP Guidelines state that NRAs must impose one or more SMP service conditions on a dominant provider, and it would be inconsistent with the objectives of the Framework Directive not to impose any SMP service conditions on an undertaking which has SMP.

5.43 As we explain below, KCOM is currently subject to general access, no undue discrimination and transparency requirements in this market. While KCOM has not been required specifically to provide a wholesale fixed analogue exchange line service (e.g. like WLR), we believe these remedies have been proportionate and effective in providing a framework in which competitive provision is possible. Indeed, this framework has enabled Nexus to enter the retail market in Hull by identifying and agreeing a suitable wholesale fixed analogue exchange line service. Therefore we do not believe it would be appropriate to remove this level of regulation.

Option 2 (general SMP remedies)

5.44 In order to promote competition in the provision of downstream fixed narrowband analogue access services, a set of regulatory remedies is required. Specifically, remedies are needed to ensure that KCOM provides access to its network on non-discriminatory terms, and where appropriate and proportionate make available a wholesale fixed analogue exchange lines product (similar to WLR) to other CPs. These general SMP remedies would take the same form and operate in the same way as the current SMP provisions in this market.

5.45 Requiring KCOM to meet reasonable requests for Network Access would enable CPs to compete in the downstream retail market for fixed narrowband analogue access services by enabling them to access the wholesale products that they need, but cannot easily replicate themselves. This is because for a competing CP to supply its own analogue access product it would need to make a substantial investment in deploying a competing network.

5.46 However, relying solely on a Network Access requirement may be ineffective because KCOM might discriminate in favour of its own retail divisions, by setting excessive prices for the externally supplied wholesale product, or making inferior quality (e.g. degrading the terms of supply or the availability or functionality). Such discrimination would restrict the ability of other CPs to compete effectively with KCOM in the downstream markets.

5.47 Therefore, the obligation to provide Network Access is only likely to be effective if supported by an obligation not to discriminate unduly. Currently, KCOM is subject to an obligation not to discriminate unduly in the provision of wholesale fixed analogue exchange lines and we propose to retain this obligation.

- 5.48 However, in order to ensure that KCOM complies with the requirements to supply Network Access and not to discriminate unduly, additional obligations related to transparency are also required. Transparency obligations would provide CPs with access to the information they need in order to make informed decisions about purchasing KCOM's wholesale fixed analogue exchange lines products. Without these obligations, not only would it be difficult for third parties to assess whether KCOM was meeting its obligations to provide Network Access and to not discriminate unduly, it may also be the case that third parties would not have sufficient information to decide whether, or how, to enter the market. This could ultimately result in fewer CPs competing in the retail market, and therefore less choice, for consumers.
- 5.49 Obligations requiring transparency already exist in this market. Currently, KCOM is required to publish a reference offer, notify charges, notify technical information, and provide transparency as to quality of service. We propose to retain these obligations. Given that KCOM holds a position of SMP in this market, in the absence of regulation it would have no economic incentive to provide products on the same terms to competitors.
- 5.50 In addition, we consider that requiring KCOM to publish guidelines in relation to requests for new Network Access (i.e., an SOR process) will provide additional transparency for potential entrants into the Hull market.
- 5.51 Finally, to dissuade KCOM from setting excessive wholesale charges and, by extension, impacting effective competition at the retail level, both cost accounting and accounting separation obligations are in our view needed. The former requires KCOM to demonstrate how the requisite cost orientation obligation is being met. The latter requires the separation of internally and externally supplied products and thus enables Ofcom and other interested parties to monitor for discrimination and provides transparency in the way that KCOM is treating, in accounting terms, its downstream businesses and other wholesale buyers.
- 5.52 Therefore, we have provisionally concluded that the existing framework of supply, non-discrimination, and transparency obligations is necessary going forward to ensure continuing competitiveness in the downstream retail market. In addition, we propose to require KCOM to publish guidelines in relation to requests for new Network Access.

Option 3 (pricing remedies (in addition to Option 2))

- 5.53 As we noted in paragraph 5.22, in a competitive market charges for services would be expected to tend towards the cost of provision. However, where competition cannot be expected to provide an effective constraint, *ex ante* regulation may be needed to prevent charges from being set at an excessive level. Such intervention could also have as its objective the aim of promoting efficiency and of allowing the development of effective competition in downstream markets.
- 5.54 We consider three possible approaches to regulating wholesale charges, each of which is examined in turn below. The three approaches are:
- no specific charging obligations;
 - a basis of charges (cost orientation) obligation; and
 - a charge control.

No specific charging obligations

- 5.55 In the absence of specific charging obligations, KCOM may be constrained by other SMP conditions imposed within the market. The requirement to provide Network Access and the obligation not to discriminate unduly would mean that BT would be required to provide access on fair and reasonable terms, conditions and charges. Additionally, it would not be permitted to discriminate unduly between customers and this would restrict its ability to set different charges. Regulation set on this basis may be considered to provide a light touch approach and could be sufficient in certain circumstances, for example when we consider a market is moving towards being competitive or there is a risk that specific charge regulation could deter investment. KCOM would also be subject to the requirements of the EU and UK competition law.
- 5.56 In this market, we are proposing to find that KCOM holds SMP and therefore has the ability to maintain charges that are excessive. We also consider that the position of SMP held by KCOM is enduring and that the market will not move towards becoming effectively competitive over the period of this review.
- 5.57 Therefore, we are of the view that wholesale charging obligations are required to address KCOM's SMP. The options we consider below would to differing degrees constrain KCOM's ability to set excessive charges.

Basis of charges (cost orientation)

- 5.58 As discussed above, we believe that, without some additional constraint on wholesale charges, KCOM would have the ability to set excessive charges in order to maximise profits, which are likely to translate into high retail prices.
- 5.59 A cost orientation obligation would require KCOM to set charges based on the long run incremental costs ("LRIC") plus an appropriate mark-up for costs which are common across products, and for recovery of the cost of capital in providing wholesale fixed analogue exchange lines.
- 5.60 We could chose to limit the pricing remedy to the imposition of a cost orientation obligation. However, given KOM's position in the market it is likely to be able to exploit the pricing freedom available under a cost orientation requirement by setting charges at the higher end of the range permitted. While this may meet the first order test for cost orientation, it might still result in charges being set higher than the competitive level. A cost orientation obligation on its own might not therefore be sufficient to adequately protect consumers and citizens. Whether this would be a concern in practice is likely to depend on the level of demand for wholesale products.

Charge Control

- 5.61 Where there is a risk of a firm setting excessive charges due to a lack of competition in the market, a charge control can help to ensure that firms are not able to abuse a position of dominance. The benefits associated with the imposition of a charge control, and potential negative effects that might arise from a poorly formulated control are the same as those outlined in paragraphs 5.31 to 5.34 above.

Conclusion on ex ante charging obligations

- 5.62 We propose that KCOM's charges for wholesale fixed analogue exchange lines services in this market should be subject to a cost orientation obligation. While we recognise the attendant risk that KCOM could set wholesale charges above the

competitive level we are not proposing to introduce a charge control on KCOM. This is because we consider the application of charge control remedies on KCOM in the particular circumstances of the Hull area where demand for wholesale provision of fixed analogue exchange lines is low would be a disproportionate use of regulation and would not therefore meet the requirements of section 47(2) of the Act.

Proposed conditions for KCOM

- 5.63 Based on the above, we propose to retain the obligations which currently apply. We are also proposing to introduce a new condition whereby KCOM is required to publish guidelines in relation to requests for new Network Access (i.e., an SOR process). These proposed requirements are set out in summary in Table 5.1.

Proposed SMP conditions on BT and KCOM

- 5.64 The remainder of the section explains the detailed rationale for proposing each of the SMP conditions. The product-specific conditions that we propose to apply to BT are covered in detail in Section 7. Where we are proposing to apply the same remedy to both BT and KCOM we consider them together, given the underlying similarities in the competition issues that apply to the respective markets in each case.

Requirement to provide Network Access on reasonable request

- 5.65 We are proposing to retain a condition requiring BT and KCOM to meet reasonable requests for Network Access in the wholesale fixed analogue exchange line markets.

Aim of regulation

- 5.66 This remedy is designed to promote competition in downstream markets by requiring CPs with SMP to provide wholesale access to their network facilities. The level of investment required by a third party to replicate BT's and KCOM's networks is a significant barrier to market entry. We consider that in the absence of such a requirement, the dominant provider would have an incentive not to provide access. The ability of competing providers to gain wholesale access could facilitate the development of competition in retail markets.

Proposed condition

- 5.67 The proposed condition would require BT and KCOM to provide Network Access in response to a reasonable request and that access should be provided on fair and reasonable terms, conditions and charges.

Legal tests

- 5.68 Section 87(3) of the Act authorises us to set SMP services conditions requiring the dominant CP to provide Network Access as we may, from time to time, direct. These conditions may, under section 87(5), include provision for securing fairness and reasonableness in the way in which requests for Network Access are made and responded to, and that the conditions are complied with within the periods and at the times required.
- 5.69 When considering the imposition of such conditions, we must have regard to the six factors set out in section 87(4) of the Act, including, among other things, the technical and economic viability of installing other competing facilities and the feasibility of the

proposed Network Access. In proposing the condition detailed above we have considered these six factors.

- 5.70 We have considered our duties under section 3 of the Act. We consider that, in ensuring Network Access at the reasonable request of third parties, the proposed condition would in particular further the interests of citizens in relation to communications matters and further the interests of consumers in relevant markets by the promotion of competition.
- 5.71 We have considered the European Community (“Community”) requirements as set out in section 4 of the Act. In particular, the proposed obligation would promote competition in relation to the provision of electronic communications networks and encourage the provision of Network Access for the purpose of securing efficient and sustainable competition in markets for electronic communications networks and services. We have taken account of the current existence of a requirement to provide Network Access on reasonable request in relation to wholesale analogue exchange lines, and in particular that it has been effective in enabling increasingly competitive conditions in the downstream retail market in the UK outside of the Hull area. We believe that removal of the requirement could harm or reverse this.
- 5.72 We consider that the proposed condition meets the criteria set out in section 47(2) of the Act. The proposed condition is:
- objectively justifiable, as its intention is to promote retail competition by ensuring third parties are able to acquire wholesale access on fair and reasonable terms where they are unable to replicate the networks of BT or KCOM;
 - non-discriminatory, as it is only imposed on CPs who are found to have SMP and we propose that both these CPs should be subject to the same obligation;
 - proportionate, since without such an obligation BT and KCOM could refuse to provide access and this would mean other CPs would not be able to effectively compete in markets where we are proposing BT and KCOM hold SMP, but does not require BT and KCOM to provide access where it is not technically feasible or reasonable; and
 - transparent as it is clear the intention is to ensure that BT and KCOM provide access to their networks in order to facilitate competition.

Requests for new Network Access

- 5.73 We are proposing to retain a condition on BT and impose a new condition on KCOM requiring them both to publish guidelines in relation to requests made for new Network Access.
- 5.74 The obligation relates to a SOR process that accompanies the proposed obligation to meet all reasonable requests for Network Access. Both BT and KCOM currently employ SOR processes. Currently, BT is required to publish its process to meet an existing regulatory obligation and KCOM does so as a matter of commercial practice. We consider it appropriate to retain the obligation on BT and to formally impose the obligation on KCOM.

Aim of regulation

- 5.75 We consider that there is a need to ensure that wholesale customers have transparency in the process for obtaining Network Access (including certain enhancements and modifications to existing products), thereby giving them clarity over the form of a request and the timing needed to evaluate it. By requiring that such a process is offered we also consider that it provides a means to assess the basis of any subsequent dispute e.g. the reasons for rejecting a request.
- 5.76 This was the rationale for introducing the SOR obligation on BT in 2003⁵⁷ as part of our *Review of the fixed narrowband wholesale exchange line origination, conveyance and transit markets* (“the 2003 Review”) under SMP Conditions AA1(b).1 and AA1(b).2, obliging it to publish:
- reasonable guidelines on requesting a new product;
 - information for the purpose of making a request for a new product; and
 - a process for dealing with requests for new products.
- 5.77 BT’s Undertakings (“the Undertakings”) were subsequently introduced requiring BT to apply the SOR process for SMP products on an equivalent basis. This includes request for certain enhancements and modifications to SMP products.⁵⁸

Proposed condition (including changes to existing regulation)

- 5.78 In 2009, we set out certain key principles required for an effective and efficient SOR process and as such the SMP condition that we imposed on BT requires it to have in place, and follow for each SOR, an SOR process which:
- is documented end-to-end, with this documentation being available to CPs;
 - has reasonable timescales for each stage of the process;
 - clearly identifies the criteria by which a SOR will be judged;
 - sets out the information that should be provided in order for an SOR to be accepted; and
 - should be agreed between BT and industry.
- 5.79 We did this because we recognised that, while the 2003 SOR process met these criteria, the functioning of the actual SOR process had been limited to a ‘safety net’ role in ensuring process steps were completed within a regulated timeframes. We further recognised that this constraint was a function of certain deficiencies in the

⁵⁷ *Review of the fixed narrowband wholesale exchange line, call origination, conveyance and transit markets: Identification and analysis of markets, determination of market power and the setting of SMP conditions: Final Explanatory Statement and Notification*, 23 November 2003, at <http://stakeholders.ofcom.org.uk/binaries/consultations/750148/fixednarrowbandstatement.pdf>

⁵⁸ Final statements on the Strategic Review of Telecommunications, and undertakings in lieu of a reference under the Enterprise Act 2002, Statement, 22 September 2005, at <http://stakeholders.ofcom.org.uk/binaries/consultations/752417/statement/statement.pdf>, and Undertakings given to Ofcom by BT pursuant to the Enterprise Act 2002 [Consolidated version of the Undertakings (covering all variations up to and including variation number22) dated 23 March 2010], at <http://stakeholders.ofcom.org.uk/binaries/telecoms/policy/bt/consolidated.pdf>

process, and rather than attempting to address these deficiencies in a prescriptive manner it was more appropriate to adopt a principle based approach in the formulation of the SMP Condition. By taking this approach it gave sufficient scope to BT to include improvements over the term of the remedy.

- 5.80 In the period since our September 2009 Wholesale Review, BT has made specific changes to its SOR process in consultation with industry.⁵⁹ We consider that the current SMP condition provides the appropriate level of flexibility to accommodate those SOR process improvements, as well as future developments. For these reasons we do not intend to revise the basis of the new Network Access condition currently in place on BT.
- 5.81 In the same intervening period, we have also seen KCOM meet a reasonable request for Network Access from Nexus. To promote competitive developments in this product, or alternative wholesale analogue access products we consider that it is appropriate to mirror the principles based SOR requirement placed on BT. This will provide a common basis for making such requests across geographic wholesale fixed analogue exchange lines markets and makes clear to CPs what they can expect from the process.

Legal tests

- 5.82 Section 87(3) of the Act authorises the setting of SMP services conditions in relation to the provision of network services. We consider that that under section 87(5)(a), the proposed condition will assist in securing fairness and reasonableness in the way in which requests for Network Access are made and responded to. The condition provides a framework for agreeing and implementing improvements to the existing system, while retaining a 'safety-net'.
- 5.83 Ofcom has considered the Community requirements set out in section 4 of the Act and believes that the proposed condition meets the requirements. Specifically, section 4(8), as the proposed condition has the purpose of securing efficient and sustainable competition in the markets reviewed. We have also considered our duties under section 3 of the Act. We consider that, in requiring certain obligations to be met in relation to requests for new Network Access, the proposed condition would in particular further the interests of citizens in relation to communications matters and further the interests of consumers in relevant markets by the promotion of competition.
- 5.84 Ofcom deems that the proposed condition meets the criteria set out in section 47(2) of the Act. The proposed condition is:
- objectively justifiable as it recognises that a process for handling new requests is needed but that the condition should be flexible to allow for process improvements;
 - not unduly discriminatory as it only applies to providers with SMP and we propose that both are subject to the same obligation;
 - proportionate as it continues to provide a SOR process based on the currently implemented process while allowing scope for industry to be involved in agreeing process improvements; and

⁵⁹ *Changes to the Openreach Statement of Requirements Process*, Customer briefing, GEN036/10, 25/02/2010, at <http://www.openreach.co.uk/orpg/news/generalbriefings/gen03610.do>

- transparent as its intention is to ensure that changes to BT's and KCOM's SOR process are reflective of industry feedback.

Requirement not to discriminate unduly

5.85 We propose to retain the requirement on BT and KCOM not to discriminate unduly in relation to the provision of wholesale analogue exchange line services.

Aim of regulation

5.86 Where dominant CPs are vertically integrated like BT and KCOM they may have an incentive to provide wholesale services on terms and conditions that favour their own retail activities in a way that would have a material adverse effect on competition. In particular, they may charge competing CPs different amounts for the same service, thereby increasing the costs to some competing CPs and giving others an unfair competitive advantage. They might also provide services on different terms and conditions, for example with different delivery timescales, which would disadvantage retail competitors and in turn consumers.

5.87 An obligation to provide Network Access on its own is not adequate to promote downstream competition. In the absence of a requirement not to discriminate unduly, BT and KCOM could favour downstream businesses, which would have the effect of restricting or distorting competition in the retail market.

5.88 We have considered whether allegations or evidence of discriminatory behaviour could be adequately addressed through competition law. However, we consider that in order to meet our objective to promote efficient and sustainable competition at the wholesale level, a no undue discrimination condition is necessary. This condition would ensure that all parties were treated on the same basis, thereby creating the right environment for competition to develop.

Proposed condition

5.89 BT and KCOM should not unduly discriminate against other CPs, in favour of their own retail activities, in the provision of Network Access. This includes any undue discrimination in relation to the underlying components of the Network Access services.

Legal tests

5.90 Section 87(6)(a) of the Act authorises the setting of a SMP services condition requiring the dominant CP not to discriminate unduly against particular persons, or against a particular description of persons, in relation to matters connected with the provision of Network Access.

5.91 Together with an obligation to provide Network Access, the proposed obligation would in particular encourage the provision of Network Access and service interoperability for the purpose of efficiency and sustainable competition in downstream markets by ensuring that BT and KCOM were not permitted to discriminate unduly. This would ensure a competitive playing field and thereby promoting competition and so furthering the interests of consumers through the increased choice in downstream markets.

5.92 Therefore, we consider that the proposed condition in particular furthers the interests of citizens in relation to communications matters and further the interests of

consumers in relevant markets by the promotion of competition in line with section 3 of the Act. We have taken account of the current existence of a requirement not to discriminate unduly in relation to wholesale provision of analogue exchange line services, and that it has, in particular been effective in enabling increasingly competitive conditions in the downstream retail market in the UK outside of the Hull area. Furthermore, the proposed condition has also played an important role in fostering greater competition in the retail market in the Hull area. We believe that removal of the requirement could harm or reverse this.

- 5.93 We have considered the Community requirements as set out in section 4 of the Act. The proposed condition, in particular, would encourage the provision of Network Access and service interoperability for the purpose of securing efficient and sustainable competition in the retail markets for access and calls, by ensuring BT and KCOM were not permitted to unfairly favour particular retail businesses and therefore distort competition.
- 5.94 We consider that the proposed condition meets the criteria set out in section 47(2) of the Act. We believe the proposed condition is:
- objectively justifiable, as it would provide a safeguard to prevent BT and KCOM from favouring their own or affiliated businesses, to the disadvantage of their competitors;
 - not unduly discriminatory, as it would be imposed only on CPs who are found to have SMP and we propose that both CPs should be subject to the same obligation;
 - proportionate, as it is intended to prohibit discrimination that is undue only, that is discrimination that would materially affect the ability of BT's and KCOM's competitors to compete on equal terms; and
 - transparent, as it is clear that its intention is to prevent discrimination that is undue.

Basis of charges (cost orientation)

- 5.95 We are proposing to retain the basis of charges requirement on BT and KCOM. This obliges BT and KCOM to comply with a cost orientation condition, whereby Network Access charges must be made on the basis of long run incremental costs plus an appropriate mark-up for costs which are common across products, and for recovery of the cost of capital.

Aim of regulation

- 5.96 In a competitive market, the pricing of services on the basis of the commercial judgements of individual companies could be expected to deliver cost reflective pricing. However, where competition cannot be expected to provide effective constraints, *ex ante* regulation may be desirable to prevent excessive pricing. Such intervention could also have as its objectives the aim of promoting efficiency and allowing the development of effective competition in downstream markets.
- 5.97 Without some intervention in pricing, dominant providers have the ability to charge excessive prices in order to maximise profits by increasing their revenues. A concern regarding the follow on effect is that this impacts the cost base of competing providers who purchase wholesale services from the dominant provider. It could

make it difficult for third party CPs to compete at the retail level with the dominant provider and in the long term, may result in market exit. In terms of the effect on the retail market, unjustifiably high wholesale charges are also likely to mean high retail prices. High retail prices indicate that consumers may be paying more for a service than they should expect to if wholesale prices were constrained by effective competition.

LRIC plus an appropriate mark up for common costs and for recovery of cost of capital is the preferred method for this type of access regulation in communications markets. This is because communications markets experience economies of scale and high sunk costs, which can potentially cause competition problems. Pricing strategies which do not reflect the need to recover high fixed sunk costs could deter market entry and could therefore restrict or distort competition in the retail market.

Proposed condition

- 5.98 The proposed condition requires that the charges made by BT and KCOM for Network Access services should be reasonably derived from the costs of providing those services, and that the costs must be calculated on a forward looking long-run incremental cost approach, and allowing an appropriate mark up for the recovery of common costs including an appropriate return on capital employed.
- 5.99 The proposed condition would apply to BT in the market for provision of wholesale analogue exchange lines in the UK except the Hull area in which our preliminary conclusion is that it has SMP, and to KCOM in the market for provision of wholesale analogue exchange lines in the Hull area in which our preliminary conclusion is that it has SMP.⁶⁰

Legal tests

- 5.100 Section 87(9) of the Act authorises the setting of SMP services conditions imposing on the dominant provider rules concerning the recovery of costs and cost orientation
- 5.101 We have considered the Community requirements set out in section 4 of the Act. In particular, the proposed condition promotes competition and secures efficient and sustainable competition by ensuring that charges for wholesale services are at a level that enables operators to compete. We also consider that the proposed condition in particular furthers the interests of citizens in relation to communications matters and furthers the interests of consumers in relevant markets by promotion of competition in line with section 3 of the Act.
- 5.102 We consider that the proposed condition meets the criteria set out in section 47(2) of the Act. Ofcom considers the proposed condition is:

⁶⁰ As we note in paragraph 6.7, BT currently offers some services, within the wholesale analogue exchange lines services, that provide an enhanced level of service support to rented wholesale lines ("Enhanced Service Level Care Services"). We previously concluded that different pricing constraints apply to these services within the wholesale analogue exchange line services market and that we should not continue to apply the cost orientation obligations to these services. We therefore issued a Direction disapplying service Conditions AAA3.1 and AAA10.2 to Enhanced Service Level Care Services provided by BT in support of the rental of wholesale lines for the wholesale analogue exchange lines services market. See, *Charge controls for Wholesale Line Rental – implementation and cost orientation*, Second Statement, 23 February 2010, at http://stakeholders.ofcom.org.uk/binaries/consultations/wlr/statement/wlr_statement.pdf

- objectively justifiable as it enables competitors to purchase services at charges that will enable them to develop competitive services to the benefit of consumers, while also allowing BT and KCOM a return to recover common costs and cost of capital;
- not unduly discriminatory, as it is only imposed on both BT and KCOM and no other operator has SMP in these markets and all providers are subject to the same obligation;
- proportionate as without such an obligation the price-setting behaviour of BT and KCOM would not be constrained by competitive pressure, allowing them to set charges which restricted the ability of other CPs to buy wholesale products that allow them to provide competitive products to consumers; and
- transparent as it is clear the intention is to ensure that BT and KCOM charge on a cost-oriented basis.

5.103 Ofcom has also considered the tests set out in section 88 and believes the proposed obligation is therefore appropriate. Further to the arguments outlined above, there is a risk that, in situations where SMP is persistent, pricing will be distorted and not at competitive levels, as dominant providers are likely to want to charge excessive prices in order to maximise profits by increasing their revenues and the costs of competing providers. The proposed condition promotes efficiency, promotes sustainable competition and provides the greatest possible benefits to consumers by enabling competing providers to buy wholesale services at levels that might be expected in competitive market.

5.104 The extent of investment of the dominant operator has been taken into account as set out in section 88(2), as the obligation provides for a mark-up for an appropriate return on capital employed.

5.105 In regard to the provision of WLR, we discuss the elements of the WLR product that should be subject to this condition in Section 6.

Transparency

5.106 We consider that it is appropriate to ensure that there is transparency of charges, terms and conditions in a market in which one CP is dominant. In the absence of requirements obliging an SMP CP to publish information, it might offer differential charges, terms and conditions to its downstream division and other CPs, or as between other CPs. Third party CPs would not be able to check that they were being charged the same rate, or offered the same terms and conditions as their competitors.

5.107 Section 87(6)(b) of the Act authorises the setting of SMP services conditions which require a dominant CP to publish all such information, and in such manner as we may direct, for the purpose of securing transparency. Section 87(6)(c) of the Act authorises the setting of SMP services conditions requiring the dominant CP to publish, in such manner as we may direct, the terms and conditions on which it is willing to enter into an access contract. Section 87(6)(d) also permits the setting of SMP services conditions requiring the dominant CP to include specified terms and conditions in the reference offer. Finally, section 87(6)(e) permits the setting of SMP services conditions requiring the dominant CP to make such modifications to the reference offer as we may direct from time to time.

We propose to impose the following obligations to provide transparency in the markets for wholesale provision of analogue exchange line services:

- requirement to publish a reference offer;
- requirement to notify charges;
- requirement to notify technical information;
- transparency as to quality of service;⁶¹ and
- requirement to account separately.

Requirement to publish a reference offer

5.108 We are proposing to retain the requirement BT and KCOM to publish a reference offer (“RO”) for services and products offered in the markets for wholesale analogue exchange line services.

Aim of regulation

5.109 The main reasons for requiring the publication of a RO is to assist with transparency in monitoring for potential anti-competitive behaviour and to give visibility to the terms and conditions on which other CPs would be able to purchase wholesale analogue exchange line services. The publication of a RO would therefore help to ensure stability in markets and that incentives to invest would not be undermined.

5.110 The publication of a RO would allow for faster negotiations and might avoid possible disputes. Together with a no undue discrimination requirement, the publication of a RO would give confidence to those purchasing wholesale analogue exchange line services that they were being provided on non-discriminatory terms. We have taken account of the current requirement to publish a RO for wholesale analogue exchange line services, and that it has been effective in enabling increasingly competitive conditions in the downstream retail markets for fixed narrowband access. We consider that removal of the requirement could harm downstream competition.

Proposed condition

5.111 We consider that the RO should include:

- a clear description of the services on offer;
- terms and conditions including charges and ordering, provisioning, billing and dispute resolution procedures. The RO should provide sufficient information to enable providers to make technical and commercial judgements such that there is no material adverse effect on competition;
- information relating to technical interfaces and points of interconnection. Such information should ensure that CPs were able to make full and effective use of all the services provided;
- conditions relating to maintenance and quality (service level agreements and guarantees). The inclusion of service levels, as part of the contractual terms of

⁶¹ We do not propose to impose this obligation on KCOM for the reasons set out below.

the RO, that provide for a minimum acceptable level of service, would ensure that services would be provided in a fair, reasonable, timely and non-discriminatory fashion; and

- terms and conditions that are fair and reasonable. This would ensure that products are offered on similar terms and conditions as would apply in a competitive market and that they were sensible, practical, and did not impose a margin squeeze on competitors.

5.112 The list of network components that comprise the services detailed in the reference offer is contained within, the regulatory financial reporting obligations on BT and KCOM⁶² and associated Directions made from time to time amending the list of network components.

5.113 In addition, BT and KCOM must include in the RO the amounts charged to their own retail activities (transfer charges) and the underlying components from which those amounts are derived, for the equivalent service that they provide to competing providers.

Legal tests

5.114 The requirement to publish a RO would, in combination with a requirement not to discriminate unduly, facilitate service interoperability, secure freedom of choice for wholesale customers of BT and KCOM and allow CPs to make informed decisions about wholesale investment. Further, the proposed obligation would promote the interests of purchasers of wholesale analogue exchange lines by enabling them to adjust their downstream offerings in competition with BT or KCOM, in response to changes in their terms and conditions. Finally, the proposed obligation would make it easier for CPs in the relevant market, and us, to monitor any instances of undue discrimination.

5.115 For the reasons set out above, we consider that the proposed condition in particular furthers the interests of citizens in relation to communications matters and furthers the interests of consumers in relevant markets by the promotion of competition in line with section 3 of the Act.

5.116 We consider that the proposed condition meets the Community requirements set out in section 4 of the Act. In particular, the proposed condition could promote competition and encourage the provision of Network Access and service interoperability for the purpose of securing efficient and sustainable competition and the maximum benefit for customers. The publication of a RO would mean that CPs would have the necessary information readily available to allow them to make informed decisions about entry into the market.

5.117 We consider that the proposed condition meets the criteria set out in section 47(2) of the Act. The proposed obligation is:

- objectively justifiable, in that would require that terms and conditions were published allowing competing CPs the ability to ensure they were receiving offers that did not discriminate unduly in favour of the dominant CP's own retail operations, therefore encouraging competition to the benefit of consumers;

⁶² *The regulatory financial reporting obligations on BT and Kingston Communications, Final Statement and notification: Accounting separation and cost accounting*, Statement, 22 July 2004, at http://stakeholders.ofcom.org.uk/consultations/fin_reporting/fin_report_statement

- not unduly discriminatory, as would be applied only to CPs who hold SMP and we propose that both are subject to the same obligation;
- proportionate, in that only information that is necessary to ensure that there is no material adverse effect on competition would be required to be provided; and
- transparent, as it is clear the obligation would be designed to ensure that potential competitors have sufficient information to make investment decisions about entry into this market.

Requirement to notify charges

5.118 We are proposing to retain a requirement on BT and KCOM to publish any planned changes to wholesale charges in advance of those changes taking place for wholesale analogue exchange line services.

Aim of regulation

5.119 Notification of changes to services at the wholesale level can further assist competition, as it means other CPs would have the opportunity to consider whether these changes require amendments to their own retail offerings.

5.120 The notification of charges at the wholesale level has the joint purpose to assist transparency for the monitoring of potential anti-competitive behaviour and to give advanced warning of charge changes to competing providers who purchase wholesale analogue exchange line services. The latter purpose ensures that competing providers would have sufficient time to plan for such changes. Notification of changes therefore helps to ensure stability in markets without which incentives to invest might be undermined and market entry made less likely.

Proposed condition

5.121 We consider that the notice should include:

- A description of the access service;
- The location of terms and conditions in the RO;
- The effective date or period from which the changes will have effect;
- The current and proposed charge and the relevant usage factors applied to each network component; and
- Other charges for services that would be directly affected by the proposed change.

5.122 Furthermore, we continue to consider that the following charge notification periods are appropriate for wholesale analogue exchange line services:

- 90 days for BT's Wholesale Line Rental charge;
- 90 days for KCOM's Wholesale Line Rental charge; and
- 28 days for all other services.

5.123 The proposed condition would apply to BT in the market for provision of wholesale analogue exchange lines in the UK except the Hull area, and to KCOM in the market for provision of wholesale analogue exchange lines in the Hull area.

Legal tests

5.124 The requirement to notify charges would, in combination with a requirement not to discriminate unduly, allow CPs to make informed decisions about wholesale investment. Further, the proposed obligation would promote the interests of purchasers of wholesale analogue exchange line services by enabling them to adjust their downstream offerings in competition with BT and KCOM in response to changes in BT or KCOM's charges. The proposed obligation would also make it easier for us to monitor any instances of discrimination.

5.125 We have taken account of the existence of a current requirement to notify charges, terms and conditions for wholesale analogue exchange lines. In particular, the existing obligation has been effective in enabling increasingly competitive conditions in the downstream retail market in the UK outside of the Hull area. It is also likely to have been a key factor in informing market entry in the Hull area, and will support the development of nascent competition in the retail market.⁶³ We believe that removal of the requirement could harm or reverse this.

5.126 For the reasons set out above, we consider that the proposed condition in particular furthers the interests of citizens in relation to communications matters and furthers the interests of consumers in relevant markets by the promotion of competition in line with section 3 of the Act.

5.127 We consider that the proposed condition meets the Community requirements set out in section 4 of the Act. In particular, the proposed condition could promote competition and secure efficient and sustainable competition and the maximum benefit for customers by ensuring that CPs have the necessary information to allow them to make informed decisions about competing in the relevant market.

5.128 We consider that the proposed condition meets the criteria set out in section 47(2) of the Act. It is:

- objectively justifiable, because general and reliable visibility of a dominant CP's charges is needed to enable competitors to set prices for their services that are based on purchasing the regulated inputs. It would also allow CPs and us to monitor BT and KCOM's charges for possible anti-competitive behaviour;
- not unduly discriminatory, as it is only imposed on CPs who have SMP and we propose that both CPs should be subject to the same obligation;
- proportionate, in that only information that other CPs would need to know in order to adjust for any changes would have to be notified. The period of 28 days is proposed to be the minimum required to allow changes to be reflected in retail offers; and
- transparent, as it is clear the intention is to ensure that BT and KCOM notify CPs who purchase wholesale access of changes to charges.

⁶³ While KCOM has yet to notify a charge change for its wholesale analogue exchange line offering, KCOM is now providing a wholesale exchange lines product.
http://www.kcomplc.com/aboutus/regulatoryinformation/charge_change_notices.asp

Requirement to notify technical information

5.129 We are proposing to retain a requirement on BT and KCOM to notify technical information a minimum of 90 days in advance of providing new wholesale fixed analogue exchange line services, or amending existing technical terms and conditions.

Aim of regulation

5.130 The aim of an obligation to provide advance notification of technical characteristics is to ensure that competing CPs have sufficient time to respond to changes that may affect them. For example, a competing CP may need to introduce new equipment or modify existing equipment or systems to support a new or changed technical interface.

5.131 Technical information includes new or amended technical characteristics, including information on network configuration, locations of the points of Network Access and technical standards (including any usage restrictions and other security issues). Relevant information about network configuration is likely to include information about the function and connectivity of points of access, for example, the connectivity of exchanges to end users and other exchanges.

Proposed condition

5.132 The existing condition requires the notification of new technical information 90 days in advance of providing new wholesale services or amending existing technical terms and conditions. We continue to believe that 90 days' notice is the minimum time that competing CPs would need to make modifications to their network to support changes.

5.133 This condition for 90 days' notice relates to changes to technical information related to SMP services. All CPs are required to comply with General Condition 2,⁶⁴ which obliges them to apply compulsory standards, or in the absence of these, voluntary standards. Such changes should be agreed through the NICC.⁶⁵ Therefore, agreement of such standards should normally have been agreed at NICC prior to this 90 day period.

5.134 The proposed condition would apply to BT in the market for wholesale fixed analogue exchange lines in the UK (except the Hull area), and to KCOM in the market for wholesale fixed analogue exchange lines in the Hull area.

Major changes and Next Generation Access networks

5.135 For major changes to the existing network and migration to NGA networks, we consider that industry consultation (including through the NICC) continues to be an appropriate way to progress modifications. This consultation and agreement phase would not fall within the notice period; therefore the formal 90 day notification period would follow the industry process. That is, the notification should be made only following the conclusion of the industry consultation process.

⁶⁴ http://www.ofcom.org.uk/telecoms/ioi/g_a_regime/

⁶⁵ NICC is a technical forum for the UK communications sector that develops interoperability standards for public communications networks and services in the UK. See <http://www.niccstandards.org.uk/>.

Legal tests

- 5.136 We consider that, by ensuring that CPs' systems are interoperable with any changes to technical specifications that might affect their businesses, the proposed condition in particular furthers the interests of citizens in relation to communications matters and furthers the interests of consumers in relevant markets by the promotion of competition in line with section 3 of the Act.
- 5.137 We consider that the proposed condition meets the Community requirements set out in section 4 of the Act. In particular, the proposed condition could promote competition and secure efficient and sustainable competition and the maximum benefits for customers by ensuring that CPs have sufficient notification of technical changes to the dominant CP's network to enable them to compete. We have taken account of the current existence of a requirement to notify technical information in relation to wholesale analogue exchange lines, and that, in particular, it has been effective in enabling increasingly competitive conditions in the downstream retail market in the UK outside of the Hull area. It is also likely to have been a factor in informing market entry in the Hull area, and will support the development of nascent competition in the retail market in the Hull area. We believe that removal of the requirement could harm or reverse this.
- 5.138 We consider that the proposed condition meets the criteria set out in section 47(2) of the Act. It is:
- objectively justifiable, as it would enable CPs to make full and effective use of Network Access. The period would allow CPs time to react to proposed changes without imposing an unnecessarily long notification period on BT and KCOM that may restrict their ability to develop and deploy new features or products;
 - not unduly discriminatory, as we only imposed on CPs who have SMP and we that both should be subject to the same obligation;
 - proportionate, in that 90 days, notice is considered the minimum period necessary to allow CPs to modify their networks; and
 - transparent, in that it is clear in its intention that BT and KCOM notify technical information.

Transparency as to quality of service

- 5.139 We consider it appropriate to continue to require BT to provide transparency as to the quality of service it provides. No requirement for this currently applies to KCOM and, given the size of the market and the limited demand for a wholesale service, we do not believe it would be proportionate to extend this regulation onto KCOM.

Aim of regulation

- 5.140 Dominant CPs in wholesale markets have the ability to favour their own downstream or affiliated businesses over third party CPs, by differentiating on price or terms and conditions including quality of service (either in service provision and maintenance or in the quality of network service provided by the dominant CP to external CPs compared to its own retail operations). This has the potential to distort competition at the retail level by placing third party CPs at a disadvantage in terms of the services they can offer consumers to compete in downstream retail markets. Distortions can

also be caused by provision of wholesale services with varying levels of service quality.

- 5.141 The intention of the transparency of quality of service remedy is to monitor whether any undue discrimination is occurring by requiring the publication of data regarding the delivery of wholesale services by Openreach to downstream BT businesses and other third party CPs. We believe that it is necessary for quality of service to be measured and transparent.

Proposed condition

- 5.142 The September 2009 Wholesale Review imposed a requirement on BT to publish data on specified Key Performance Indicators (KPIs) in the analogue exchange line market. This requirement was made under a Direction under SMP Condition AAA7. Previous KPIs which applied to those markets were withdrawn.
- 5.143 We consider it appropriate to continue to require BT to provide transparency as to the quality of service it provides and intend to set a new Direction

New Direction

- 5.144 We continue to believe that effective reporting of BT's service provision and fault repair performance remains critical to ensuring transparency of the quality of service. For these reasons we consider it necessary to require BT to report key indicators that track core fault and repair processes as these are key indicators of the quality of service being provided.
- 5.145 To those ends, we consider that it is important that BT provides us with a set of KPIs (see Table 5.2 below) to enable us to effectively monitor potential instances of service level discrimination. We also consider it appropriate that BT publishes:
- that same set of KPIs on an industry average basis;
 - a common sub-set of those KPIs identifying WLR provisioning and repair performance in relation to:
 - Openreach's supply of WLR to its own downstream divisions; and
 - alternative grades of service level offerings made available to other non-BT CPs.
- 5.146 In addition, we also consider it appropriate that BT makes available the key set of KPIs that we have identified on an individual company basis to enable each CP buying WLR services to evaluate the individual service performance they have received from BT. Given the sensitive nature of that information, we are of the view that BT should provide access to that information using a confidential link to an appropriate website.⁶⁶

⁶⁶ For the avoidance of doubt, we consider that where BT makes company specific KPI data available to each third party that is using WLR, which it can access at its own discretion using the confidential link then this qualifies as providing that information by the specified means.

Table 5.2: BT's non-discrimination KPIs

Proposed KPIs to be reported
Volume of wholesale fixed analogue exchange lines ⁶⁷ orders submitted
Volume of wholesale fixed analogue exchange lines orders rejected
Volume of wholesale fixed analogue exchange lines orders rejected broken down by order type
Aggregate percentage across all CPs of wholesale fixed analogue exchange lines orders rejected broken down by order type
Average time between acceptance of wholesale fixed analogue exchange lines orders and service activation
Average time between acceptance of a wholesale fixed analogue exchange lines order and service activation date for orders requiring an engineering visit
Percentage of subject to faults within a specified period
Average time between submission of a wholesale fixed analogue exchange lines fault report and fault being cleared
Percentage of times and engineering visit is missed
Percentage of wholesale fixed analogue exchange lines subject to a repeat fault
Percentage of billable Call Data Records ("CDRs") produced on time
Order gateway availability
Data Exchange & Distribution Server ("DEDS") availability
eCo repair availability

- 5.147 Since our September 2009 Wholesale Review, Openreach's has further developed its KPI Online reporting tool.⁶⁸ This offers CPs a range of instant access capabilities to enable them to conduct detailed analysis of service level performance. The reporting capability, together with its broader development path, provides Openreach with an opportunity to collaborate with its customers in order to provide them with service level information that they need to support effective and efficient product delivery. While the KPI Online reporting tool can be used by BT as the delivery mechanism to meet its company specific KPI reporting requirement, whether BT chooses to use it to meet the requirement is at BT's discretion. Other methods of complying may also be considered.
- 5.148 While the proposed direction is unchanged from that which is currently in place, we have considered it appropriate to use this opportunity to confirm the purpose of the provision and to ensure that the requirements continue to remain relevant.
- 5.149 The proposed condition and associated direction would apply to BT in the market for provision of wholesale analogue exchange lines in the UK except in the Hull area.

⁶⁷ Openreach's reporting system specifies the wholesale fixed analogue access product as Wholesale Access ("WA")

⁶⁸ Available to communications providers in the form Openreach Analytics, *KPI Online Handbook*, at <http://www.openreach.co.uk/org/products/cpp/downloads/KPI%20On-line%20handbook090730.pdf>

Legal test

- 5.150 We consider that, in ensuring the Network Access that third party CPs receive from Openreach is on the same terms as downstream BT divisions the condition, in particular, furthers the interests of citizens in relation to communications matters and furthers the interests of consumers in relevant markets by the promotion of competition in line with section 3 of the Act.
- 5.151 Ofcom has considered the Community requirements in section 4 of the Act and believes that the proposed condition promotes competition and secures efficient and sustainable competition by ensuring transparency through comparison of the service levels BT provides to itself versus third party CPs.
- 5.152 Ofcom considers that the proposed condition meets the requirements in section 47. The proposed condition is:
- objectively justifiable because in the absence of a requirement to publish specific KPIs, it would not be possible to monitor if there is any undue discrimination in the quality of service provided by BT;
 - not unduly discriminatory as it applies to BT only. We will not impose this obligation on KCOM as we not consider that such an obligation would be justifiable as the information provided would not be statistically meaningful given the number of CPs active in the Hull area;
 - proportionate as BT will only be required to publish data related to key business processes; and
 - transparent as it is clear that its intention is to monitor for undue discrimination in the quality of service provided by BT.
- 5.153 We consider that the KPI Direction meets the requirements in section 49. We are satisfied that the direction:
- is objectively justifiable, as we have identified a need to publish specific KPIs to ensure that we can monitor any discrimination that is undue in the market;
 - does not discriminate unduly, as it only applies to BT and it is subject to SMP transparency condition;
 - is proportionate, as BT is only required to publish specific KPI data related to key business processes. Further, BT is already supplying such data on a voluntary basis, and has systems and procedures in place to supply the required information; and
 - is transparent, as it is clear from the Direction as to what information would be required to be published and supplied by Openreach.

Cost accounting

- 5.154 Ofcom considers that it is appropriate to retain a cost accounting obligation on BT and KCOM in relation to the markets and technical area where they have been found to hold SMP.

Aim of regulation

- 5.155 The cost accounting obligation will require BT and KCOM to demonstrate that their charges are cost orientated on the basis of Long Run Incremental Cost (“LRIC”) with an appropriate mark-up for the recovery of common costs, and therefore meet the cost orientation obligation. It will also provide information necessary for Ofcom to set, monitor and review charge control obligations for BT.
- 5.156 Paragraphs 5.95 to 5.105 and paragraphs 7.7 to 7.19 outline our arguments for why, and in which markets, we propose to impose a cost orientation and/or a charge control.

Proposal

5.157 We propose that BT and KCOM should continue to be required to comply with obligations governing cost accounting systems and processes as set out in an Ofcom statement published in 2004.⁶⁹ The outputs include:

- Generic cost orientation and non-discrimination requirements:
 - Preparation of a variety of financial statements;
 - Preparation of extensive supporting documentation explaining how the financial statements have been put together;
 - Provision of an independent assurance statement;
 - Publication of most of the information; and
 - Preparation of reconciliation statements;
- Cost orientation specific requirements:
 - Preparation of service level cost data (LRIC and Fully Allocated Cost (“FAC”)) compared to average charges;
 - Preparation of costs of network components used to deliver services; and
 - Analysis of service cost stack by component;
- Non-discrimination specific requirements:
 - Analysis of internal and external sales including volume data.

5.158 The proposed condition would apply to BT in the market for wholesale fixed analogue exchange lines in the UK (except the Hull area), and to KCOM in the market for wholesale fixed analogue exchange lines in the Hull area.

⁶⁹ *The regulatory financial reporting obligations on BT and Kingston Communications, Statement and notification: Accounting separation and cost accounting*, 22 July 2004, http://www.ofcom.org.uk/consult/condocs/fin_reporting/fin_report_statement/

Legal tests

- 5.159 We have considered our duties under section 3 of the Act. In particular, the imposition of a cost accounting obligation is justifiable and proportionate to promote competition in relation to the provision of electronic communications networks and services; to ensure the provision of Network Access and service interoperability for the purpose of securing efficient and sustainable competition and the maximum benefit for the persons who are customers of CPs. This is because the imposition of the obligation ensures that obligations designed to curb potentially damaging leverage of market power – in particular the setting of charges at seemingly excessive levels – can be effectively monitored and enforced.
- 5.160 Ofcom has considered the Community requirements set out in section 4 of the Act and believes that the proposed condition meets the requirements. Specifically, the condition would meet the requirement under sections 4(7) and 4(8) to encourage the provision of network access for purpose of securing efficient and sustainable competition in the markets for electronic communications networks and services, by ensuring dominant providers comply with cost orientation and charge control remedies implemented to promote competition.
- 5.161 Under sections 87(9) to 87(11) and 88 of the Act, appropriate cost accounting obligations may be imposed on dominant providers in respect of the provision of Network Access, the use of the relevant network and the availability of relevant facilities. Cost accounting rules may be made in relation to charge controls, the recovery of costs and cost orientation.
- 5.162 Ofcom deems the proposed condition meets the criteria set out in section 47(2) of the Act. The obligation is:
- objectively justifiable as it relates to the need to ensure competition develops fairly, to the benefit of consumers;
 - non-discriminatory as BT and KCOM are the only providers to hold SMP in the relevant markets;
 - proportionate as it is necessary as a mechanism to allow third parties sight of regulatory accounts to ensure compliance with cost orientation and charge control remedies; and
 - transparent as it is clear the intention is to monitor compliance with specific remedies and the particular cost accounting requirements of BT and KCOM are clearly documented.

Accounting Separation

- 5.163 Ofcom considers that it is appropriate to retain an accounting separation obligation on BT and KCOM in relation to the markets and technical area where they have been found to hold SMP.

Aim of regulation

- 5.164 The accounting separation obligation will require BT and KCOM to account separately for internal and external 'sales', which will allow Ofcom and third party CPs to monitor the activities of dominant providers to ensure that they do not discriminate in favour of their own downstream businesses.

5.165 Paragraphs 5.85 to 5.94 outline our arguments for why and in which markets we propose to impose a non-discrimination remedy.

Proposal

5.166 BT and KCOM are required to continue to produce a range of outputs, which support compliance with a no undue discrimination remedy, according to requirements set out in an Ofcom statement published in 2004.⁷⁰

5.167 The proposed condition would apply to BT in the market for provision of wholesale analogue exchange lines in the UK except the Hull area, and for KCOM in the market for provision of wholesale analogue exchange lines in the Hull area.

Legal tests

5.168 The imposition of an accounting separation obligation is justifiable and proportionate to promote competition in relation to the provision of electronic communications networks and service to ensure the provision of Network Access and service interoperability for the purpose of securing efficient and sustainable competition and the maximum benefit for end consumers.

5.169 Ofcom has considered the Community requirements set out in section 4 of the Act and believes that the proposed condition meets the requirements. Specifically, the condition would meet the requirement under sections 4(7) and 4(8) to encourage the provision of network access for the purpose of securing efficient and sustainable competition in the markets for electronic communications networks and services, by ensuring dominant providers do not favour their own downstream businesses, thereby disadvantaging third party CPs.

5.170 Under section 87(7) and 87(8) of the Act, appropriate accounting separation obligations may be imposed on the dominant provider in respect of the provision of Network Access, the use of the relevant network and the availability of relevant facilities. This means that the dominant provider may be required to maintain a separation for accounting purposes between such different matters relating to Network Access or the availability of relevant facilities.

5.171 Ofcom considers the proposed condition meets the criteria set out in section 47(2) of the Act. The obligation is:

- objectively justifiable as it relates to the need to ensure competition develops fairly, to the benefit of consumers;
- non-discriminatory as BT and KCOM are the only providers to hold SMP in the relevant markets;
- proportionate as it is necessary as a mechanism to allow Ofcom and third parties to monitor for discriminatory behaviour by dominant providers; and
- transparent as it is clear the intention is to monitor compliance with specific remedies and the particular accounting separation requirements of BT and KCOM are clearly documented⁷¹.

⁷⁰ *Ibid*

Consultation questions

Question 4: Do you agree that Ofcom should retain the set of proposed general SMP conditions on BT and KCOM? If not, please explain why.

Question 5: Do you agree that Ofcom should impose a new general SMP condition on KCOM by requiring it to follow an SOR process in handling new requests for Network Access? If not, please explain why.

Question 6: Are the KPIs proposed above sufficient to provide industry with the necessary level of transparency?

Question 7: Do you agree that Ofcom should continue to impose an obligation on BT and KCOM to comply with obligations governing cost accounting systems and processes as set out by Ofcom? If not, please explain why.

Question 8: Do you agree that Ofcom should continue to impose an obligation on BT and KCOM to comply with obligations governing accounting separation as set out by Ofcom in the markets and technical area discussed? If not, please explain why.

⁷¹ 'The regulatory financial reporting obligations on BT and Kingston Communications, Final Statement and notification: Accounting separation and cost accounting', 22 July 2004, http://www.ofcom.org.uk/consult/condocs/fin_reporting/fin_report_statement/

Section 6

Specific remedy for BT - Wholesale Line Rental

Introduction

- 6.1 In addition to the general remedies set out in Section 5, this section considers the appropriateness of imposing specific remedies on BT given our proposed finding that BT has SMP in the wholesale analogue exchange lines market.

Requirement to provide analogue Wholesale Line Rental (WLR)

- 6.2 Analogue WLR is a wholesale exchange line service sold by BT both to its own downstream businesses and to competing CPs. It is either onward sold to different retail providers, or used by the wholesale purchaser to provide retail narrowband access services either as a line rental service or as part of a bundle of services. When using WLR providers take on the full retail relationship with the customer and can offer a 'single bill' to end-users for all basic telecommunications services.

Aim of regulation

- 6.3 The aim of the analogue WLR remedy is to address directly BT's SMP in the wholesale access market by requiring it to make available a product which allows other CPs to compete with BT's downstream businesses on an equivalent basis. Furthermore, this remedy also has the ability to enhance downstream calls markets remedies (Carrier-Pre Selection ("CPS") and Indirect Access remedies that apply in the call origination market) by exposing a greater part of the value chain to competition.

Existing regulation

- 6.4 In our September 2009 Wholesale Review, we imposed an obligation on BT to provide WLR in response to the finding that BT held SMP.

Proposed regulation

- 6.5 As discussed in Section 4, we are proposing to find that BT still has SMP in the wholesale analogue exchange lines market in the UK (excluding the Hull area), and as discussed in Section 5 we are proposing to retain the requirement for BT to provide a WLR product.⁷² Analogue WLR has been, and remains, a central service supporting effective competition in fixed narrowband services at the retail level (as demonstrated by our recent finding that BT no longer holds SMP in the provision of retail analogue access services).⁷³
- 6.6 We are not proposing to amend the current WLR SMP condition. Specifically, we are proposing to retain the requirement placed on BT to provide an analogue WLR product to CPs.

⁷² Section 7 outlines our proposals in relation to the application of charge controls for WLR products.

⁷³ *Review of Fixed Narrowband Retail Services Markets*, Statement, 15 September 2009, at http://www.ofcom.org.uk/consult/condocs/retail_markets/statement/

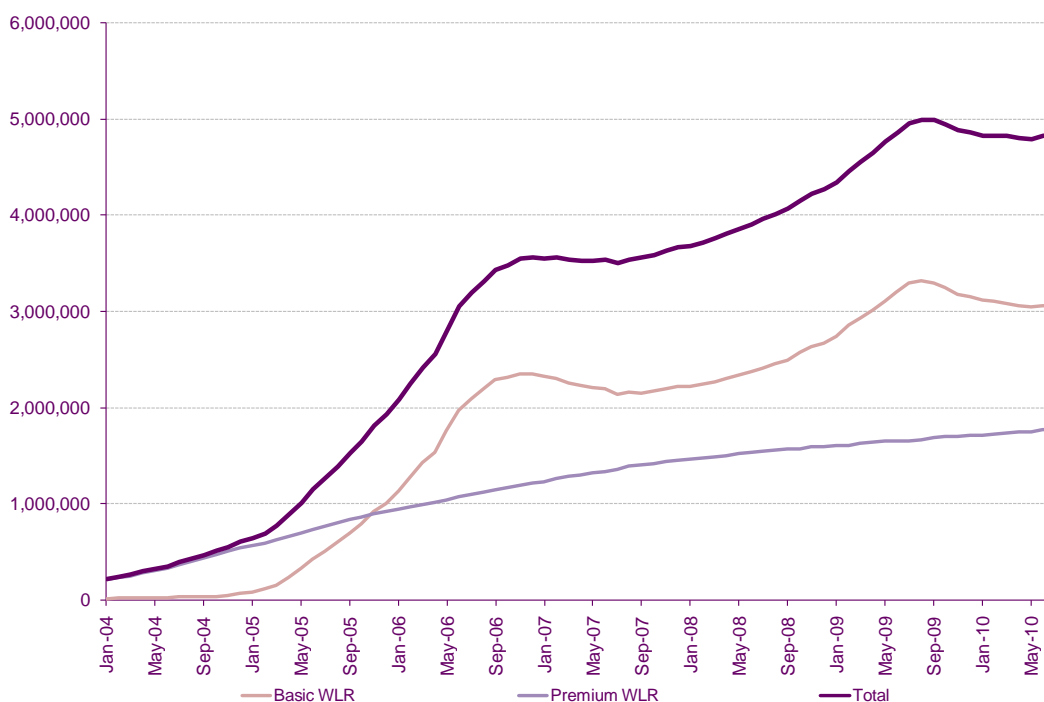
6.7 However, as we set out in our 2010 statement on *Charge controls for Wholesale Line Rental – implementation and cost orientation* we found that it was no longer appropriate to regulate the higher care service options for the analogue WLR product and therefore removed the basis of charges (cost orientation) obligation on those specific services.⁷⁴

6.8 As set out in this document, given that there has only been a limited number of developments that have impacted competition in this market and we do not consider that these developments require us to reach a different conclusion to that reached previously, we are proposing to retain the direction attached to our 2010 statement removing the basis of charges obligation from certain specific enhanced care serviced and have inserted wording at conditions AAAA3.4 and AAAA.10.5 to this effect.

6.9 As we identified in the September 2009 Retail Review the retail market for both narrowband analogue access and calls is competitive and a key driver in facilitating that development has been the provision of analogue WLR. The wholesale product remedy (analogue WLR) enables existing competitors, and new entrants, to access a service that supports retail competition and provides consumers with greater choice.

6.10 Figure 6.1 below graphs the demand for WLR lines.

Figure 6.1: Analogue WLR demand



Source: Ofcom

⁷⁴ *Charge controls for Wholesale Line Rental – implementation and cost orientation*, Second Statement, 23 February 2010, at http://stakeholders.ofcom.org.uk/binaries/consultations/wlr/statement/wlr_statement.pdf

Hull area / KCOM

- 6.11 We recognised in the September 2009 Wholesale Review that the arguments for mandating product for the Hull area are likely to be similar to those made for the rest of the UK. However, without demonstrated demand for such a product we also recognised that it would not be reasonable to require KCOM to produce a product
- 6.12 Since the September 2009 Wholesale Review KCOM has made available a wholesale analogue exchange lines product to Nexus, who is now offering both analogue exchange lines and calls to retail customers in the Hull area. It is our understanding however that the product agreed between KCOM and Nexus is not the same as the BT WLR product. We continue to take the view that if a requesting party requires a product similar to the BT WLR product then this is likely to be a reasonable request for Network Access, subject to the specific technical and commercial requirements. However, we do not consider that it is appropriate to require KCOM to produce a wholesale analogue exchange lines product like WLR absent reasonable demand for such a product.

Legal tests

- 6.13 We consider that the proposed condition in particular furthers the interests of citizens in relation to communications matters and furthers the interests of consumers in relevant markets, where appropriate by the promotion of competition in line with section 3 of the Act.
- 6.14 Ofcom also considers that the proposed condition meets the requirements set out in Section 4 of the Act. In particular, the condition promotes competition and secures efficient and sustainable competition and the maximum benefit for customers by enabling providers to compete in downstream access markets.
- 6.15 We consider the proposed condition meets the criteria set out in section 47(2) of the Act. The condition is:
- objectively justifiable in that it relates to the need to ensure that competition develops to the benefit of consumers. The growth of competition based on WLR has delivered benefits to consumers in terms of competition. Removing the obligation to provide WLR may result in BT withdrawing the product or otherwise changing it to the detriment of the competition that has developed;
 - not unduly discriminatory as the obligation on KCOM to provide Network Access on reasonable request is sufficient based on the market conditions of the Hull area;
 - proportionate in that it is necessary to enable competition but is not unduly burdensome on BT; and
 - transparent in that it is clear in its intention to ensure that BT provides WLR products.
- 6.16 In addition, we have taken into account the factors set out in section 87(4) and, in particular, the economic viability of service providers building an alternative direct access network and the feasibility of providing WLR.
- 6.17 Finally, we consider that the tests in section 88 have been met. There is risk that in situations where SMP is persistent, pricing will be distorted and not at competitive

levels as dominant providers are likely to want to charge excessive prices in order to maximise profits by increasing their revenues and the costs of competing providers. The proposed condition is appropriate in order to promote efficiency and sustainable competition and confer the greatest possible benefits on end users by enabling competing providers to buy wholesale services at levels that might be expected in a competitive market.

- 6.18 The proposed condition would apply to the wholesale analogue exchange lines market in which our preliminary conclusion is that BT has SMP.
- 6.19 The provisional findings that we have reached here do not affect the remedies that we imposed in the September 2009 Wholesale Review in which we concluded that it was appropriate to impose a specific WLR SMP remedy on BT in relation to the supply of wholesale digital (ISDN2) exchange lines.

Basis of charges obligation in regard to WLR

- 6.20 In Section 5 we have proposed to oblige BT to provide products in the wholesale analogue exchange lines market on a cost orientated basis.
- 6.21 Ofcom continues to consider that this obligation should apply to all the elements required to provide the basic level of service required by consumers. These are:
- rental charges;
 - connection, rearrangement and termination charges; and
 - network features that comprise the basic WLR service.
- 6.22 We have set out our general approach to cost orientation in the exchange lines markets in Section 5. In paragraphs 5.95 to 5.105 we concluded that a basis of charges condition would be an appropriate condition to impose in the wholesale analogue exchange line services markets. In imposing that condition it will apply to all services provided within the market.
- 6.23 This approach continues the regulatory approach previously imposed under our SMP conditions.

Next generation access networks (NGA)

- 6.24 As a matter of principle we take a technology neutral approach to market assessments. We therefore focus on the service rather than the underlying technology that is used to support it. Although clearly when specifying and implementing a specific access remedy it is necessary to do this in the context of the technology deployed in the SMP operators network.
- 6.25 The specific access remedy that has been adopted in this market is wholesale line rental (WLR) and this is a copper based exchange line which needs to be used in conjunction with BT's switches. Naturally, the specification of WLR was to a large extent driven by the technology and architecture of BT's existing network.
- 6.26 As we noted in Sections 3 and 4, over the next few years BT plans to deploy a NGA network. If a voice line rental service is provided over this new network then, in line with our technology neutral approach, we would consider this to be analogue exchange line as defined within the wholesale fixed analogue exchange lines market.

In such a situation it may therefore be necessary to consider what specific access remedy should be adopted in order for BT to comply with its access obligations. We set out below our current understanding and thinking on this issue.

- 6.27 BT plans to use two different technologies in its NGA deployment: FTTC and FTTP.
- 6.28 In the case of its FTTC deployments BT uses a VDSL DSLAM in its street cabinets in order to provide higher speed broadband services. However, it currently plans to leave the existing voice service unchanged. This means that BT can continue to provide the existing WLR service and accordingly BT's FTTC deployments will not have any impact in the wholesale fixed analogue exchange lines market.
- 6.29 In the case of its brown-field FTTP deployments BT intends to deploy the fibre network as an overlay to the existing copper network. This means that the existing 'copper' connection will continue to be available and accordingly BT will be able to provide the existing WLR service. In this regard BT's FTTP deployments will not have any impact in the wholesale fixed analogue exchange lines market. However, it is our understanding that, in situations where an end user purchases a high speed broadband service over the FTTP network, BT intends to offer an optional voice line service over the FTTP network also. Thus, in this situation BT will be required to provide a wholesale version of this 'FTTP-based' voice line service in order to comply with its access obligations.
- 6.30 Given that this is an entirely new network there is no reason to assume that this wholesale service will be the same as the current WLR service. There may be a case to emulate the current WLR service, if this is what BT's customers demand. However, it may be that the new network allows BT's customers to specify a wholesale service that affords them more control and commercial opportunities. We understand that, following discussions with some of its main customers, BT is currently planning to provide a Fixed Voice Access product which will allow access to and control of an analogue terminal adaptor ("ATA") – an arrangement that is termed 'Open ATA'⁷⁵. Whether, or not, Open ATA becomes the standard wholesale exchange line access remedy on BT's FTTP network will depend on the extent to which it meets the needs of BT's customers. We would however note that BT is subject to a requirement to provide access on reasonable request, thus if BT's customers require a different form of access they can make a request to BT.
- 6.31 As discussed above, in brown-field FTTP deployments the existing WLR service remains as an option. However, in green-field FTTP deployments this will not be the case. The issue of the wholesale exchange line access remedy on BT's FTTP network therefore becomes more important in green-field situations, as there is no WLR option. This being said we would note that the total coverage of BT's green-field FTTP deployments is expected to be very small within the period covered by this review.

Consultation questions

Question 9: *Do you agree that Ofcom should impose an obligation on BT to provide analogue WLR products in the wholesale fixed analogue exchange lines market? If not, please explain why.*

Question 10: *Do you agree that it is not currently necessary to require KCOM to provide a wholesale analogue exchange line product? If not, please explain why.*

⁷⁵ BT now terms Open ATA as 'Fibre Voice Access'.

Question 11: *Do you agree that additional requirements for wholesale analogue exchange products, arising as a result of NGA deployments should for the time being be met under the terms of the general access obligation?*

Section 7

Specific remedy for BT - WLR charge control

Introduction

- 7.1 In addition to the general remedies set out in Section 5, in this section we set out our proposal to continue to impose a charge control on BT's analogue WLR product.

Approach to implementing the charge controls

- 7.2 In setting any SMP condition we must satisfy the tests set out in section 47 in the Act.
- 7.3 In considering the application of section 47, it is important to note that we will consider separately, when the mechanisms for each of the identified charge controls are set, the application of section 47 to the condition as drafted. Where we have provisionally found SMP in a market, we are proposing to impose appropriate remedies to address the identified competition concerns.
- 7.4 In the wholesale analogue exchange line services market in the UK (excluding Hull) we have provisionally concluded that there is a risk that BT could set prices at an excessively high level. We, therefore consider that the introduction of a remedy to address this risk is appropriate. The identification of that risk is a necessary precondition under section 88 to enable us to set an SMP condition imposing a charge control.

Charge controls to be imposed on BT

WLR analogue

- 7.5 Section 87(9) of the Act authorises the setting of charge controls in relation to matters connected with Network Access or with the availability of relevant facilities.
- 7.6 The existing Analogue Core WLR Rental charge control was imposed to address concerns identified in our previous market assessment and applies to BT for WLR services. That charge control continues to apply until it expires in March 2011.

Aims and effects

- 7.7 We have said that in the absence of regulation, we believe that BT has an incentive to set prices for analogue WLR services higher than could be expected in a competitive market. BT retains a high market share at the wholesale level in the provision of analogue exchange lines and the use of analogue WLR has been central to promoting competition in the retail narrowband markets.
- 7.8 We have set out above that a basis of charges condition would act to constrain BT's pricing. We said that a charge control was necessary because even though cost orientation may constrain prices it still provides considerable pricing freedom and does not provide the same incentive for BT's to improve its efficiency. Therefore, a charge control is likely to be required to ensure CPs are able to purchase analogue WLR at wholesale charges that would be expected in a competitive market. Given

this we are proposing to introduce a further analogue WLR charge control after the current control expires in March 2011.

- 7.9 The charge control would result in prices being based on a forward-looking view of the costs⁷⁶ related to the provision of wholesale analogue exchange line services over the charge control period, taking into account efficiency improvements and possible future investment by BT.

Minor modification to the existing charge control obligation

- 7.10 The existing WLR charge control operates in tandem with the general basis of charges obligation. That means that the obligation for costs to be based on LRIC+ continues to apply to the services subject to the WLR charge control, with the exception of the Analogue Core WLR Rental, which is specifically exempted from the basis of charges obligation.
- 7.11 As we are proposing to revoke the 2009 obligations where relevant and replace them with our new proposed obligations, we have included a minor modification in the legal instrument to update the cross reference in the existing WLR charge control Condition AAA4(WLR). This proposes to replace the reference to the existing basis of charges obligation (AAA3) with the proposed basis of charges obligation (AAAA3).
- 7.12 We are also proposing to replace the cross reference to the existing SMP condition concerning the provision of Wholesale Line Rental (AAA10) in condition AAA4(WLR) with the reference to the new proposed equivalent obligation (AAAA10).

Legal tests

- 7.13 From our market analysis, it appears that there is a risk that BT might set its prices for WLR at an excessively high level. We do not consider that cost orientation alone would be appropriate in relation to analogue WLR services.
- 7.14 While we will consult separately on this matter, we consider that in principle a charge control is required for analogue WLR services to ensure that it provides the right incentives for BT to seek further efficiency savings. This should ultimately allow the benefits of lower costs to be passed on to consumers.
- 7.15 Section 88 requires a charge control SMP condition can only be set if:
- There is a relevant risk of adverse effects arising from price distortion;
 - The setting of the condition is appropriate for the purposes of
 - (i) promoting efficiency;
 - (ii) promoting sustainable competition; and
 - (iii) conferring the greatest possible benefits on the end users of public electronic communications services; and
 - we have taken into account the extent of the investment by the Dominant Provider.

⁷⁶ We propose to consider the specifics of the charge control, including the relevant costs, in a separate consultation.

- 7.16 While we identify the particular market failure through our market assessment in this consultation, should we conclude that a charge control is appropriate we will set the individual control through a separate consultation process. In setting SMP service conditions each condition will have to comply with the requirements of section 88.
- 7.17 We are of the view that a charge control would promote efficiency by requiring BT to price at the level of an efficient firm in the absence of competitive constraints in this market. Depending on the specific form of control BT would likely be incentivised to improve its efficiency ahead of the efficiency improvements built into the charge control. It would also likely promote sustainable competition at the retail level by restricting BT's ability to price excessively with the aim of making it more difficult for other providers to compete. We expect that the benefits of this pricing would eventually flow through to consumers.
- 7.18 The current analogue WLR charge control was set was set on 23 November 2009, fully implemented by 31 July 2010, and expires in March 2011. At this stage we are consulting only on the principle of having a WLR charge control. We are not proposing to review the form, level, or duration of the control at this stage. Rather, we plan to propose the appropriate form, level and duration for the charge control as part of a separate consultation before the current control expires. Nevertheless, we consider that in principle a charge control on WLR would meet the criteria set out in section 47(2) of the Act, since it is objectively justifiable, non-discriminatory, proportionate and transparent. This is for the reasons below.
- objectively justifiable, as BT has SMP in the market, it is unlikely to be incentivised to reduce its costs and set prices at the competitive level;
 - not unduly discriminatory, as it only applies to providers with SMP. Ofcom does not propose to impose this obligation on KCOM as, based on our analysis, we do not think that such an imposition would be proportionate;
 - proportionate, as we will ensure that it will allow BT to make a return on investment whilst acting to constrain BT's ability to set prices above the competitive level which may result in consumers paying higher retail prices; and
 - transparent, in that the condition, when we formulate our detailed proposals, will be clear in its intention.
- 7.19 For the reasons set out above, we consider that the imposition of a charge control would in particular further the interests of citizens and further the interests of consumers in relevant markets by the promotion of competition in line with section 3 of the Act. Further, we consider that, in line with section 4 of the Act, the proposed condition in particular promotes competition in relation to the provision of electronic communications networks and encourages the provision of Network Access for the purpose of securing efficiency and sustainable competition in downstream markets for electronic communications networks and services and the maximum benefit for customers.

Hull area / KCOM

- 7.20 We are not proposing any charge controls on KCOM in the Hull area. Based on our analysis we do not think that such an imposition would be proportionate. We are proposing that KCOM is subject to a number of other remedies, including a requirement to provide Network Access on reasonable request, not to unduly

discriminate and to provide services on a cost oriented basis. During the term of existing remedies, there has been no significant entry into the Hull market.

- 7.21 We continue to take the view that increased regulation will not prompt rapid entry into this market. The existing regulatory obligations, which we are proposing to retain provide a framework that should support entry. The imposition of additional regulatory obligations on KCOM, without sufficient demand to justify them would increase KCOM's costs. Any increase in costs would need to be recovered from KCOM's existing retail customers. Therefore, consumers in the Hull area could end up having to pay higher prices but still not have any more competition or choice.
- 7.22 Therefore, we are not proposing charge control regulation on KCOM.

Consultation questions

Question 12: *Do you agree that Ofcom should impose charge controls on BT in its provision of wholesale fixed analogue exchange line services? If not please explain why.*

Question 13: *Do you agree that it would be disproportionate to impose charge controls on KCOM in wholesale analogue exchange lines? If not, please explain why.*

Annex 1

Responding to this consultation

How to respond

- A1.1 Ofcom invites written views and comments on the issues raised in this document, to be made **by 5pm on 18 November 2010**.
- A1.2 Ofcom strongly prefers to receive responses using the online web form at <http://stakeholders.ofcom.org.uk/consultations/review-wholesale-fixed-exchange/>, as this helps us to process the responses quickly and efficiently. We would also be grateful if you could assist us by completing a response cover sheet (see Annex 3), to indicate whether or not there are confidentiality issues. This response coversheet is incorporated into the online web form questionnaire.
- A1.3 For larger consultation responses - particularly those with supporting charts, tables or other data - please email WAELmarketreview@ofcom.org.uk attaching your response in Microsoft Word format, together with a consultation response coversheet.
- A1.4 Responses may alternatively be posted or faxed to the address below, marked with the title of the consultation.
- Marvin Luttrell
Fourth Floor
Competition Group
Riverside House
2A Southwark Bridge Road
London SE1 9HA
- Fax: 020 7783 4103
- A1.5 Note that we do not need a hard copy in addition to an electronic version. Ofcom will acknowledge receipt of responses if they are submitted using the online web form but not otherwise.
- A1.6 It would be helpful if your response could include direct answers to the questions asked in this document, which are listed together at Annex 4. It would also help if you can explain why you hold your views and how Ofcom's proposals would impact on you.

Further information

- A1.7 If you want to discuss the issues and questions raised in this consultation, or need advice on the appropriate form of response, please contact Marvin Luttrell on 020 7783 4516.

Confidentiality

- A1.8 We believe it is important for everyone interested in an issue to see the views expressed by consultation respondents. We will therefore usually publish all responses on our website, www.ofcom.org.uk, ideally on receipt. If you think your

response should be kept confidential, can you please specify what part or whether all of your response should be kept confidential, and specify why. Please also place such parts in a separate annex.

- A1.9 If someone asks us to keep part or all of a response confidential, we will treat this request seriously and will try to respect this. But sometimes we will need to publish all responses, including those that are marked as confidential, in order to meet legal obligations.
- A1.10 Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use. Ofcom's approach on intellectual property rights is explained further on its website at <http://www.ofcom.org.uk/about/accoun/disclaimer/>

Next steps

- A1.11 Following the end of the consultation period, Ofcom intends to publish a statement in December 2010.
- A1.12 Please note that you can register to receive free mail Updates alerting you to the publications of relevant Ofcom documents. For more details please see: http://www.ofcom.org.uk/static/subscribe/select_list.htm

Ofcom's consultation processes

- A1.13 Ofcom seeks to ensure that responding to a consultation is easy as possible. For more information please see our consultation principles in Annex 2.
- A1.14 If you have any comments or suggestions on how Ofcom conducts its consultations, please call our consultation helpdesk on 020 7981 3003 or e-mail us at consult@ofcom.org.uk . We would particularly welcome thoughts on how Ofcom could more effectively seek the views of those groups or individuals, such as small businesses or particular types of residential consumers, who are less likely to give their opinions through a formal consultation.
- A1.15 If you would like to discuss these issues or Ofcom's consultation processes more generally you can alternatively contact Vicki Nash, Director Scotland, who is Ofcom's consultation champion:

Vicki Nash
Ofcom
Sutherland House
149 St. Vincent Street
Glasgow G2 5NW

Tel: 0141 229 7401
Fax: 0141 229 7433

Email vicki.nash@ofcom.org.uk

Annex 2

Ofcom's consultation principles

A2.1 Ofcom has published the following seven principles that it will follow for each public written consultation:

Before the consultation

A2.2 Where possible, we will hold informal talks with people and organisations before announcing a big consultation to find out whether we are thinking in the right direction. If we do not have enough time to do this, we will hold an open meeting to explain our proposals shortly after announcing the consultation.

During the consultation

A2.3 We will be clear about who we are consulting, why, on what questions and for how long.

A2.4 We will make the consultation document as short and simple as possible with a summary of no more than two pages. We will try to make it as easy as possible to give us a written response. If the consultation is complicated, we may provide a shortened Plain English Guide for smaller organisations or individuals who would otherwise not be able to spare the time to share their views.

A2.5 We will consult for up to 10 weeks depending on the potential impact of our proposals.

A2.6 A person within Ofcom will be in charge of making sure we follow our own guidelines and reach out to the largest number of people and organisations interested in the outcome of our decisions. Ofcom's 'Consultation Champion' will also be the main person to contact with views on the way we run our consultations.

A2.7 If we are not able to follow one of these principles, we will explain why.

After the consultation

A2.8 We think it is important for everyone interested in an issue to see the views of others during a consultation. We would usually publish all the responses we have received on our website. In our statement, we will give reasons for our decisions and will give an account of how the views of those concerned helped shape those decisions.

Annex 3

Consultation response cover sheet

- A3.1 In the interests of transparency and good regulatory practice, we will publish all consultation responses in full on our website, www.ofcom.org.uk.
- A3.2 We have produced a coversheet for responses (see below) and would be very grateful if you could send one with your response (this is incorporated into the online web form if you respond in this way). This will speed up our processing of responses, and help to maintain confidentiality where appropriate.
- A3.3 The quality of consultation can be enhanced by publishing responses before the consultation period closes. In particular, this can help those individuals and organisations with limited resources or familiarity with the issues to respond in a more informed way. Therefore Ofcom would encourage respondents to complete their coversheet in a way that allows Ofcom to publish their responses upon receipt, rather than waiting until the consultation period has ended.
- A3.4 We strongly prefer to receive responses via the online web form which incorporates the coversheet. If you are responding via email, post or fax you can download an electronic copy of this coversheet in Word or RTF format from the 'Consultations' section of our website at www.ofcom.org.uk/consult/.
- A3.5 Please put any parts of your response you consider should be kept confidential in a separate annex to your response and include your reasons why this part of your response should not be published. This can include information such as your personal background and experience. If you want your name, address, other contact details, or job title to remain confidential, please provide them in your cover sheet only, so that we don't have to edit your response.

Cover sheet for response to an Ofcom consultation

BASIC DETAILS

Consultation title:

To (Ofcom contact):

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

CONFIDENTIALITY

Please tick below what part of your response you consider is confidential, giving your reasons why

Nothing Name/contact details/job title

Whole response Organisation

Part of the response If there is no separate annex, which parts?

If you want part of your response, your name or your organisation not to be published, can Ofcom still publish a reference to the contents of your response (including, for any confidential parts, a general summary that does not disclose the specific information or enable you to be identified)?

DECLARATION

I confirm that the correspondence supplied with this cover sheet is a formal consultation response that Ofcom can publish. However, in supplying this response, I understand that Ofcom may need to publish all responses, including those which are marked as confidential, in order to meet legal obligations. If I have sent my response by email, Ofcom can disregard any standard e-mail text about not disclosing email contents and attachments.

Ofcom seeks to publish responses on receipt. If your response is non-confidential (in whole or in part), and you would prefer us to publish your response only once the consultation has ended, please tick here.

Name

Signed (if hard copy)

Annex 4

Consultation questions

A4.1 In this consultation we have asked the following questions on which we would like stakeholders to provide their views

Question 1: Do you agree with Ofcom's proposed wholesale market definition? If not, please explain why.

Question 2: Do you agree with Ofcom's proposed assessment that BT has SMP in the wholesale fixed analogue exchange lines market in the UK (excluding the Hull area), and KCOM has SMP in the same product market in the Hull area? If not, please explain why.

Question 3: Do you agree with Ofcom's analysis of future developments that may affect these assessments? If not, please explain why.

Question 4: Do you agree that Ofcom should retain the set of proposed general SMP conditions on BT and KCOM? If not, please explain why.

Question 5: Do you agree that Ofcom should impose a new general SMP condition on KCOM by requiring it to follow an SOR process in handling new requests for Network Access? If not, please explain why.

Question 6: Are the KPIs proposed above sufficient to provide industry with the necessary level of transparency?

Question 7: Do you agree that Ofcom should continue to impose an obligation on BT and KCOM to comply with obligations governing cost accounting systems and processes as set out by Ofcom? If not, please explain why.

Question 8: Do you agree that Ofcom should continue to impose an obligation on BT and KCOM to comply with obligations governing accounting separation as set out by Ofcom in the markets and technical area discussed? If not, please explain why.

Question 9: Do you agree that Ofcom should impose an obligation on BT to provide analogue WLR products in the wholesale fixed analogue exchange lines market? If not, please explain why.

Question 10: Do you agree that it is not currently necessary to require KCOM to provide a wholesale analogue exchange line product? If not, please explain why.

Question 11: Do you agree that additional requirements for wholesale analogue exchange products, arising as a result of NGA deployments should for the time being be met under the terms of the general access obligation?

Question 12: Do you agree that Ofcom should impose charge controls on BT in its provision of wholesale fixed analogue exchange line services? If not please explain why.

Question 13: Do you agree that it would be disproportionate to impose charge controls on KCOM in wholesale analogue exchange lines? If not, please explain why.

Annex 5

Analytical approach to our market review

Introduction

A5.1 This Annex details the processes that we have followed in Sections 3 - 6, in defining the markets within this review, how and on what basis we assess whether anyone has SMP in a given market, whether SMP conditions should be imposed in a relevant market, and of what form.

The time period under review

A5.2 Rather than just looking at the current position, market reviews look ahead to how competitive conditions may change in future. Our evaluation of the current market takes into account past developments and evidence. Then we consider the foreseeable market changes that we expect to effect its development over the three and a half year period to April 2014. This forecast period reflects the characteristics of the wholesale analogue exchange market and the factors likely to influence its competitive development.

A5.3 The forward look period that we have used allows for the possibility of our next market review taking place in that timeframe. However, it does not preclude us reviewing the market before that point should the market develop in way we have not foreseen to the extent that it is likely to affect the competitive conditions that are operating. For this reason, we will continue to monitor the market, and we will consider the timing of the next review accordingly. In doing this, we will also consider the new procedures and timeframes for conducting market reviews introduced by the amendments to the EU regulatory framework. Those requirements will apply in the UK from 26 May 2011.

Approach to market definition

A5.4 There are two dimensions to the definition of the relevant market: the relevant products to be included within the market and the geographic extent of the market. As such it is often practical to define the relevant product market before exploring the geographic dimension of the market.

A5.5 The market definition exercise of the market analysis is not an end in itself, but a means to an end. Market definition aids the assessment of whether end-users of a product are protected by effective competition and thus whether there is a requirement for the imposition of *ex ante* regulation. It is in this light that we have conducted our market definition in this review.

Demand-side and supply-side substitution

A5.6 Market boundaries are determined by identifying constraints on the price setting behaviour of firms. There are two main constraints to consider: first, to what extent is it possible for a customer to substitute other services for those in question (demand-side substitution); and second, to what extent can suppliers switch, or increase, production to supply the relevant products or services (supply-side substitution) in response to a relative price increase.

- A5.7 The 'hypothetical monopolist test' ("HMT") is a useful tool often used to identify close demand-side and supply side substitutes. A product is considered to constitute a separate market if the hypothetical monopolist supplier could impose a small but significant non-transitory increase in price ("SSNIP") above the competitive level without losing sales to such a degree as to make this price rise unprofitable. If such a price rise would be unprofitable, because consumers would switch to other products, or because suppliers of other products would begin to compete with the hypothetical monopolist, then the market definition should be expanded to include the substitute products.
- A5.8 We define markets first on the demand-side. The analysis of demand-side substitution (set out in Sections 3) has been undertaken considering if other services could be considered as substitutes by consumers, in the event of the hypothetical monopolist supplier introducing a SSNIP above the competitive level.
- A5.9 Then we assess supply-side substitution possibilities to consider whether they provide any additional constraints on the pricing behaviour of the hypothetical monopolist which have not been captured by the demand-side analysis. In this assessment, supply-side substitution is considered to be a low cost form of entry which can take place within a reasonable timeframe (e.g. up to 12 months). The key point is that, for supply-side substitution to be relevant, not only must suppliers be able, in theory, to enter the market quickly and at low cost by virtue of their existing position in the supply of other products or areas, but there must also be an additional competitive constraint arising from such entry into the supply of the service in question.
- A5.10 Therefore, in identifying potential supply-side substitutes it is important that providers of these services have not already been taken into consideration. There might be suppliers who provide other services but who might also be materially present in the provision of demand-side substitutes to the service for which the hypothetical monopolist has raised its price. Such suppliers are not relevant to supply-side substitution since they supply services already identified as demand-side substitutes. As such, their entry has already been taken into account and so supply-side substitution from these suppliers cannot provide an additional competitive constraint on the hypothetical monopolist. However, the impact of expansion by such suppliers can be taken into account in the assessment of market power.

Common pricing constraints

- A5.11 Another factor that is sometimes an additional consideration in setting market boundaries is whether there exist common pricing constraints across customers, services or geographic areas (i.e., areas in which a firm voluntarily offers its services at a geographically uniform price). Where common pricing constraints exist the geographic areas in which they apply could be included within the same relevant market even if demand-side and supply-side substitutes are not present. Failure to consider the existence of a common pricing constraint could lead to unduly narrow markets being defined.

Homogeneous competitive conditions

A5.12 Our approach also takes into account the SMP Guidelines.⁷⁷ In particular, paragraph 56 of the SMP Guidelines states that:

“According to established case-law, the relevant geographic market comprises an area in which the undertakings concerned are involved in the supply and demand of the relevant products or services, in which area the conditions of competition are similar or sufficiently homogeneous and which can be distinguished from neighbouring areas in which the prevailing conditions of competition are appreciably different...”

A5.13 Hence, subject to the relevant caveats above, where there are geographic areas where competitive conditions are sufficiently homogeneous the definition of the relevant geographic market will include all of those areas within one market.

Relationship between wholesale and retail markets

A5.14 Analysis of retail market definitions logically takes place prior to the definition of wholesale markets. This is because the demand for the upstream service provided in the wholesale market is a derived demand for the product sold in the downstream retail market i.e., the level of demand for the upstream input depends on the demand for the retail services which it supports. If the upstream input accounts for a sufficiently large proportion of the downstream price, the range of available substitutes at the downstream (retail) level will inform the likely range of substitutes for the upstream (wholesale) service. This is because a rise in the price of a wholesale service which is passed through to the retail service might cause retail customers to switch products to services which may adequately substitute for the service in question, thus reducing demand for the wholesale input.

Relevance of existing regulation

A5.15 When we conduct our analysis to define the relevant retail and wholesale markets we assume that there is no SMP regulation in place in the market under consideration.

A5.16 In addition, the wholesale market is defined assuming the absence of regulation at the retail level. We have therefore considered demand-side and supply-side substitution possibilities at the retail level only if they are economically viable in the absence of SMP regulation in the market being considered. This approach is consistent with the Explanatory Memorandum.⁷⁸

A5.17 On the other hand, it is appropriate to take into account any regulation that is upstream of the market being considered, as upstream regulation (e.g. wholesale

⁷⁷ Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services, Official Journal of the European Communities, C165, 11/7/2002, p 6-31, at: http://ec.europa.eu/information_society/topics/telecoms/regulatory/new_rf/documents/smp_guidelines/c_16520020711en00060031.pdf

⁷⁸ Explanatory Memorandum to the Commission Recommendation of 17 December 2007 on relevant Product and Service Markets, Commission Staff Working Document, SEC(2007) 1483 final, Brussels, at http://ec.europa.eu/information_society/policy/ecomms/doc/library/proposals/sec2007_1483_final.pdf

remedies) has the potential to affect the competitive state of downstream (i.e. retail) markets. Indeed, this is generally one of the main intentions of upstream regulation.

Geographic market

- A5.18 In addition to the product(s) to be included within a market, market definition also requires the geographic extent of the market to be specified. The geographic market is the area within which demand side and/or supply side substitution can take place and is defined using a similar approach to that used to define the product market. We have considered the geographic extent of each relevant market covered in this market review.
- A5.19 There are a number of possible approaches to geographic market definition. One approach would be to begin with a narrowly-defined area and then consider whether a price increase by a hypothetical monopolist in that narrowly defined area would encourage customers to switch to suppliers located outside the area (demand-side substitution) or CPs outside the area to begin to offer services in the area (supply-side substitution). If demand and/or supply side substitution is sufficient to constrain prices then it is appropriate to expand the geographic market boundary.
- A5.20 We recognise that in certain communications (product) markets in the UK, there could be different competitive pressures in different geographic areas. For example, BT competes in the provision of local access with Virgin Media where it has cable access network infrastructure. We have to consider whether, in this case, it would be appropriate to identify separate geographic markets for some services. We have, for example, defined separate geographic markets in our *Review of the wholesale broadband access markets*.⁷⁹
- A5.21 Therefore, defining separate geographic markets is appropriate only where the market conditions are considered to be sufficiently different on an ongoing basis. Defining separate markets by area may be problematic because, due to the dynamic nature of communications markets, the boundary between areas where there are different competitive pressures may be unstable and change over time, rendering the market definition obsolete.
- A5.22 An alternative approach is to define geographic markets in a broader sense. This involves defining a single geographic market but recognising that this single market has local geographical characteristics. That is to say, recognising that within the single market there are areas where competition is more developed than in other areas. This avoids the difficulties of proliferation and instability in the definition.
- A5.23 In carrying out this particular market review, we have taken into account the guidance on geographic markets produced by the European Regulators Group (“ERG”), *ERG Common position on Geographic Aspects of Market Analysis*, published in October 2008.⁸⁰

⁷⁹ See, http://stakeholders.ofcom.org.uk/binaries/consultations/wholesale-broadband-markets/summary/WBA_condoc.pdf and http://stakeholders.ofcom.org.uk/binaries/consultations/wholesale-broadband-markets/summary/WBA_condoc.pdf

⁸⁰ *ERG Common Position on Geographic Aspects of Market Analysis (definition and remedies)*, ERG (08) 20 final CP Geog Aspects 081016, 16 October 2008, at http://berec.europa.eu/doc/publications/erg_08_20_final_cp_geog_aspects_081016.pdf

Market power assessment

A5.24 As we recognise above, market definition is not an end in itself. The definition of the scope of the relevant economic market is carried out in order to identify the product(s) and the geographic area over which a competition assessment can be made of CPs' ability to act to an appreciable extent independently of competitors, customers and consumers, i.e. whether there are any CPs that hold a position of SMP within a particular market.

Definition of SMP

A5.25 Sections 45, 46 and 78 of the Act grant us the power under certain circumstances to set conditions which require CPs to do certain things. Specifically, Section 46(7) states that SMP services conditions may be imposed on a particular person who is either a CP or a person who makes associated facilities available, and who has been determined to have SMP in a services market (i.e., a specific market for electronic communications networks, electronic communications services or associated facilities).

A5.26 Accordingly, having identified the relevant product and geographic market(s), we are required to analyse each market in order to assess whether any person or persons have SMP as defined in Section 78 of the Act (Article 14 of the Framework Directive).⁸¹ Section 78 of the Act provides that SMP is defined as being equivalent to the competition law concept of dominance in accordance with Article 14(2) of the Framework Directive which provides:

"An undertaking shall be deemed to have significant market power if, either individually or jointly with others, it enjoys a position equivalent to dominance, that is to say a position of economic strength affording it the power to behave to an appreciable extent independently of competitors, customers and ultimately consumers."

A5.27 Further, Article 14(3) of the Framework Directive states that:

"Where an undertaking has significant market power on a specific market, it may also be deemed to have significant market power on a closely related market, where the links between the two markets are such as to allow the market power held in one market to be leveraged into the other market, thereby strengthening the market power of the undertaking".

A5.28 Therefore, in the relevant market, one or more undertakings may be designated as having SMP where that undertaking or undertakings enjoy a position of dominance. Also, an undertaking may be designated as having SMP where it could lever its market power from a closely related market into the relevant market, thereby strengthening its market power in the relevant market.

⁸¹ Directive 2002/21/EC on a common regulatory framework for electronic communications networks and services (the "Framework Directive")

http://ec.europa.eu/information_society/policy/ecomm/current/index_en.htm

- A5.29 In assessing whether an undertaking has SMP, we have taken due account of the SMP Guidelines as we are required to do under Section 79 of the Act. We have also considered the application of the equivalent guidelines published by Oftel.⁸²

The Criteria for assessing SMP

- A5.30 The SMP Guidelines require NRAs to assess whether the competition in a market is effective (i.e. no CP is found individually or jointly dominant). This is undertaken through a forward looking evaluation of the market, determining whether the market is prospectively competitive, taking account of foreseeable developments.
- A5.31 Market share is an indicator of market power but the SMP Guidelines note that high market share alone is not sufficient to establish the possession of SMP. The SMP Guidelines further note that, in the European Commission's practice, single dominance normally arises where market shares are over 40%, and very large market shares of over 50% are evidence of the existence of a dominant position. This presumption is rebuttable and a thorough and overall analysis is required before coming to a conclusion on the existence of SMP. Non-exhaustive criteria are suggested to measure the power of a market undertaking. This is considered in Annex 7.
- A5.32 Where a market is found to be competitive then no SMP conditions can be imposed. Section 84(4) requires that any SMP condition in that market, applying to a person by reference to a market power determination made of the basis of an earlier analysis, must be revoked.

The need for *ex ante* regulation

- A5.33 Before turning to the last market review stage concerning *ex ante* remedies, it is necessary to consider whether competition law (*ex post*) remedies are sufficient. This consideration is necessary to establish, in line with the 27th recital to the Framework Directive, whether or not a market is effectively competitive. (In this context it is to be noted that the importance of identifying the problem reappears under Article 8(4) of the Access and Interconnection Directive. This is because obligations imposed in accordance with Article 8 shall be based on the nature of the problem identified, proportionate and justified in light of the objectives laid down in Article 8 of the Framework Directive.) In assessing the sufficiency of Competition Law, a number of considerations are taken into account.
- A5.34 As a competitive market will produce a more efficient outcome than a regulated market, the promotion of competition is central to securing the best deal for the consumer in terms of quality, choice and value for money.

Appropriate to promote the development of competition

- A5.35 Where markets are effectively competitive, *ex post* competition law is sufficient to deal with any competition abuses that may arise. However, without the imposition of *ex ante* regulations to promote actively the development of competition in a market which is not effectively competitive, it is unlikely that *ex post* general competition law powers will be sufficient to ensure that effective competition becomes established. For example, this is because *ex post* powers prohibit abuse of dominance rather than the holding of a dominant position. *Ex ante* powers can be

⁸² www.ofcom.org.uk/static/archive/oftel/publications/about_oftel/2002/smpg0802.htm

utilised to reduce the level of market power in a market and thereby encourage effective competition to become established.

- A5.36 The risk is not all one way as use of some *ex ante* measures can themselves limit or add nothing to the development of competition. We have recognised this in removing some regulation in some markets where markets are not effectively competitive.
- A5.37 We are proposing that *ex ante* regulation is necessary in the markets covered in this consultation in which we found persons to have SMP. The proposed remedies considered in Sections 5 -7 are appropriate to promote the development of competition in downstream narrowband access services market. A failure to regulate the legacy communication providers (BT or KCOM) in these markets is likely to affect the development of competition in that competing providers would be unlikely to provide intermediate or retail services without wholesale services provided by the legacy CP in the respective geographic areas. In the absence of regulation, the legacy CP would have little incentive to provide wholesale services.
- A5.38 It is preferable to apply regulation at the wholesale level as this both addresses SMP issues in the wholesale markets and promotes competition in downstream markets that rely on wholesale inputs.⁸³ This fits with the requirement that NRAs take measures which meet the objective of encouraging efficient investment in infrastructure and promoting innovation (see Article 8(2) of the Framework Directive and section 4 of the 2003 Act). The regulation of wholesale markets encourages competing providers to purchase wholesale products and combine them with their own networks to create products in competition with the legacy CP.

Imposition of *ex ante* regulation

- A5.39 We set out in Section 5 the factors relevant when assessing the need for *ex ante* regulation and whether competition law might be appropriate to address the competition concerns identified.
- A5.40 Section 87(1) of the Act provides that, where we have made a determination that a person is dominant in a particular market, we must set such SMP services conditions as it considers appropriate and as are authorised under the Act. Section 87(1) implements Article 8 of the Access Directive.
- A5.41 Paragraphs 21 and 114 of the SMP Guidelines state that NRAs must impose one or more SMP services conditions on a dominant provider, and that it would be inconsistent with the objectives of the Framework Directive not to impose any SMP services conditions on an undertaking which has SMP.
- A5.42 The Act (Sections 45-50 and 87-92) sets out the obligations that we can impose if we find that any undertaking has SMP. Sections 87 to 92 implement Articles 9 to 13 of the Access Directive and Articles 17 to 19 of the Universal Service Directive.
- A5.43 Recital 27 of the Framework Directive provides that *ex ante* regulation should be imposed only where there is not effective competition and where competition law remedies are not sufficient to address the perceived problem. In order to provide a full analysis, we have considered whether we could rely on competition law alone, while noting the obligations referred to above.

⁸³ However, for the Hull area we consider that it is necessary to continue to apply retail regulation in KCOM's supply of retail fixed narrowband analogue telephone lines for businesses and consumers.

A5.44 Section 3 of the Act sets out our general duties. Section 3(1) states that our principal duty is to further the interests of citizens in relation to communications matters and consumers in relevant markets, where appropriate, by promoting competition. Specifically, Section 3(2)(b) states that we are required to secure the availability of a wide range of electronic communications services throughout the UK. Section 3(4)(b) explains that, in meeting these requirements, we must have regard to the desirability of promoting competition in relevant markets. Also, in furthering the interests of consumers, we must have regard to choice, price, quality of service and value for money. Additionally, Section 4 of the Act sets out the Community duties which flow from Article 8 of the Framework Directive.

A5.45 We, in considering whether to propose any SMP services conditions, have considered all of these requirements. In particular, we have considered the requirement to promote competition in relation to the provision of electronic communications networks and electronic communications services.

A5.46 Also, SMP services conditions must be appropriate (Section 87(1) of the Act) and satisfy the tests set out in Section 47(2) of the Act. These are that each condition must be:

- objectively justifiable in relation to the networks, services or facilities to which it relates;
- not discriminate unduly against particular persons or a particular description of persons;
- proportionate to what the condition is intended to achieve; and
- in relation to what it is intended to achieve, transparent.

A5.47 In Section 4, we have explained why we consider that BT and KCOM have SMP in their respective markets for wholesale analogue exchange lines. Article 16 of the Framework Directive provides that:

“where an NRA determines that the relevant market is not effectively competitive, it shall identify undertakings with SMP on that market... and... shall on such undertakings impose appropriate specific regulatory obligations...”

A5.48 In assessing the appropriate level of regulation to be applied, we have also taken into account the SMP Guidelines which state at paragraph 15 that regulation should aim to promote an open and competitive market, and at paragraph 16 that *ex ante* regulations should be imposed to ensure that an SMP provider cannot use its market power to restrict or distort competition on the relevant market or leverage market power in to adjacent markets.

A5.49 We have also taken full account of Oftel’s guidelines, which were published on 13 September 2002 (“the Access Guidelines”), on the imposition of access obligations under the new Directives.⁸⁴ These describe the circumstances in which we would consider the imposition of wholesale access obligations to be appropriate, give guidance on the nature of the wholesale products we would expect to be supplied as a result of an obligation to provide access, and describe the conditions under which products should be made available.

⁸⁴ http://www.ofcom.org.uk/static/archive/oftel/publications/ind_guidelines/acce0902.htm

A5.50 In addition, we have considered the Revised ERG Common Position on the approach to appropriate remedies in the electronic communication networks and services (“ECNS”) regulatory framework⁸⁵ (“The ERG Remedies Position”) and, in particular, the statement that:

“...there is a presumption that *ex ante* regulation is appropriate on the 18 markets in the Recommendation if a position of SMP is found.”

A5.51 The ERG Remedies Position sets out that in the case of markets where there is a single firm having SMP, remedies should be considered to address the following concerns:

- entry-deterrence;
- exploitative behaviour; and
- productive inefficiencies.

A5.52 The ERG Remedies Position sets out that, in the case of a single firm having SMP in a wholesale market such as that for the provision of wholesale analogue exchange lines, the following remedies should be considered to address the concerns set out above:

- a requirement to publish a reference offer;
- an obligation to meet reasonable requests for access to, and use of, specific network elements and associated facilities;
- an obligation for access charges to be cost-orientated;
- a requirement to pre-notify changes in tariffs;
- the setting of price controls; and
- an obligation not to discriminate.

European Commission’s Recommendation on Markets

A5.53 In 2003, the European Commission issued its Recommendation identifying product and service markets within the electronic communications sector in which *ex ante* regulation may be warranted. In 2007, the European Commission revised its Recommendation, reducing the number of markets on the list from the identified as potentially subject to *ex ante* regulation was reduced to seven.⁸⁶

A5.54 In formulating our proposals, we have taken utmost account of the Recommendation on Markets, the Explanatory Memorandum and the SMP Guidelines.

⁸⁵ See http://erg.eu.int/doc/meeting/erg_06_33_remedies_common_position_june_06.pdf

⁸⁶ Commission Recommendation of 17 December 2007 on relevant product and service markets within the electronic communications sector susceptible to *ex ante* regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communication networks and services, 2007/879/EC, OJ L344, 28.12.2007, p.65, at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:344:0065:0069:EN:PDF>

Annex 6

Regulatory framework

Introduction

- A6.1 This annex provides an overview of the market review process, to give some additional context and understanding of the matters discussed in the main body of this document and the legal instruments (statutory notifications) published at Annex 7.
- A6.2 Market review regulation is technical and complex, including the legislation and the recommendations and guidelines that we need to consider as part of the process. There may be many relevant documents depending on the market and/or issues in question. This overview does not purport to give a full and exhaustive account of all such materials that we have considered in reaching our preliminary views on this market. Key aspects of materials relevant to this market review are, however, discussed in this document.

Market review concept

- A6.3 The concept of a market review refers to procedures under which we at regular intervals identify relevant markets appropriate to national circumstances, carry out analyses of these markets to determine whether they are effectively competitive and then decide on appropriate remedies (known as SMP obligations or conditions). We explain the concept of SMP (significant market power) below.
- A6.4 In carrying out this work, we act in our capacity as the sector-specific regulator for the UK communications industries, particularly relating to our role as the regulator for telecommunications. Our functions in this regard are to be found in Part 2 of the Communications Act 2003 (the Act). We exercise those functions within the framework harmonised across the European Union for the regulation of electronic communications by the Member States (known as the Common Regulatory Framework or the CRF), as transposed by the Act. The applicable rules⁸⁷ are contained in a package of five EC Directives, of which two Directives are immediately relevant for these purposes, namely:
- Directive 2002/21/EC on a common regulatory framework for electronic communications networks and services (the Framework Directive); and
 - Directive 2002/19/EC on access to, and interconnection of, electronic communications networks and associated facilities (the Access Directive).
- A6.5 The Directives require that NRAs (such as Ofcom) carry out reviews of competition in communications markets to ensure that SMP regulation remains appropriate and proportionate in the light of changing market conditions.
- A6.6 Each market review normally has three stages, namely:

⁸⁷ The Directives have recently been reviewed and amendments were adopted on 19 December 2009. The amendments will need to be transposed into the national legislation by 25 May 2011, and then apply with effect from 26 May 2011

- the procedure for the identification and definition of the relevant markets (the market definition procedure);
- the procedure for the assessment of competition in each market, in particular whether the relevant market is effectively competitive (the market analysis procedure); and
- the procedure for the assessment of appropriate regulatory obligations (the remedies procedure).

A6.7 These stages are normally carried out together.

Market definition procedure

A6.8 The Act provides that, before making a market power determination⁸⁸, we must identify the market, which is, in our opinion, the one which, in the circumstances of the UK, is the market in relation to which it is appropriate to consider making such a determination and to analyse that market.

A6.9 The Framework Directive requires that NRAs shall, taking the utmost account of the 2007 Commission Recommendation on Relevant Product and Service Markets⁸⁹ and SMP Guidelines published by the European Commission, define the relevant markets appropriate to national circumstances, in particular relevant geographic markets within their territory, in accordance with the principles of competition law.

A6.10 The 2007 Commission Recommendation identifies a set of product and service markets within the electronic communications sector in which *ex ante* regulation may be warranted. Its purpose is twofold. First, seeking to achieve harmonisation across the single market by ensuring that the same markets will be subject to a market analysis in all Member States. Secondly, providing legal certainty by making market players aware in advance of the markets to be analysed. However, NRAs are able to regulate markets that differ from those identified in the 2007 Commission Recommendation where this is justified by national circumstances taking account of the three cumulative criteria referred to in the 2007 Commission Recommendation⁹⁰ (the three-criteria test) and where the European Commission does not raise any objections.

A6.11 The fact that an NRA identifies the product and service markets listed in the 2007

A6.12 Commission Recommendation or identifies other product and service markets that meet the three-criteria test does not mean that regulation is warranted. Market definition is not an end in itself but is a means of assessing effective competition.

⁸⁸ The market power determination concept is used in the Act to refer to a determination that a person has SMP in an identified services market.

⁸⁹ Commission Recommendation of 17 December 2007 on relevant product and service markets within the electronic communications sector susceptible to *ex ante* regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communication networks and services.

⁹⁰ The Recommendation states that, “[w]hen identifying markets other than those set out in the Annex, national regulatory authorities should ensure that the following three criteria are cumulatively met: (a) the presence of high and non-transitory barriers to entry. These may be of a structural, legal or regulatory nature; (b) a market structure which does not tend towards effective competition within the relevant time horizon. The application of this criterion involves examining the state of competition behind the barriers to entry; (c) the insufficiency of competition law alone to adequately address the market failure(s) concerned.”

The three-criteria test is also different from the SMP assessment because the test's focus is on the general structure and market characteristics.

- A6.13 The relationship between the market definition identified in this review and those listed in the 2007 Commission Recommendation is discussed in Section 3 of this document.
- A6.14 The SMP Guidelines make clear that market definition is not a mechanical or abstract process. It requires an analysis of any available evidence of past market behaviour and an overall understanding of the mechanics of a given sector. As market analyses have to be forward-looking, the Guidelines state that NRAs should determine whether the market is prospectively competitive, and thus whether any lack of effective competition is durable, by taking into account expected or foreseeable market developments over the course of a reasonable period. They clarify that NRAs enjoy discretionary powers that reflect the complexity of all the relevant factors that must be assessed (economic, factual and legal) when identifying the relevant market, and assessing whether an undertaking has SMP.
- A6.15 The SMP Guidelines also describe how competition law methodologies may be used by NRAs in their analyses. In particular, there are two dimensions to the definition of a relevant market: the relevant products to be included in the same market and the geographic extent of the market. Ofcom's approach to market definition follows that used by the UK competition authorities, which is in line with the approaches adopted by the European Commission.
- A6.16 While such methodologies are being used in identifying the *ex ante* markets, they will not necessarily be identical to markets defined in individual competition law cases. This may be the case, especially as the former is based on an overall forward-looking assessment of the structure and the functioning of the market under examination. Accordingly, the economic analysis carried out for the purpose of this review, including the identified markets, is without prejudice to any analysis that may be carried out in relation to any investigation pursuant to the Competition Act 1998 (relating to the application of the Chapter I or II prohibitions or Article 101 or 102 of the EC Treaty⁹¹) or the Enterprise Act 2002.

Market analysis procedure

Effective competition

- A6.17 The Act requires that, at such intervals as we consider appropriate, we carry out market analyses of identified markets for the purpose of making or reviewing market power determinations. In any event, such analyses are to be carried out as soon as reasonably practicable after recommendations are made by the European Commission that affect matters that were taken into account, or could have been taken into account, in the case of our last analysis of that market.
- A6.18 In carrying out a market analysis, the key issue for an NRA is to determine whether the market in question is effectively competitive. The 27th recital to the Framework Directive clarifies the meaning of that concept. Namely, "[it] is essential that *ex ante* regulatory obligations should only be imposed where there is not effective competition, i.e. in markets where there are one or more undertakings with

⁹¹ Previously Article 81 and Article 82 of the EC Treaty, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:083:FULL:EN:PDF>

significant market power, and where national and Community competition law remedies are not sufficient to address the problem”.

- A6.19 The definition of SMP is equivalent to the concept of dominance as defined in competition law. The Framework Directive requires, however, that NRAs must carry out market analysis taking the utmost account of the SMP Guidelines. The latter emphasise that NRAs should undertake a thorough and overall analysis of the economic characteristics of the relevant market before coming to a conclusion as to the existence of significant market power.
- A6.20 In that regard, the SMP Guidelines set out, additionally to market shares, a number of criteria that can be used by NRAs to measure the power of an undertaking to behave to an appreciable extent independently of its competitors, customers and consumers, including (a) overall size of the undertaking; (b) control of infrastructure not easily duplicated; (c) technological advantages or superiority; (d) absence of or low countervailing buying power; (e) easy or privileged access to capital markets/financial; (f) resources; (g) product/services diversification (e.g. bundled products or services); (h) economies of scale; (i) economies of scope; (j) vertical integration; (k) highly developed distribution and sales network; (l) absence of potential competition; and (m) barriers to expansion. A dominant position can derive from a combination of these criteria, which taken separately may not necessarily be determinative.

Sufficiency of competition law

- A6.21 As part of our overall forward-looking analysis, we also assess whether competition law by itself (without *ex ante* regulation) is sufficient to address the competition problems identified. Aside from the need to address this issue as part of the three-criteria test, we normally also conclude on this matter in dealing with the appropriate remedies which, as explained below, are based on the nature of the specific competition problems we identify. We always consider the option of no *ex ante* regulation, while noting that the SMP Guidelines clarify that, if NRAs designate undertakings as having SMP, they must impose on them one or more regulatory obligations.
- A6.22 In considering this matter, we bear in mind the specific characteristics of communications markets. Generally, the case for *ex ante* regulation in communications markets is based on the existence of market failures, which, by themselves or in combination, mean that competition might not be able to become established, if the regulator relied solely on its *ex post* competition law powers that are established for dealing with more conventional sectors of the economy. Therefore, it is appropriate for *ex ante* regulation to be used to address these market failures and any entry barriers that might otherwise prevent effective competition from becoming established. By imposing *ex ante* regulation that promotes competition, it may be possible to reduce such regulation over time, as markets become more competitive, and instead place greater reliance on *ex post* competition law.
- A6.23 *Ex post* competition law is also unlikely in itself to bring about effective competition, as it prohibits the abuse of dominance rather than the holding of a dominant position. In contrast, *ex ante* regulation is normally needed to promote actively the development of competition. *Ex ante* regulation attempts to reduce the level of market power in a market, thereby encouraging effective competition to become

- A6.24 established. This is particularly the case when addressing the effects of network externalities, because the network externality effect generally re-enforces a dominant position and, as noted above, under general competition law there is no prohibition on the holding of a position of dominance in itself. Therefore, it is more appropriate to address the impact of network externality through *ex ante* obligations.
- A6.25 Additionally, unless we consider otherwise in relation to a specific obligation in this review, we generally take the view that *ex ante* regulation is needed to create legal certainty for the market under review. Linked to that certainty is the fact that the SMP obligations we have proposed are necessary to enable us to intervene in a timely manner. For some other specific obligations, we generally consider that they are needed as competition law would not remedy the particular market failure, or we believe that specific clarity and detail of the obligation is required to achieve a particular result.

Remedies procedure

Powers and legal tests

- A6.26 The Framework Directive prescribes what regulatory action NRAs must take depending upon whether or not the market in question has been found effectively competitive. Where a market has been found effectively competitive, NRAs are not allowed to impose SMP obligations and must withdraw such obligations where they already exist. On the other hand, where the market is found not effectively competitive, the NRAs must identify the undertakings with SMP on that market and then impose appropriate obligations.
- A6.27 NRAs have a suite of regulatory tools at their disposal, as reflected in the Act. Specifically, the Access Directive specifies a number of SMP obligations, including transparency, non-discrimination, accounting separation, access to and use of specific network elements and facilities, price control and cost accounting. When imposing a specific obligation, the NRA will need to demonstrate that the obligation in question is based on the nature of the problem identified, proportionate and justified in the light of the policy objectives as set out in Article 8 of the Framework Directive, as implemented by national law.
- A6.28 Specifically, for each and every proposed SMP obligation we explain why it satisfies the test that the obligation is: (a) objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates; (b) not such as to discriminate unduly against particular persons or against a particular description of persons; (c) proportionate to what the condition or modification is intended to achieve; and (d) in relation to what it is intended to achieve, transparent.
- A6.29 Additional legal requirements may also need to be satisfied depending on the SMP obligation in question, for example, for price controls where the NRA's market analysis must indicate that the lack of effective competition means that the operator concerned might sustain prices at an excessively high level, or apply a price squeeze, to the detriment of end-users. In that instance, NRAs must take into account the investment made by the operator and allow him a reasonable rate of return on adequate capital employed, taking into account the risks involved, as well as ensure that any cost recovery mechanism or pricing methodology that is mandated serves to promote efficiency and sustainable competition and maximise consumer benefits. Where an obligation to provide third parties with Network

Access is considered appropriate, NRAs must take into account factors including the feasibility of the proposed Network Access, the technical and economic viability of creating networks that would make the Network Access unnecessary and the investment of the network operator who is required to provide access.

A6.30 To the extent relevant to this review, we demonstrate the application of these requirements to the SMP obligations in question at Section X of this document. In doing so, we also set our assessment of how, in our opinion, the performance of our general duties under section 3 of the Act is secured or furthered by our regulatory intervention, and that it is in accordance with the six Community requirements in section 4 of the Act. This assessment is also relevant to our assessment of the likely impact of implementing our proposals. A number of specific points should be noted in this regard.

Ofcom's general duties – section 3 of the Act

A6.31 Under the Act, our principal duty in carrying out functions is to further the interests of citizens in relation to communications matters and to further the interests of consumers in relevant markets, where appropriate by promoting competition.

A6.32 In so doing, we are required to secure a number of specific objectives and to have regard to a number of matters set out in section 3 of the Act. As to the prescribed specific statutory objectives in section 3(2), we consider that the objective of securing the availability throughout the UK of a wide range of electronic communications services as particularly relevant to this review.

A6.33 In performing our duties, we are also required to have regard to a range of other considerations, as appear to us to be relevant in the circumstances. In this context, we consider that a number of such considerations are relevant, namely:

- the desirability of promoting competition in relevant markets;
- the desirability of encouraging investment and innovation in relevant markets; and
- the desirability of encouraging the availability and use of high speed data transfer services throughout the United Kingdom.

A6.34 We have also had regard to the principles under which regulatory activities should be transparent, accountable, proportionate, consistent, and targeted only at cases in which action is needed, as well as the interest of consumers in respect of choice, price, quality of service and value for money.

A6.35 Ofcom has, however, a wide measure of discretion in balancing its statutory duties and objectives. In so doing, we have taken account of all relevant considerations, including responses received during our consultation process, in reaching our conclusions.

European Community requirements for regulation – section 4 of the Act

A6.36 As noted above, our functions exercised in this review fall under the CRF. As such, section 4 of the Act requires us to act in accordance with the six European Community requirements for regulation.

A6.37 In summary, these six requirements are:

- to promote competition in the provision of electronic communications networks and services, associated facilities and the supply of directories;
- to contribute to the development of the European internal market;
- to promote the interests of all persons who are citizens of the European Union;
- to take account of the desirability of Ofcom's carrying out its functions in a manner which, so far as practicable, does not favour one form of or means of providing electronic communications networks, services or associated facilities over another, i.e. to be technologically neutral;
- to encourage, to such extent as Ofcom considers appropriate for certain prescribed purposes, the provision of Network Access and service interoperability, namely securing efficient and sustainable competition and the maximum benefit for customers of CPs;
- to encourage compliance with certain standards in order to facilitate service interoperability and secure freedom of choice for the customers of CPs.

A6.38 We consider that the first, third, fourth and fifth of those requirements are of particular relevance to the matters under review and that no conflict arises in this regard with those specific objectives in section 3 that we consider are particularly relevant in this context.

Impact assessment – section 7 of the Act

A6.39 The analysis presented in the whole of this document represents an impact assessment, as defined in section 7 of the Act.

A6.40 Impact assessments provide a valuable way of assessing different options for regulation and showing why the preferred option was chosen. They form part of best practice policy-making. This is reflected in section 7 of the Act, which means that generally Ofcom has to carry out impact assessments where its proposals would be likely to have a significant effect on businesses or the general public, or when there is a major change in Ofcom's activities. However, as a matter of policy Ofcom is committed to carrying out and publishing impact assessments in relation to the great majority of its policy decisions. For further information about Ofcom's approach to impact assessments, see the guidelines, Better policy-making: Ofcom's approach to impact assessment, which are on the Ofcom website: http://www.ofcom.org.uk/consult/policy_making/guidelines.pdf.

A6.41 Specifically, pursuant to section 7, an impact assessment must set out how, in our opinion, the performance of our general duties (within the meaning of section 3 of the Act) is secured or furthered by or in relation to what we propose.

A6.42 Ofcom is separately required by statute to assess the potential impact of all our functions, policies, projects and practices on race, disability and gender equality. Equality impact assessments (EIAs) also assist us in making sure that we are meeting our principal duty of furthering the interests of citizens and consumers

regardless of their background or identity. Unless we otherwise state in this document, it is not apparent to us that the outcome of our review is likely to have any particular impact on race, disability and gender equality. Specifically, we do not envisage the impact of any outcome to be to the detriment of any group of society.

- A6.43 Nor are we envisaging any need to carry out separate EIAs in relation to race or gender equality or equality schemes under the Northern Ireland and Disability Equality Schemes. This is because we anticipate that our regulatory intervention will affect all industry stakeholders equally and therefore not have a differential impact in relation to people of different gender or ethnicity, on consumers in Northern Ireland or on disabled consumers compared to consumers in general. Similarly, we are not envisaging making a distinction between consumers in different parts of the UK or between consumers on low incomes. Again, we believe that our intervention will not have a particular effect on one group of consumers over another.

Regulated entity

- A6.44 The power in the Act to impose an SMP obligation by means of an SMP services condition provides that it is to be applied only to a 'person' whom we have determined to be a 'person' having SMP in a specific market for electronic communications networks, electronic communications services or associated facilities (i.e. the 'services market').
- A6.45 The Framework Directive requires that, where an NRA determines that a relevant market is not effectively competitive, it shall identify 'undertakings' with SMP on that market and impose appropriate specific regulatory obligations. For the purposes of EC competition law, 'undertaking' includes companies within the same corporate group (*Viho v Commission Case C-73/95 P [1996] ECR I-5447*), for example, where a company within that group is not independent in its decision making.
- A6.46 We consider it appropriate to prevent a dominant provider to whom a SMP service condition is applied, which is part of a group of companies, exploiting the principle of corporate separation. The dominant provider should not use another member of its group to carry out activities or to fail to comply with a condition, which would otherwise render the dominant provider in breach of its obligations.
- A6.47 Accordingly, we are seeking to apply the proposed SMP conditions as relevant to the MCPs listed in schedule 1 of annex 7 and any subsidiary or holding company, or any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined in section 1159 of the Companies Act 2006.

Annex 7

Legal instruments

PART I – SETTING OF, AND MODIFICATION TO, SMP CONDITIONS

NOTIFICATION OF PROPOSALS UNDER SECTIONS 48(2) AND 80 OF THE COMMUNICATIONS ACT 2003

Proposals for identifying markets, making market power determinations and the setting of SMP services conditions in relation to BT and KCOM under section 45 of the Communications Act 2003

Background

1. On 22 July 2004, Ofcom published '*The regulatory financial reporting obligations on BT and Kingston Communications Final statement and notification (Accounting separation and cost accounting: Final statement and notification)*'.⁹²
2. On 15 September 2009, Ofcom published a '*Review of the fixed narrowband services wholesale markets: Statement on the markets, market power determinations and remedies including further consultation*'⁹³. This found (among others) that BT had SMP in wholesale analogue exchange line services in the UK, excluding the Hull Area, and that KCOM had SMP in wholesale analogue exchange line services in the Hull Area.
3. On 26 October 2009, Ofcom published '*Charge controls for Wholesale Line Rental and related services: Statement and consultation*'⁹⁴, with reference to Ofcom's findings in the 2009 Notification.
4. On 23 February 2010, Ofcom published '*Charge controls for Wholesale Line Rental – implementation and cost orientation*'⁹⁵ which removed the basis of charges (cost orientation) obligation on specific higher care services linked to WLR arising out of the SMP conditions imposed by the 2009 Notification.

Proposals for identifying markets and making market power determinations

5. Ofcom hereby makes, in accordance with sections 48(2) and 80 of the Communications Act 2003 (the "Act"), the following proposals for identifying markets, making market power determinations and the setting of SMP services conditions by reference to such determinations ("SMP conditions").
6. Ofcom is proposing to identify the following markets for the purpose of making market power determinations:
 - (a) for the United Kingdom, except the Hull Area wholesale analogue exchange line services; and

⁹² 'The regulatory financial reporting obligations on BT and Kingston Communications, Final Statement and notification: Accounting separation and cost accounting', 22 July 2004, http://www.ofcom.org.uk/consult/condocs/fin_reporting/fin_report_statement/

⁹³ http://stakeholders.ofcom.org.uk/binaries/consultations/wnmr_statement_consultation/summary/main.pdf

⁹⁴ <http://stakeholders.ofcom.org.uk/binaries/consultations/wlr/summary/wlrcondoc.pdf>

⁹⁵ http://stakeholders.ofcom.org.uk/binaries/consultations/wlr/statement/wlr_statement.pdf

(b) for the Hull Area wholesale analogue exchange line services;

7. Ofcom is proposing to make market power determinations that the following persons have significant market power:

(a) in relation to the market set out in paragraph 6(a) above, BT;

(b) in relation to the market set out in paragraph 6(b) above, KCOM.

Proposals to set SMP service conditions

8. Ofcom is proposing to set on the persons referred to in paragraph 7(a) above:

(a) the SMP conditions as set out in Schedule 1 to this Notification; and

(b) SMP conditions OA1 to OA28, OA32 and OA33 as set out in Schedule 2 to Annex 2 of the financial reporting statement.

9. Ofcom is proposing to set SMP conditions on the persons referred to in paragraph 7 (b) above:

(a) as set out in Schedule 2 to this Notification; and

(b) SMP conditions OB1 to OB27, OB31 and OB32 as set out in Schedule 2 to Annex 3 of the financial reporting statement.

10. The effect of, and Ofcom's reasons for making, the proposals to identify the markets set out in paragraph 6 above and to make the market power determinations set out in paragraph 7 above are contained in the case of the markets set out in sub-paragraphs 6(a), and 6(b) in Section 3 of the consultation document accompanying this Notification;

11. The effect of, and Ofcom's reasons for making, the proposals to set the SMP conditions set out in Schedules 1 and 2 to this Notification and the SMP conditions set out in the financial reporting statement are contained in Sections 5 to 7 of the consultation document accompanying this Notification.

Proposals to modify SMP service conditions

12. Ofcom is proposing, in accordance with section 48(2) of the Act, to make a minor modification to SMP Condition AAA4(WLR) (as modified) to ensure that it cross-references to the proposed new SMP conditions concerning basis of charges and the provision of Wholesale Line Rental (see paragraph 8 above) in light of the proposed revocation of the existing SMP Condition AAA3 and AAA10 (see paragraph 14 below). Accordingly:

(i) in paragraph AAA4(WLR).3 of SMP Condition AAA4(WLR) (as modified) as set out in Schedule 1 to the 2009 Second Notification, for the reference to Condition AAA3, there shall be substituted the reference to Condition AAAA3, and Condition AAA4(WLR).3 shall be read accordingly; and

(ii) in paragraph AAA4(WLR).12 of SMP Condition AAA4(WLR) (as modified) as set out in Schedule 1 to the 2009 Second Notification, for the reference to Condition AAA10.1(a), there shall be substituted the reference to Condition AAAA10.1, and Condition AAA4(WLR).12 shall be read accordingly.

13. The effect of, and Ofcom's reasons for making, these proposals are contained in Sections 5 to 7 of the consultation document accompanying this Notification.

Proposals to revoke SMP service conditions

14. Ofcom is proposing to revoke existing SMP service conditions, as detailed in paragraph 15 below, insofar as they relate to the following markets:

- (i) in relation to BT only, the market for wholesale analogue exchange line services in the United Kingdom, except the Hull Area; and
- (ii) in relation to KCOM only, the market for wholesale analogue exchange line services in the Hull Area.

15. The SMP conditions referred to in paragraph 14, above, are as follows:

- (a) the SMP conditions (as modified) set out in Schedule 1 to the 2009 Notification but excluding Condition AAA4(WLR); and
- (b) the SMP conditions (as modified) set out in Schedule 2 to the 2009 Notification.

16. The proposed revocations in paragraphs 14 and 15 above would take effect on the publication of any Notification under sections 48(1) and 79(4) of the Act adopting these proposals.

17. The effect of, and Ofcom's reasons for making, the proposals to revoke SMP conditions set out in paragraph 14 above are contained in Section 5 of the consultation document accompanying this Notification.

18. For the avoidance of doubt, Ofcom is not proposing to revoke any SMP services conditions set out in the 2009 Notification in relation to the following markets:

(a) for the United Kingdom, except the Hull Area:

- (i) wholesale ISDN2 exchange line services;
- (ii) wholesale call origination on a fixed narrowband network;
- (iii) wholesale fixed geographic call termination on each individual network.
- (iv) local-tandem conveyance and transit on fixed public narrowband networks; and

(b) for the Hull Area:

- (i) wholesale ISDN2 exchange line services; and
- (ii) wholesale call origination on a fixed narrowband network

Ofcom's duties and legal tests

19. In identifying and analysing the markets referred to in paragraph 6 above, and in considering whether to make the proposals set out in this Notification, Ofcom has, in accordance with section 79 of the Act, taken due account of all applicable guidelines and recommendations which have been issued or made by the European Commission in

pursuance of a Community instrument, and relate to market identification and analysis or the determination of what constitutes significant market power.

20. Ofcom considers that, given the proposed SMP conditions referred to in paragraph 8 above comply with the requirements of sections 45 to 47, 87, 88 and 90 of the Act, as appropriate and relevant to each such SMP condition.
21. In making all of the proposals referred to in paragraphs 5 to 18 of this Notification, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act and the six Community requirements in section 4 of the Act.

Making representations

22. Representations may be made to Ofcom about any of the proposals set out in this Notification and the accompanying consultation document by no later than 15 November 2010.
23. Copies of this Notification and the accompanying consultation document have been sent to the Secretary of State for Business, Innovation and Skills and President of the Board of Trade in accordance with sections 50(1)(a) and 81 of the Act, as well as the European Commission and to the regulatory authorities of every other Member State in accordance with sections 50(3) and 81 of the Act.

Interpretation

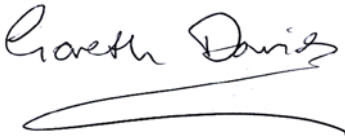
24. Save as to referring to markets identified in paragraph 6 of this Notification and except as otherwise defined in paragraph 25 of this Notification, words or expressions used shall have the same meaning as they have been ascribed in the Act.
25. In this Notification:
 - (a) **“2009 Notification”** means the notification under sections 48(1) and 79(4) of the Act set out at Annex 7 of the Review of the fixed narrowband services wholesale markets: Statement on the markets, market power determinations and remedies including further consultation, dated 15 September 2009;
 - (b) **“2009 Second Notification”** means the notification under sections 48(1) and 79(4) of the Act set out at Annex 6 of the Charge controls for Wholesale Line Rental and related services: Statement and consultation, dated 26 October 2009;
 - (c) **“the Act”** means the Communications Act 2003 (c. 21);
 - (d) **“BT”** means British Telecommunications plc, whose registered company number is 1800000, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006;
 - (e) **“Hull Area”** means the area defined as the 'Licensed Area' in the licence granted on 30 November 1987 by the Secretary of State under section 7 of the Telecommunications Act 1984 to Kingston upon Hull City Council and Kingston Communication (Hull) plc;
 - (f) **“KCOM”** means KCOM Group plc, whose registered company number is 2150618, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006,

(g) “**financial reporting statement**” means ‘*The regulatory financial reporting obligations on BT and Kingston Communications Final statement and notification (Accounting separation and cost accounting: Final statement and notification)*’ published on 22 July 2004.

(h) “**Ofcom**” means the Office of Communications as established pursuant to section 1(1) of the Office of Communications Act 2002; and

(i) “**United Kingdom**” has the meaning given to it in the Interpretation Act 1978 (c. 30).

Signed

A handwritten signature in black ink, appearing to read 'Gareth Davies', with a long horizontal flourish underneath.

Gareth Davies
Competition Policy Director

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

15 October 2010

SCHEDULE 1

The SMP services conditions proposed to be imposed on BT under sections 45, 87, 88 and 90 of the Communications Act 2003 as a result of the analysis of the markets set out in paragraph 6(a) of the Notification in each of which it is proposed BT has significant market power (“SMP conditions”)

Part 1: Application, definitions and interpretation relating to the SMP conditions in Part 2

1. The SMP conditions in Part 2 of this Schedule 1 shall, except insofar as it is otherwise stated therein, apply to each and all of the markets set out in paragraph 6(a) of the Notification.
2. In this Schedule 1:
 - (a) “**Act**” means the Communications Act 2003 (c. 21);
 - (b) “**Access Charge Change Notice**” has the meaning given to it in Condition AAAA6(a).2;
 - (c) “**Access Contract**” means:
 - (i) a contract for the provision by the Dominant Provider to another person of Network Access to the Dominant Provider’s Electronic Communications Network;
 - (ii) a contract under which Associated Facilities in relation to the Dominant Provider’s Public Electronic Communications Network are made available by the Dominant Provider to another person;
 - (d) “**Analogue Core WLR Rental**” means, unless Ofcom directs otherwise from time to time for the purpose of the meaning of this expression, such services as the Dominant Provider is required to provide under SMP services condition AAAA10.1(a) and which on the date this Condition takes effect include:
 - (i) the rental of an analogue exchange line for control and billing purposes;
 - (ii) maintenance which is part of the service provided by the Dominant Provider in consideration of the charge for an Exchange Line and includes a maintenance service level with a fault repair time of no more than provided for Level 1 service care level for Basic lines, as defined in the Dominant Provider’s standard terms and conditions; and
 - (iii) one main directory listing per telephone number, comprising of either:
 - (i) a residential style listing; or
 - (ii) a business style listing, where the Dominant Provider provides to the Third Party a WLR3 service, as defined in the Dominant Provider’s standard terms and conditions;”

(e) “**Directory**” means a printed document containing Directory Information on Relevant Subscribers of Publicly Available Telephone Services in the United Kingdom which is made available to members of the public;

(f) “**Directory Information**” means, in the case of a Directory, the name and address of the Relevant Subscriber and the Telephone Number assigned to the Relevant Subscriber for his use of Publicly Available Telephone Services and, in the case of a Directory Enquiry Facility, shall be either such a Telephone Number of the Relevant Subscriber or information that such a Telephone Number of the Relevant Subscriber may not be supplied;

(g) “**Directory Enquiry Facility**” means Directory Information provided by means of a Public Telephone Network;

(h) “**Dominant Provider**” means British Telecommunications plc, whose registered company number is 1800000, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006;

(i) “**Exchange Line**” means Apparatus comprised in the Dominant Provider’s Electronic Communications Network and installed for the purpose of connecting a telephone exchange run by the Dominant Provider to a Network Termination Point comprised in Network Termination and Testing Apparatus installed by the Dominant Provider for the purpose of providing Electronic Communications Services at the premises at which the Network Termination and Testing Apparatus is located;

(j) “**Existing Line Transfer**” means the combination of transactions consisting of a customer (including but not limited to a customer who is a provider of a Public Electronic Communications Service) of the Dominant Provider for an Exchange Line terminating his contract (‘the customer contract’) with the Dominant Provider for the Exchange Line, and the Dominant Provider entering into a contract for that Exchange Line with a provider of a Public Electronic Communications Service (‘the Third Party contract’), except where the Third Party contract is entered into after the Dominant Provider has ceased the Exchange Line (in which case the Third Party contract shall be deemed to be a New Line Installation);

(k) “**Local Exchange**” means a telephone exchange to which Customers are connected, usually via a remote or locally sited concentrator unit, which telephone exchange supports the provision of either analogue or digital Exchange Lines;

(l) “**Network Component**” means, to the extent they are used in the Services Market, the network components specified in any direction given by Ofcom from time to time for the purpose of these SMP conditions.

(m) “**Network Termination and Testing Apparatus**” means an item of Apparatus comprised in an Electronic Communications Network installed in a fixed position on Served Premises which enables:

(a) Approved Apparatus to be readily connected to, and disconnected from, the Network;

(b) the conveyance of Signals between such Approved Apparatus and the Network;

(c) the due functioning of the Network to be tested, but the only other functions of which, if any, are:

(i) to supply energy between such Approved Apparatus and the Network;

(ii) to protect the safety or security of the operation of the Network; or

(iii) to enable other operations exclusively related to the running of the Network to be performed or the due functioning of any system to which the Network is or is to be connected to be tested (separately or together with the Network);

(n) “**Network Termination Point**” means the physical point at which a Relevant Subscriber is provided with access to a Public Electronic Communications Network and, where it concerns Electronic Communications Networks involving switching or routing, that physical point is identified by means of a specific network address, which may be linked to the Telephone Number or name of a Relevant Subscriber. Where a Network Termination Point is provided at a fixed position on Served Premises, it shall be within an item of Network Termination and Testing Apparatus;

(o) “**New Line Installation**” means a service for the installation of an Exchange Line, where some or all external (or internal) wiring has to be provided, or brought into use, by the Dominant Provider. For purposes of this definition, “external wiring” means wiring from the distribution point to the protection box (or where one would be fitted) at the premises at which the Network Termination and Testing Apparatus is located and “internal wiring” means wiring from the protection box up to and including the first main socket, block terminal or other Network Termination Point;

(p) “**Numbering Plan**” means the National Telephone Numbering Plan published from time to time by Ofcom pursuant to sections 56 and 60 of the Act;

(q) “**Ordinary Maintenance**” means maintenance which is part of the service provided by the Dominant Provider in consideration of the charge for an Exchange Line and includes normal fault repair, as defined in the Dominant Provider's standard terms and conditions;

(r) “**Point of Connection**” means a point at which the Dominant Provider's Electronic Communications Network and another person's Electronic Communications Network are connected;

(s) “**Public Pay Telephone**” means a telephone available to the general public, for the use of which the means of payment may include coins and/or credit/debit cards and/or prepayment cards, including cards for use with dialling codes;

(t) “**Public Telephone Network**” means an Electronic Communications Network which is used to provide Publicly Available Telephone Services; it supports the transfer between Network Termination Points of speech communications, and also other forms of communication, such as facsimile and data;

(u) “**Publicly Available Telephone Services**” means a service available to the public for originating and receiving national and international calls and access to Emergency Organisations through a number or numbers in a national or international telephone numbering plan, and in addition may, where relevant, include one or more of the following services: the provision of operator assistance services, Directory Enquiry Facilities, Directories, provision of Public Pay Telephones, provision of service under special terms, provision of specific facilities for End-users with disabilities or with special social needs and/or the provision of non-geographic services;

(v) “**Reference Offer**” means the terms and conditions on which the Dominant Provider is willing to enter into an Access Contract;

(w) “**Relevant Subscriber**” means any person who is party to a contract with a provider of Public Electronic Communications Services for the supply of such Services;

(x) “**Services Market**” means all of the market set out in paragraph 6(a) of the Notification;

(y) “**Subscriber**” means any person who is party to a contract with the provider of Publicly Available Telephone Services for the supply of such Services in the United Kingdom;

(z) “**Third Party**” means either:

(i) a person providing a Public Electronic Communications Network; or

(ii) a person providing a Public Electronic Communications Service;

(aa) “**Usage Factor**” means the average usage by any Communications Provider (including the Dominant Provider itself) of each Network Component in using or providing a particular product or service or carrying out a particular activity;

(bb) “**Wholesale Analogue Line Rental**” means an Electronic Communications Service provided by the Dominant Provider to a Third Party for the use and Ordinary Maintenance of an analogue Exchange Line;

(ee) “**Wholesale Line Rental**” means Wholesale Analogue Line Rental provided by the Dominant Provider:

(ff) “**Wholesale Line Rental Charge**” means the annual charge levied by the Dominant Provider for Wholesale Line Rental including packages containing a line rental charge and any included levels of service sold as part of a single marketed product;

(gg) “**Wholesale Line Rental Per Customer Line Set-up Costs**” means the costs incurred by the Dominant Provider in providing Wholesale Line Rental Per Customer Line Set-up Facilities;

(hh) “**Wholesale Line Rental Per Customer Line Set-up Facilities**” means the Wholesale Line Rental facilities required from the Dominant Provider by a Third Party in order for the Third Party to be able to set up Wholesale Line Rental on

the Exchange Line of a Subscriber to whom the Dominant Provider provides a Publicly Available Telephone Service by means of a Public Telephone Network;

(ii) **“Wholesale Line Rental Per Provider On-going Costs”** means the costs incurred by the Dominant Provider in providing Wholesale Line Rental Per Provider On-going Facilities;

(jj) **“Wholesale Line Rental Per Provider On-going Facilities”** means those Wholesale Line Rental facilities required from the Dominant Provider by any individual Third Party which enable the Third Party to continue on an on-going basis to offer Wholesale Line Rental to Subscribers to whom the Dominant Provider provides Publicly Available Telephone Services by means of a Public Telephone Network, including (without limitation to the generality of the foregoing) activities such as product management;

(kk) **“Wholesale Line Rental Per Provider Set-up Costs”** means the costs incurred by the Dominant Provider in providing Wholesale Line Rental Per Provider Set-up Facilities;

(ll) **“Wholesale Line Rental Per Provider Set-up Facilities”** means those Wholesale Line Rental facilities required from the Dominant Provider by any individual Third Party in order for the Third Party to be able to offer Wholesale Line Rental to Subscribers to whom the Dominant Provider provides Publicly Available Telephone Services by means of a Public Telephone Network, including (without limitation to the generality of the foregoing) activities such as the setting up of arrangements for the electronic transfer of customer orders;

(mm) **“Wholesale Line Rental Services”** means any and all of the following specific services provided by the Dominant Provider:

- (i) Wholesale Analogue Line Rental (residential quality of service);
- (ii) Wholesale Analogue Line Rental (business quality of service);
- (iii) Existing Line Transfer of a single analogue Exchange Line or multiplexes thereof (residential quality of service);
- (iv) Existing Line Transfer of a single analogue Exchange Line or multiplexes thereof (business quality of service);
- (v) New Line Installation (analogue) (residential quality of service); and
- (vi) New Line Installation (analogue) (business quality of service);

(nn) **“Wholesale Line Rental System Set-up Costs”** means the costs incurred by the Dominant Provider in developing and implementing Wholesale Line Rental System Set-up Facilities; and

(oo) **“Wholesale Line Rental System Set-up Facilities”** means those Wholesale Line Rental Facilities required by the Dominant Provider in order for the Dominant Provider to be able to provide Wholesale Line Rental facilities, such as the software and any alterations needed on the Dominant Provider’s switches and the modifications required for the Dominant Provider’s support systems.

3. For the purpose of interpreting the SMP conditions in Part 2:

(a) except in so far as the context otherwise requires, words or expressions shall have the meaning assigned to them in paragraph 2 of this Part above and otherwise any word or expression shall have the same meaning as it has in the Act;

(b) the Interpretation Act 1978 (c. 30) shall apply as if each of the SMP conditions in Part 2 were an Act of Parliament; and

(c) headings and titles shall be disregarded.

Part 2: The SMP conditions

Condition AAAA1(a) - Requirement to provide Network Access on reasonable request

AAAA1(a).1 Where a Third Party reasonably requests in writing Network Access, the Dominant Provider shall provide that Network Access. The Dominant Provider shall also provide such Network Access as Ofcom may from time to time direct.

AAAA1(a).2 The provision of Network Access in accordance with paragraph AAAA1(a).1 above shall occur as soon as it is reasonably practicable and shall be provided on fair and reasonable terms, conditions and charges and on such terms, conditions and charges as Ofcom may from time to time direct.

AAAA1(a).3 The Dominant Provider shall comply with any direction Ofcom may make from time to time under this Condition AAAA1(a).

AAAA1(a).4 The Direction made in the document 'BT's use of Cancel Other' published on 28 July 2005, shall continue to have force, until such time it is modified or withdrawn, for the purposes of this condition from the date that this Condition AAAA1(a) enters force.

Condition AAAA1(b) - Requests for new Network Access

AAAA1(b).1 The Dominant Provider shall, for the purposes of transparency, publish reasonable guidelines, in relation to requests for new Network Access made to it. Such guidelines shall detail:

- (a) the form in which such a request should be made;
- (b) the information that the Dominant Provider requires in order to consider a request for new Network Access; and
- (c) the time-scales in which such requests will be handled by the Dominant Provider.

AAAA1(b).2 These guidelines shall meet the following principles:

- (a) the process should be documented end-to-end;
- (b) the timescales for each stage of the process shall be reasonable;
- (c) the criteria by which requests will be assessed shall be clearly identified; and
- (d) any changes to the guidelines be agreed between BT and industry.

AAAA1(b).3 The Dominant Provider shall, upon a reasonable request from a Third Party considering making a request for new Network Access, provide that Third Party with information so as to enable that Third Party to make a request for new Network Access. Such information shall be provided within a reasonable period.

AAAA1(b).4 On receipt of a written request for new Network Access, the Dominant Provider shall deal with the request in accordance with the guidelines described at paragraph AAAA1(b).1 above. A modification of a request for new Network Access which has previously been submitted to the Dominant Provider, and rejected by the Dominant Provider, shall be considered as a new request.

AAAA1(b).5 The Dominant Provider is required to provide Ofcom with a description of the processes it has put in place to ensure compliance with this Condition AAAA1(b). The Dominant Provider shall keep those processes under review to ensure that they remain adequate for that purpose. Where changes to the process are agreed with industry, BT should notify Ofcom of those changes.

Condition AAAA2 - Requirement not to unduly discriminate

AAAA2.1 The Dominant Provider shall not unduly discriminate against particular persons or against a particular description of persons in relation to matters connected with Network Access.

AAAA2.2 In this Condition, the Dominant Provider may be deemed to have shown undue discrimination if it unfairly favours to a material extent an activity carried on by it so as to place at a competitive disadvantage persons competing with the Dominant Provider.

Condition AAAA3 - Basis of charges

AAAA3.1 Unless Ofcom directs otherwise from time to time, the Dominant Provider shall secure, and shall be able to demonstrate to the satisfaction of Ofcom, that each and every charge offered, payable or proposed for Network Access covered by Condition AAAA1(a) is reasonably derived from the costs of provision based on a forward looking long-run incremental cost approach and allowing an appropriate mark up for the recovery of common costs including an appropriate return on capital employed.

AAA3.2 For the avoidance of doubt, except for the charge for Analogue Core WLR Rental where that Analogue Core WLR Rental charge is subject to a charge control, where the charge offered, payable or proposed for Network Access covered by Condition AAAA1(a) is for a service which is subject to a charge control under Condition AAA4(WLR) the Dominant Provider shall secure, and shall be able to demonstrate to the satisfaction of Ofcom, that such a charge satisfies the requirements of paragraph AAAA3.1 above.

AAAA3.3 The Dominant Provider shall comply with any direction Ofcom may from time to time direct under this Condition AAAA3.

AAAA3.4 The Direction regarding removal of cost orientation obligation for enhanced service level care made in the document 'Charge controls for Wholesale Line Rental – implementation and cost orientation' published on 23 February 2010, shall continue to have force, until such time it is modified or withdrawn, for the purposes of this condition from the date that this Condition AAAA3 enters force.

Condition AAAA5 - Requirement to publish a Reference Offer

AAAA5.1 Except in so far as Ofcom may otherwise consent in writing, the Dominant Provider shall publish a Reference Offer and act in the manner set out below.

AAAA5.2 Subject to paragraph AAAA5.8 below, the Dominant Provider shall ensure that a Reference Offer in relation to the provision of Network Access includes at least the following:

- (a) a description of the Network Access to be provided, including technical characteristics (which shall include information on network configuration where necessary to make effective use of the Network Access);
- (b) the locations of the points of Network Access;

- (c) the technical standards for Network Access (including any usage restrictions and other security issues);
- (d) the conditions for access to ancillary, supplementary and advanced services (including operational support systems, information systems or databases for pre-ordering, provisioning, ordering, maintenance and repair requests and billing);
- (e) any ordering and provisioning procedures;
- (f) relevant charges, terms of payment and billing procedures;
- (g) details of interoperability tests;
- (h) details of traffic and network management;
- (i) details of maintenance and quality as follows:
 - (i) specific time scales for the acceptance or refusal of a request for supply and for completion, testing and hand-over or delivery of services and facilities, for provision of support services (such as fault handling and repair);
 - (ii) service level commitments, namely the quality standards that each party must meet when performing its contractual obligations;
 - (iii) the amount of compensation payable by one party to another for failure to perform contractual commitments;
 - (iv) a definition and limitation of liability and indemnity; and
 - (v) procedures in the event of alterations being proposed to the service offerings, for example, launch of new services, changes to existing services or change to prices;
- (j) details of measures to ensure compliance with requirements for network integrity;
- (k) details of any relevant intellectual property rights;
- (l) a dispute resolution procedure to be used between the parties;
- (m) details of duration and renegotiation of agreements;
- (n) provisions regarding confidentiality of non-public parts of the agreements;
- (o) rules of allocation between the parties when supply is limited (for example, for the purpose of co-location or location of masts);
- (p) the standard terms and conditions for the provision of Network Access;
- (q) in relation to those products and services subject to Conditions AAAA3 and AAA4(WLR), the amount applied to:
 - (i) each Network Component used in providing Network Access with the relevant Usage Factors; and

(ii) the Transfer Charge for each Network Component or combination of Network Components described above,

reconciled in each case to the charge payable by a Communications Provider other than the Dominant Provider.

AAAA5.3 In relation to those products and services subject to Conditions AAAA3 and AAAA4(WLR), to the extent that the Dominant Provider provides to itself Network Access that:

is the same, similar or equivalent to that provided to any other Third Party; or

may be used for a purpose that is the same, similar or equivalent to that provided to any other Third Party,

in a manner that differs from that detailed in a Reference Offer in relation to Network Access provided to any other Third Party, the Dominant Provider shall ensure that it publishes a Reference Offer in relation to the Network Access that it provides to itself which includes, where relevant, at least those matters detailed in paragraphs AAAA5.2(a) to (q) above.

AAAA5.4 The Dominant Provider shall update and publish the Reference Offer in relation to any amendments or in relation to any further Network Access provided after the date this Condition AAAA5 enters into force.

AAAA5.5 Publication referred to above shall be effected by:

(a) placing a copy of the Reference Offer on any relevant website operated or controlled by the Dominant Provider; and

(b) sending a copy of the Reference Offer to Ofcom.

AAAA5.6 The Dominant Provider shall send a copy of the current version of the Reference Offer to any person at that person's written request (or such parts which have been requested).

AAAA5.7 The Dominant Provider shall make such modifications to the Reference Offer as Ofcom may direct from time to time.

AAAA5.8 The Dominant Provider shall provide Network Access at the charges, terms and conditions in the relevant Reference Offer and shall not depart therefrom either directly or indirectly.

AAAA5.9 The Dominant Provider shall comply with any direction Ofcom may make from time to time under this Condition AAAA5.

Condition AAAA6(a) - Requirement to notify charges

AAAA6(a).1 Except in so far as Ofcom may otherwise consent in writing, the Dominant Provider shall publish charges and act in the manner set out below.

AAAA6(a).2 Except where new or amended charges are directed or determined by Ofcom or where such charges are required by a notification or an enforcement notification given by Ofcom under sections 94 or 95 of the Act, the Dominant Provider shall send to Ofcom and to every Third Party with which it has entered into an Access Contract covered by Condition AAAA1(a) a written notice of any amendment to the charges on which it provides Network

Access or in relation to any charges for new Network Access (an “Access Charge Change Notice”):

- (a) where the proposed amendment relates to the Wholesale Line Rental Charge, not less than 90 days before any such amendment comes into effect; and
- (b) in any other case, not less than 28 days before any such amendment comes into effect.

AAAA6(a).3 The Dominant Provider shall ensure that an Access Charge Change Notice includes:

- (a) a description of the Network Access in question;
- (b) a reference to the location in the Dominant Provider’s current Reference Offer of the terms and conditions associated with the provision of that Network Access;
- (c) the date on which or the period for which any amendments to charges will take effect (the “effective date”);
- (d) in relation to those products and services subject to Conditions AAAA3 and AAA4(WLR), the current and proposed new charge and the relevant Usage Factors applied to each Network Component comprised in that Network Access, reconciled in each case with the current or proposed new charge;
- (e) the information specified in sub-paragraph (d) above with respect to that Network Access to which that paragraph applies; and
- (f) in relation to those products and services subject to Conditions AAAA3 and AAA4(WLR) , the relevant network tariff gradient.

AAAA6(a).4 The Dominant Provider shall not apply any new charge identified in an Access Charge Change Notice before the effective date.

AAAA6(a).5 In relation to those products and services subject to Conditions AAAA3 and AAA4(WLR) , to the extent that the Dominant Provider provides to itself Network Access that:

- (a) is the same, similar or equivalent to that provided to any other Third Party; or
- (b) may be used for a purpose that is the same, similar or equivalent to that provided to any other Third Party, in a manner that differs from that detailed in an Access Charge Change Notice in relation to Network Access provided to any other Third Party, the Dominant Provider shall ensure that it sends to Ofcom an Access Charge Change Notice in relation to the Network Access that it provides to itself which includes, where relevant, at least those matters detailed in paragraphs AAAA6(a).3(a) to (f).

Condition AAAA6(b) - Requirement to notify technical information

AAAA6(b).1 Save where Ofcom consents otherwise, where the Dominant Provider:

- (a) proposes to provide Network Access covered by Condition AAAA1(a), the terms and conditions for which comprise new:

(i) technical characteristics (including information on network configuration where necessary to make effective use of the Network Access);

(ii) locations of the points of Network Access; or

(iii) technical standards (including any usage restrictions and other security issues), or

(b) proposes to amend an existing Access Contract covered by Condition AAAA1(a) by modifying the terms and conditions listed in paragraph AAAA6(b).1(a)(i) to (iii) above on which the Network Access is provided,

the Dominant Provider shall publish a written notice (the "Notice") of the new or amended terms and conditions not less than 90 days before either the Dominant Provider enters into an Access Contract to provide the new Network Access or the amended terms and conditions of the existing Access Contract come into effect. This obligation for prior notification shall not apply where new or amended terms and conditions are directed or determined by the Office of Communications ("Ofcom") or are required by a notification or an enforcement notification given by Ofcom under sections 94 or 95 of the Act.

AAAA6(b).2 The Dominant Provider shall ensure that the Notice includes:

(a) a description of the Network Access in question;

(b) a reference to the location in the Dominant Provider's Reference Offer of the relevant terms and conditions;

(c) the date on which or the period for which the Dominant Provider may enter into an Access Contract to provide the new Network Access or any amendments to the relevant terms and conditions will take effect (the "effective date").

AAAA6(b).3 The Dominant Provider shall not enter into an Access Contract containing the terms and conditions identified in the Notice or apply any new relevant terms and conditions identified in the Notice before the effective date.

AAAA6(b).4 Publication referred to in paragraph AAAA6(b).1 shall be effected by:

(a) placing a copy of the Notice on any relevant website operated or controlled by the Dominant Provider;

(b) sending a copy of the Notice to Ofcom; and

(c) sending a copy of the Notice to any person at that person's written request, and where the Notice identifies a modification to existing relevant terms and conditions, to every Third Party with which the Dominant Provider has entered into an Access Contract covered by Condition AAAA1(a). The provision of such a copy of the Notice may be subject to a reasonable charge.

Condition AAAA7 - Transparency as to quality of service

AAAA7.1 The Dominant Provider shall publish all such information for the purposes of securing transparency as to the quality of service in relation to Network Access provided by the Dominant Provider, in such manner and form as Ofcom may from time to time direct.

AAAA7.2 The Dominant Provider shall comply with any direction Ofcom may make from time to time under this Condition AAAA7.

Condition AAAA10 - Requirement to provide Wholesale Line Rental etc.

AAAA10.1 The Dominant Provider shall provide Wholesale Line Rental as soon as is reasonably practicable, or as directed by Ofcom, on reasonable terms to every Third Party who makes a reasonable request in relation to wholesale analogue exchange line services.

AAAA10.2 Unless Ofcom directs otherwise from time to time, the Dominant Provider shall ensure that charges of providing WLR services in paragraph AAAA10.1 are based on the forward looking long-run incremental cost, except where the Dominant Provider and Third Party have agreed another basis for the charges.

AAAA10.3 The Dominant Provider shall comply with any direction that Ofcom may make from time to time under this Condition AAAA10.

AAAA10.4 This Condition AAAA10 is without prejudice to the generality of the provisions in Conditions AAAA1(a) to AAAA7 above.

AAAA10.5 The Direction regarding removal of cost orientation obligation for enhanced service level care made in the document 'Charge controls for Wholesale Line Rental – implementation and cost orientation' published on 23 February 2010, shall continue to have force, until such time it is modified or withdrawn, for the purposes of this condition from the date that this Condition AAAA10 enters force.

SCHEDULE 2

The SMP services conditions proposed to be imposed on KCOM under sections 45, 87, 88 and 90 of the Communications Act 2003 as a result of the analysis of the markets set out in paragraph 6(b) of the Notification in each of which it is proposed KCOM has significant market power (“SMP conditions”)

Part 1: Application, definitions and interpretation relating to the SMP conditions in Part 2

1. The SMP conditions in Part 2 of this Schedule 1 shall, except insofar as it is otherwise stated therein, apply to each and all of the markets set out in paragraph 6(b) of the Notification.
2. In this Schedule 2:
 - (a) “**Act**” means the Communications Act 2003 (c. 21);
 - (b) “**Access Charge Change Notice**” has the meaning given to it in Condition AAAB5(a).2;
 - (c) “**Access Contract**” means:
 - (i) a contract for the provision by the Dominant Provider to another person of Network Access to the Dominant Provider’s Electronic Communications Network;
 - (ii) a contract under which Associated Facilities in relation to the Dominant Provider’s Public Electronic Communications Network are made available by the Dominant Provider to another person;
 - (d) “**Directory**” means a printed document containing Directory Information on Relevant Subscribers of Publicly Available Telephone Services in the United Kingdom which is made available to members of the public;
 - (e) “**Directory Information**” means, in the case of a Directory, the name and address of the Relevant Subscriber and the Telephone Number assigned to the Relevant Subscriber for his use of Publicly Available Telephone Services and, in the case of a Directory Enquiry Facility, shall be either such a Telephone Number of the Relevant Subscriber or information that such a Telephone Number of the Relevant Subscriber may not be supplied;
 - (f) “**Directory Enquiry Facility**” means Directory Information provided by means of a Public Telephone Network;
 - (g) “**Dominant Provider**” means KCOM Group plc, whose registered company number is 2150618, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006;
 - (h) “**Exchange Line**” means Apparatus comprised in the Dominant Provider’s Electronic Communications Network and installed for the purpose of connecting a telephone exchange run by the Dominant Provider to a Network Termination

Point comprised in Network Termination and Testing Apparatus installed by the Dominant Provider for the purpose of providing Electronic Communications Services at the premises at which the Network Termination and Testing Apparatus is located;

(i) “**Local Exchange**” means a telephone exchange to which Customers are connected, usually via a remote or locally sited concentrator unit, which telephone exchange supports the provision of either analogue or digital Exchange Lines;

(j) “**Network Component**” means, to the extent they are used in the Services Market, the network components specified in any direction given by Ofcom from time to time for the purpose of these SMP conditions.

(k) “**Network Termination and Testing Apparatus**” means an item of Apparatus comprised in an Electronic Communications Network installed in a fixed position on Served Premises which enables:

(a) Approved Apparatus to be readily connected to, and disconnected from, the Network;

(b) the conveyance of Signals between such Approved Apparatus and the Network;

(c) the due functioning of the Network to be tested,

but the only other functions of which, if any, are:

(i) to supply energy between such Approved Apparatus and the Network;

(ii) to protect the safety or security of the operation of the Network; or

(iii) to enable other operations exclusively related to the running of the Network to be performed or the due functioning of any system to which the Network is or is to be connected to be tested (separately or together with the Network);

(l) “**Network Termination Point**” means the physical point at which a Relevant Subscriber is provided with access to a Public Electronic Communications Network and, where it concerns Electronic Communications Networks involving switching or routing, that physical point is identified by means of a specific network address, which may be linked to the Telephone Number or name of a Relevant Subscriber. Where a Network Termination Point is provided at a fixed position on Served Premises, it shall be within an item of Network Termination and Testing Apparatus;

(m) “**Public Pay Telephone**” means a telephone available to the general public, for the use of which the means of payment may include coins and/or credit/debit cards and/or prepayment cards, including cards for use with dialling codes;

(n) “**Public Telephone Network**” means an Electronic Communications Network which is used to provide Publicly Available Telephone Services; it supports the transfer between Network Termination Points of speech

communications, and also other forms of communication, such as facsimile and data;

(o) “**Publicly Available Telephone Services**” means a service available to the public for originating and receiving national and international calls and access to Emergency Organisations through a number or numbers in a national or international telephone numbering plan, and in addition may, where relevant, include one or more of the following services: the provision of operator assistance services, Directory Enquiry Facilities, Directories, provision of Public Pay Telephones, provision of service under special terms, provision of specific facilities for End Users with disabilities or with special social needs and/or the provision of non-geographic services;

(p) “**Reference Offer**” means the terms and conditions on which the Dominant Provider is willing to enter into an Access Contract;

(q) “**Relevant Subscriber**” means any person who is party to a contract with a provider of Public Electronic Communications Services for the supply of such Services;

(r) “**Served Premises**” means a single set of premises in single occupation where Apparatus has been installed for the purpose of the provision of Electronic Communications Services by means of an Electronic Communications Network at those premises;

(s) “**Services Market**” means all of the market set out in paragraph 6(b) of the Notification;

(t) “**Subscriber**” means any person who is party to a contract with the provider of Publicly Available Telephone Services for the supply of such Services in the United Kingdom;

(u) “**Third Party**” means either:

(i) a person providing a Public Electronic Communications Network; or

(ii) a person providing a Public Electronic Communications Service;

(v) “**Transfer Charge**” means the charge or price that is applied, or deemed to be applied, by the Dominant Provider to itself for the use or provision of an activity or group of activities. For the avoidance of doubt, such activities or group of activities include, amongst other things, products and services provided from, to or within the Services Market and the use of Network Components in that Services Market;

(w) “**Usage Factor**” means the average usage by any Communications Provider (including the Dominant Provider itself) of each Network Component in using or providing a particular product or service or carrying out a particular activity; and

(x) “**Wholesale Analogue Line Rental**” means an Electronic Communications Service provided by the Dominant Provider to a Third Party for the use and Ordinary Maintenance of an analogue Exchange Line;

(y) “**Wholesale Line Rental**” means Wholesale Analogue Line Rental provided by the Dominant Provider;

(z) “**Wholesale Line Rental Charge**” means the annual charge levied by the Dominant Provider for Wholesale Line Rental including packages containing a line rental charge and any included levels of service sold as part of a single marketed product.

3. For the purpose of interpreting the SMP conditions in Part 2:

(a) except in so far as the context otherwise requires, words or expressions shall have the meaning assigned to them in paragraph 2 of this Part above and otherwise any word or expression shall have the same meaning as it has in the Act;

(b) the Interpretation Act 1978 (c. 30) shall apply as if each of the SMP conditions in Part 2 were an Act of Parliament; and

(c) headings and titles shall be disregarded.

Part 2: The SMP conditions

Condition AAAB1(a) - Requirement to provide Network Access on reasonable request

AAAB1.1(a) Where a Third Party reasonably requests in writing Network Access, the Dominant Provider shall provide that Network Access. The Dominant Provider shall also provide such Network Access as Ofcom may from time to time direct.

AAAB1.2(a) The provision of Network Access in accordance with paragraph AAAB1.1 shall occur as soon as it is reasonably practicable and shall be provided on fair and reasonable terms, conditions and charges and on such terms, conditions and charges as Ofcom may from time to time direct.

AAAB1.3(a) The Dominant Provider shall comply with any direction Ofcom may make from time to time under this Condition AAAB1.

Condition AAAB1(b) - Requests for new Network Access

AAAB1(b).1 The Dominant Provider shall, for the purposes of transparency, publish reasonable guidelines, in relation to requests for new Network Access made to it. Such guidelines shall detail:

- (a) the form in which such a request should be made;
- (b) the information that the Dominant Provider requires in order to consider a request for new Network Access; and
- (c) the time-scales in which such requests will be handled by the Dominant Provider.

AAAB1(b).2 These guidelines shall meet the following principles:

- (a) the process should be documented end-to-end;
- (b) the timescales for each stage of the process shall be reasonable;
- (c) the criteria by which requests will be assessed shall be clearly identified; and
- (d) any changes to the guidelines be agreed between the Dominant Provider and industry.

AAAB1(b).3 The Dominant Provider shall, upon a reasonable request from a Third Party considering making a request for new Network Access, provide that Third Party with information so as to enable that Third Party to make a request for new Network Access. Such information shall be provided within a reasonable period.

AAAB1(b).4 On receipt of a written request for new Network Access, the Dominant Provider shall deal with the request in accordance with the guidelines described at paragraph AAAB1(b).1 above. A modification of a request for new Network Access which has previously been submitted to the Dominant Provider, and rejected by the Dominant Provider, shall be considered as a new request.

AAAB1(b).5 The Dominant Provider is required to provide Ofcom with a description of the processes it has put in place to ensure compliance with this Condition AAAB1(b). The

Dominant Provider shall keep those processes under review to ensure that they remain adequate for that purpose. Where changes to the process are agreed with industry, The Dominant Provider should notify Ofcom of those changes.

Condition AAAB2 - Requirement not to unduly discriminate in the Hull Area

AAAB2.1 The Dominant Provider shall not unduly discriminate against particular persons or against a particular description of persons in relation to matters connected with Network Access.

AAAB2.2 In this Condition, the Dominant Provider may be deemed to have shown undue discrimination if it unfairly favours to a material extent an activity carried on by it so as to place at a competitive disadvantage persons competing with the Dominant Provider.

Condition AAAB3 - Basis of charges in the Hull Area

AAAB3.1 Unless Ofcom directs otherwise from time to time, the Dominant Provider shall secure, and shall be able to demonstrate to the satisfaction of Ofcom, that each and every charge offered, payable or proposed for Network Access covered by Condition AAAB1 is reasonably derived from the costs of provision based on a forward looking long-run incremental cost approach and allowing an appropriate mark up for the recovery of common costs including an appropriate return on capital employed.

AAAB3.2 The Dominant Provider shall comply with any direction Ofcom may from time to time direct under this Condition AAAB3.

Condition AAAB4 - Requirement to publish a Reference Offer in the Hull Area

AAAB4.1 Except in so far as Ofcom may otherwise consent in writing, the Dominant Provider shall publish a Reference Offer and act in the manner set out below.

AAAB4.2 Subject to paragraph AAAB4.8 below, the Dominant Provider shall ensure that a Reference Offer in relation to the provision of Network Access includes at least the following:

- (a) a description of the Network Access to be provided, including technical characteristics (which shall include information on network configuration where necessary to make effective use of the Network Access);
- (b) the locations of the points of Network Access;
- (c) the technical standards for Network Access (including any usage restrictions and other security issues);
- (d) the conditions for access to ancillary, supplementary and advanced services (including operational support systems, information systems or databases for pre-ordering, provisioning, ordering, maintenance and repair requests and billing);
- (e) any ordering and provisioning procedures;
- (f) relevant charges, terms of payment and billing procedures;
- (g) details of interoperability tests;

- (h) details of traffic and network management;
- (i) details of maintenance and quality as follows:
 - (i) specific time scales for the acceptance or refusal of a request for supply and for completion, testing and hand-over or delivery of services and facilities, for provision of support services (such as fault handling and repair);
 - (ii) service level commitments, namely the quality standards that each party must meet when performing its contractual obligations;
 - (iii) the amount of compensation payable by one party to another for failure to perform contractual commitments;
 - (iv) a definition and limitation of liability and indemnity; and
 - (v) procedures in the event of alterations being proposed to the service offerings, for example, launch of new services, changes to existing services or change to prices;
- (j) details of measures to ensure compliance with requirements for network integrity;
- (k) details of any relevant intellectual property rights;
- (l) a dispute resolution procedure to be used between the parties;
- (m) details of duration and renegotiation of agreements;
- (n) provisions regarding confidentiality of non-public parts of the agreements;
- (o) rules of allocation between the parties when supply is limited (for example, for the purpose of co-location or location of masts); and
- (p) the standard terms and conditions for the provision of Network Access; and
- (q) the amount applied to:
 - (i) each Network Component used in providing Network Access with the relevant Usage Factors; and
 - (ii) the Transfer Charge for each Network Component or combination of Network Components described above, reconciled in each case to the charge payable by a Communications Provider other than the Dominant Provider.

AAAB4.3 To the extent that the Dominant Provider provides to itself Network Access that:

- (a) is the same, similar or equivalent to that provided to any other Third Party; or
- (b) may be used for a purpose that is the same, similar or equivalent to that provided to any other Third Party, in a manner that differs from that detailed in a Reference Offer in relation to Network Access provided to any other Third Party, the Dominant Provider shall ensure that it publishes a Reference Offer in relation to the Network Access that it provides to itself which includes, where relevant, at least those matters detailed in paragraphs AAAB4.2(a) to (q) above.

AAAB4.4 The Dominant Provider shall update and publish the Reference Offer in relation to any amendments or in relation to any further Network Access provided after the date this Condition AAAB4 enters into force.

AAAB4.5 Publication referred to above shall be effected by:

- (a) placing a copy of the Reference Offer on any relevant website operated or controlled by the Dominant Provider; and
- (b) sending a copy of the Reference Offer to Ofcom.

AAAB4.6 The Dominant Provider shall send a copy of the current version of the Reference Offer to any person at that person's written request (or such parts which have been requested).

AAAB4.7 The Dominant Provider shall make such modifications to the Reference Offer as Ofcom may direct from time to time.

AAAB4.8 The Dominant Provider shall provide Network Access at the charges, terms and conditions in the relevant Reference Offer and shall not depart therefrom either directly or indirectly.

AAAB4.9 The Dominant Provider shall comply with any direction Ofcom may make from time to time under this Condition AAAB4.

Condition AAAB5(a) - Requirement to notify charges in respect of Network Access in the Hull Area

AAAB5(a).1 Except in so far as Ofcom may otherwise consent in writing, the Dominant Provider shall publish charges and act in the manner set out below.

AAAB5(a).2 The Dominant Provider shall send to Ofcom and to every Third Party with which it has entered into an Access Contract covered by Condition AAAB1 a written notice of any amendment to the charges on which it provides Network Access or in relation to any charges for new Network Access (an "Access Charge Change Notice"):

- (a) where the proposed amendment relates to the Wholesale Line Rental Charge, not less than 90 days before any such amendment comes into effect; and
- (b) in any other case, not less than 28 days before any such amendment comes into effect.

AAAB5(a).3 The Dominant Provider shall ensure that an Access Charge Change Notice includes:

- (a) a description of the Network Access in question;
- (b) a reference to the location in the Dominant Provider's current Reference Offer of the terms and conditions associated with the provision of that Network Access; and
- (c) the date on which or the period for which any amendments to charges will take effect (the "effective date").
- (d) in relation to those products and services subject to Condition AAAB3, the current and proposed new charge and the relevant Usage Factors applied to each

Network Component comprised in that Network Access, reconciled in each case with the current or proposed new charge;

(e) the information specified in sub-paragraph (d) above with respect to that Network Access to which that paragraph applies; and

(f) in relation to those products and services subject to Condition AAAB3, the relevant network tariff gradient.

AAAB5(a).4 The Dominant Provider shall not apply any new charge identified in an Access Charge Change Notice before the effective date.

AAAB5(a).5 In relation to those products and services subject to Condition AAAB3, to the extent that the Dominant Provider provides to itself Network Access that:

(a) is the same, similar or equivalent to that provided to any other Third Party; or

(b) may be used for a purpose that is the same, similar or equivalent to that provided to any other Third Party, in a manner that differs from that detailed in an Access Charge Change Notice in relation to Network Access provided to any other Third Party, the Dominant Provider shall ensure that it sends to Ofcom an Access Charge Change Notice in relation to the Network Access that it provides to itself which includes, where relevant, at least those matters detailed in paragraphs AAAB5(a).3(a) to (f).

Condition AAB5(b) - Requirement to notify technical information

AAAB5(b).1 Save where Ofcom consents otherwise, where the Dominant Provider:

(a) proposes to provide Network Access covered by Condition AAAB1, the terms and conditions for which comprise new:

(i) technical characteristics (including information on network configuration where necessary to make effective use of the Network Access);

(ii) locations of the points of Network Access; or

(iii) technical standards (including any usage restrictions and other security issues),

or

(b) proposes to amend an existing Access Contract covered by Condition AAAB1 by modifying the terms and conditions listed in paragraph AAAB5(b).1(a)(i) to (iii) above on which the Network Access is provided, the Dominant Provider shall publish a written notice (the "Notice") of the new or amended terms and conditions not less than 90 days before either the Dominant Provider enters into an Access Contract to provide the new Network Access or the amended terms and conditions of the existing Access Contract come into effect.

AAAB5(b).2 The Dominant Provider shall ensure that the Notice includes:

(a) a description of the Network Access in question;

(b) a reference to the location in the Dominant Provider's Reference Offer of the relevant terms and conditions;

(c) the date on which or the period for which the Dominant Provider may enter into an Access Contract to provide the new Network Access or any amendments to the relevant terms and conditions will take effect (the "effective date").

AAAB5(b).3 The Dominant Provider shall not enter into an Access Contract containing the terms and conditions identified in the Notice or apply any new relevant terms and conditions identified in the Notice before the effective date.

AAAB5(b).4 Publication referred to in paragraph AAAB5(b).1 shall be effected by:

(a) placing a copy of the Notice on any relevant website operated or controlled by the Dominant Provider;

(b) sending a copy of the Notice to Ofcom; and

(c) sending a copy of the Notice to any person at that person's written request, and where the Notice identifies a modification to existing relevant terms and conditions, to every Third Party with which the Dominant Provider has entered into an Access Contract covered by Condition AAAB1. The provision of such a copy of the Notice may be subject to a reasonable charge.

PART II – PROPOSED DIRECTION REGARDING SETTING WHOLESALE LINE RENTAL KEY PERFORMANCE INDICATORS

NOTIFICATION UNDER SECTION 49 OF THE COMMUNICATIONS ACT 2003

Proposed Direction under section 49 of the Communications Act 2003 and Condition AAAA7 proposed as a result of the analysis of the wholesale analogue exchange line access market in the United Kingdom (excluding the Hull Area) in the *Review of wholesale analogue exchange line markets*

Proposal in this Notification

1. Ofcom hereby makes, in accordance with sections 49(4) of the Act, the following proposal for giving a direction in relation to the publishing of Wholesale Line Rental Key Performance Indicators.
2. The proposed direction setting Wholesale Line Rental Key Performance Indicators is set out in the Schedule to this Notification.
3. The effect of and the reasons for giving the proposed direction is set out in the accompanying consultation document in Section 5.

Ofcom's Duties

4. In making the proposal set out in the Notification, Ofcom has considered and acted in accordance with its general duties in section 3 of the Act and the six Community requirements in section 4 of the Act.

Making representations

5. Representations may be made to Ofcom about this proposal set out in this Notification and the accompanying consultation document by no later than 18 November 2010.
6. In accordance with section 50 of the Act, copies of this Notification have been sent to the Secretary of State, the European Commission and to regulatory authorities of every other Member State.

Interpretation

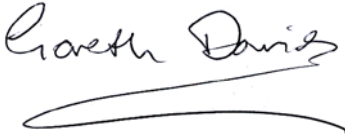
7. Except for references made to the identified services markets in this Notification and subject to paragraph 8 below, words or expressions used in this Notification shall have the same meaning as they have been ascribed in the Act.
8. In this Notification—
 - (a) “**Act**” means the Communications Act 2003 (c.21);
 - (b) “**BT**” means British Telecommunications plc, whose registered company number is 1800000, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006;
 - (c) “**Hull Area**” means the area defined as the ‘Licensed Area’ in the licence granted on 30 November 1987 by the Secretary of State under section 7 of the

Telecommunications Act 1984 to Kingston upon Hull City Council and Kingston Communications (Hull) plc;

For the purpose of interpreting this Notification—

- (a) headings and titles shall be disregarded; and
- (b) the Interpretation Act 1978 (c. 30) shall apply as if this Notification were an Act of Parliament.

Signed

A handwritten signature in black ink, appearing to read 'Gareth Davies', with a long horizontal flourish underneath.

Gareth Davies
Competition Policy Director

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

15 October 2010

SCHEDULE

[*Proposed*] Direction under section 49 of the Communications Act 2003 and Condition AAAA7 proposed as a result of the analysis of the wholesale access markets in the *Review of the wholesale analogue exchange line markets*

Background

1. On [date of final statement] Ofcom concluded its *Review of the wholesale analogue exchange line markets* in which it identified markets, made market power determinations and set appropriate SMP conditions as set out in the Notification at Annex [X] to the review, and explained in the accompanying explanatory statement.
2. Ofcom determined in the review referred to in paragraph 1, above, that BT, as a Dominant Provider, has significant market power in the wholesale analogue exchange line services markets in the United Kingdom, excluding the Hull Area.
3. SMP service Condition AAAA7 (Transparency as to quality of service) was set in relation to, amongst others, the markets referred to in paragraph 2.
4. This Direction concerns matter to which proposed Condition AAAA7 relates.
5. For the reasons set out in Section [] of the explanatory statement accompanying this Direction Ofcom is satisfied that, in accordance with section 49(2) of the Act, this Direction is:
 - i. objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;
 - ii. not such as to discriminate unduly against particular persons or against a particular description of persons;
 - iii. proportionate to what it is intended to achieve; and
 - iv. in relation to what it is intended to achieve, transparent.
6. For the reasons set out in Section [] of the explanatory statement accompanying this Direction, Ofcom is satisfied that it has acted in accordance with the relevant duties set out in sections 3 and 4 of the Act.
7. Ofcom has considered every representation about the proposed Direction duly made to it and the Secretary of State has not notified Ofcom of any international obligation of the United Kingdom for this purpose.

Direction

8. Ofcom hereby, pursuant to section 49 of the Act and proposed Condition AAAA7 in Schedule 1 to the Notification, directs the Dominant Provider to act as prescribed in paragraphs 9 to 14 below:
9. The Dominant Provider shall publish the information specified in Parts 1 and 2 of Annex A to this Direction in relation to the provision of Wholesale Line Rental, as required in paragraph 12 below.
10. The Dominant Provider shall provide to individual Third Parties the information specified in Parts 1 and 2 of Annex A to this Direction in relation to the provision of Wholesale Line Rental, as required in paragraph 12 below.

11. The Dominant Provider shall provide to Ofcom, by means of electronic mail to such person in Ofcom as notified from time to time, the information specified in Parts 1 and 2 of Annex A to this Direction in relation to the provision of Wholesale Line Rental, as required in paragraph 12 below.
12. The information required by paragraphs 9, 10 and 11 above shall be published and provided as required by the Dominant Provider within 14 Working Days of the last Working Day of every month in respect of that month.
13. Annex A to this Direction forms part of the Direction.
14. Nothing in this Direction shall require the Dominant Provider to publish confidential information relating to its business or that of a Third Party.
15. For the purpose of interpreting this Direction the following definitions shall apply:
 - “Act” means the Communications Act 2003;
 - “Committed Order” means an Order which has passed validation and has been registered on the Dominant Provider’s operational support system and a Contract Delivery Date has been confirmed;
 - “Completed Order” means an Order which has been provisioned and for which all other related work has been carried out;
 - “Contract Delivery Date” means the date agreed between the Dominant Provider and a Third Party for an Order to become a Completed Order;
 - “Dominant Provider” means British Telecommunications plc, whose registered company number is 1800000, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006;
 - “Exchange Line” means Apparatus comprised in the Dominant Provider’s Electronic Communications Network and installed for the purpose of connecting a telephone exchange run by the Dominant Provider to a Network Termination Point comprised in Network Termination and Testing Apparatus installed by the Dominant Provider for the purpose of providing Electronic Communications Services at the premises at which the Network Termination and Testing Apparatus is located;
 - “Fault” means a degradation or problem or with Wholesale Line Rental which is identified by the Dominant Provider or a Third Party and which is registered on the Dominant Provider’s operational support system;
 - “Hull Area” means the area defined as the ‘Licensed Area’ in the licence granted on 30 November 1987 by the Secretary of State under section 7 of the Telecommunications Act 1984 to Kingston upon Hull City Council and Kingston Communications (Hull) plc;
 - “Installed Base” means the average number of Wholesale Line Rental lines that are in use during the Reporting Period;
 - “KPI” means key performance indicator;

“Level 1 Care” means the level of care provided by the Dominant Provider which provides the standard level of response to a Fault on an Exchange Line, provided as part of the basic line rental;

“Level 2 Care” means the level of care provided by the Dominant Provider which provides an enhanced level of response to a Fault on an Exchange Line, guaranteeing a response within a specified time;

“Level 3 Care” means the level of care provided by the Dominant Provider which provides an enhanced level of response to a Fault on an Exchange Line, guaranteeing a response within a specified time and providing cover 24 hours per day, seven days a week including public and bank holidays;

“Newly Provisioned Lines” means an Order where any Wholesale Line Rental product/Exchange Line Service is not being provided by the Dominant Provider to the Third Party at the time of order;

“Notification” means the Notification referred to in Recital (A) of this Direction above, as published on [date of Final Statement];

“Order” means a request for Wholesale Line Rental submitted to the Dominant Provider by a Third Party;

“Pending Order” means an Order which has been approved by the Dominant Provider and is awaiting a Contractual Delivery Date;

“Rejected Order” means an Order which cannot be placed by the Dominant Provider on its operational support system;

“Reporting Period” means the month in respect of which the Dominant Provider is required to publish or provide to Ofcom as required the Wholesale Line Rental KPIs;

“Restored Service” means the point at which the Wholesale Line Rental in relation to which a Fault was registered becomes available again for use by the Third Party;

“Scheduled Outages” means the defined periods of time whereby the Dominant Provider’s operational support system is not available for use by Third Parties in order for the Dominant Provider to perform certain tasks including, but not limited to, routine maintenance, changing configurations, software upgrades and updating facilities and may include specific maintenance activities whereby the Dominant Provider must have given as much notice as reasonably practicable and in any event not less than seven calendar days;

“Third Party” means either:

- i. a person providing a Public Electronic Communications Network; or
- ii. a person providing a Public Electronic Communications Service;

“Transferred Lines” means an Order where Wholesale Line Rental is being provided to the Third Party by another Third Party (including those provided by the Dominant Provider) at the time of order;

“Wholesale Analogue Line Rental” means an Electronic Communications Service provided by the Dominant Provider to a Third Party for the use and Ordinary Maintenance of an analogue Exchange Line;

“Wholesale Line Rental” means Wholesale Analogue Line Rental provided to Third Parties’ End Users provided by the Dominant Provider:

“Working Day” means any day other than Saturdays, Sundays, public holidays or bank holidays in the United Kingdom.

16. Except insofar as the context otherwise requires, words or expressions shall have the meaning assigned to them and otherwise any word or expression shall have the same meaning as it has in the Act, or if it has no meaning there, in Part 1 of Schedule 1 to the Notification.
17. For the purpose of interpreting this Direction:
 - i. headings and titles shall be disregarded; and
 - ii. the Interpretation Act 1978 shall apply as if this Direction were an Act of Parliament.
18. This direction shall take effect on the day that it is published.

Signed

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

Date

Annex A Wholesale Line Rental KPIs

Part 1: Indicators

1. The Dominant Provider shall publish the information required in KPIs (i) to (viii) below in relation to the provision of Wholesale Line Rental, in at least the detail outlined below:
 - a) an industry average (for the avoidance of doubt this excludes provision by the Dominant Provider to itself);
 - b) best in class.
2. The Dominant Provider shall also publish the information required in KPIs (ii) to (vi) below in relation to the provision of Wholesale Line Rental to itself.
3. In relation to KPIs (ii) to (vi), the Dominant Provider should publish separate KPI results where options exist for third parties to purchase differing WLR line rental packages.
4. The Dominant Provider shall provide to Ofcom KPIs (i) to (vii) as described in paragraphs 1, 2 and 3 above by electronic mail to the designated person.
5. The Dominant Provider shall also provide to Ofcom data relating to specific third parties upon request.
6. The Dominant Provider shall provide to each third party on a confidential basis the information required in KPIs (i) to (vii) below for that third party.
7. Where the Dominant Provider does not provide Wholesale Line Rental to itself, it shall instead publish or provide as required the information required in relation to the equivalent implicit wholesale product provided by the Dominant Provider to itself in order for it to provide downstream services to End Users.

KPI(i) - Percentage of orders rejected

the percentage of Committed Orders that became Rejected Orders during the Reporting Period;

KPI(ii) - Percentage of orders provisioned on time

the percentage of Completed Orders that were completed by the Contract Delivery Date during the Reporting Period in relation to each of:

- (a) Newly Provisioned Lines; and
- (b) Transferred Lines;

KPI(iii) - Percentage of new provisions reported as faulty

the percentage of Completed Orders that were reported as having a Fault during the Reporting Period whereby that Fault was reported within 30 calendar days of the date that it became a Completed Order;

KPI(iv) - Percentage of installed base reported as faulty

the number of Completed Orders that were registered as having a Fault during a three month rolling period, ending at the end of the Reporting Period, measured as a percentage of the mean of the Installed Base;

KPI(v) - Average time to restore service

the average time (in working hours) during the Reporting Period for the Dominant provider to achieve Restored Service after a Fault has been registered in relation to each of:

- (a) Level 1 Care;
- (b) Level 2 Care; and
- (c) Level 3 Care.

KPI(vi) - Percentage of repeat faults

the percentage of Faults that were reported as having a further Fault during the Reporting Period whereby the further Fault was registered within 30 calendar days of the Dominant Provider achieving Restored Service of the previous Fault;

KPI(vii) - Gateway availability

the percentage of actual availability of the Dominant Provider's ordering gateway during the Reporting Period compared to the potential availability during the same period as published by the Dominant Provider, excluding any Scheduled Outages;

Part 2: Volumes

1. The Dominant Provider shall publish the information required in KPIs (i) to (iv) below in relation to the provision of Wholesale Line Rental to all Third Parties (as an aggregate figure which, for the avoidance of doubt includes provision by the Dominant Provider of Wholesale Line Rental to itself);
2. The Dominant Provider shall provide to Ofcom by electronic mail the information required in KPIs (i) to (iv) below in relation to the provision of End User Access to itself. BT shall also provide to Ofcom data relating to specific third parties upon request.
3. Where the Dominant Provider does not provide End User Access to itself, it shall instead publish or provide as required the information required in relation to the equivalent implicit wholesale product provided by the Dominant Provider to itself in order for it to provide downstream services to End Users.

KPI(i) - Volume of orders submitted

the total number of Orders that became Pending Orders during the Reporting Period

KPI(ii) - Volume of orders completed

the total number of Committed Orders that became Completed Orders during the Reporting Period in relation to each of:

- (a) Newly Provisioned Lines; and
- (b) Transferred Lines;

KPI(iii) - Volume of installed base

the Installed Base during the Reporting Period;

KPI(iv) - Volume of faults reported

the number of Faults where the Dominant Provider subsequently achieves Restored Service during the Reporting Period in relation to each of:

- (a) Level 1 Care;
- (b) Level 2 Care; and
- (c) Level 3 Care.