BT's response to Ofcom's consultation document

"Review of the wholesale broadband access markets

Second consultation on market definition, market power determinations and remedies"

1st October 2010

NON CONFIDENTIAL VERSION

BT welcomes comments on the content of this document, which is available electronically at http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Consultativeresponses/Ofcom/index.htm

Comments can be addressed via e-mail to Neena Rupani at the following address: neena.rupani@bt.com

Contents

Section

Annexes incorporated within this document:

Supporting documents:

- **A.** Response by SPC Network to Ofcom's comments on the first submission by BT
- **B.** Response by Professor John Nankervis on the peer review of his first submission
- **C.** Report by Professor John Nankervis on the effect of entry of competing LLU CPs on BT Wholesale's service share

1 Executive Summary

Introduction

- We fully support Ofcom’s decision to re-consult on market definition, market power determinations and remedies in the wholesale broadband access market, with the principal focus on geographic market definition.
- Ofcom’s new proposals represent a step in the right direction in better reflecting today’s market realities than those in the first consultation published in March 2010. However, we continue to believe that the competitive dynamic of the market requires a more forward-looking and light-touch approach.
- Our deregulatory position was supported by independent evidence from SPC Network and by modelling undertaken by Professor Nankervis provided with our first response and we are encouraged to see that his findings are largely supported by Professor Verboven’s peer review of his work.

Market definition and market power

- We support Ofcom’s proposal to broaden Market 3 to include all exchanges where there are three major providers and BT’s market share is below 50 percent to an extent. However, we still believe that all exchange areas with three major providers should be deregulated irrespective of BT’s market share; there are many examples in economic literature and in practice of three competitors being sufficient for effective competition.
- If however, market share is to be used to determine whether exchanges with three major providers are included in Market 3, the threshold should be set at a far higher level. Ofcom has a duty to be forward looking in a Market Review, and only by setting the threshold at a higher level will Ofcom ensure that the effect of the expected reduction in BT’s market share during the period of the review is taken into account. We suggest a threshold of at least 60 per cent market share at June 2010 is more appropriate and we provide evidence to support this.
- In addition, Ofcom’s analysis only takes into account further LLU rollout until December 2010. This is not forward looking, as within weeks of publication of the final statement Ofcom’s analysis will be out of date.
- The list of Market 1 exchanges in Appendix 1 of the consultation document includes 26 exchanges where BT does not provide broadband services. Since Market 1 is defined as ‘those BT local exchanges where BT is the only PO [Principal Operator] present’, logically this cannot be right. It makes even less sense for BT to have SMP obligations in these areas where there are no BT services to regulate and another provider is already present. We believe Ofcom should correct this anomaly and state clearly in the Final Statement that these exchanges are not in Market 1 and BT is not regulated.
- Whilst this second consultation focuses on geographic market definition, it is equally important that Ofcom provide absolute clarity on the (wholesale) product market definition. In particular, we

suggest that to avoid any confusion, the Final Statement should confirm that wholesale broadband access covers services between the End User and the Broadband Remote Access Server (BRAS) which is explicitly set out in Figure 3.1 in the March 2010 First Consultation.

Remedies

- Continued investment is essential to deliver faster broadband across the UK, including rural areas where the case for investment is most challenging. We still believe that Ofcom's proposals for cost orientation and charge controls could act as a disincentive to investment and urge Ofcom to consider alternatives.
- One pragmatic option would be to merge Ofcom's Markets 1 and 2: this would make price regulation unnecessary since competitive pressures in Market 2 coupled with the obligation for no undue discrimination, would constrain BT's pricing across the whole of the combined market. BT considers that this is an appropriate solution which is 'future proof' and avoids the real possibility of unintended consequences of cost and price controls in what is a highly dynamic marketplace.
- We continue to believe that the transitional remedies for newly deregulated exchange areas proposed in the first consultation are unnecessary, unjustified and inconsistent with the revised Framework Directive. Any such remedies should be limited to the obligation to provide Network Access on reasonable request. We note that TalkTalk Group broadly agreed with our position in their response to the first consultation.

2 Response to Ofcom's questions

This section provides our responses to Ofcom's questions in the consultation document. It is supplemented by our detailed views on Ofcom's economic assessment of geographic markets which are provided in Annex 1 to this response.

QUESTION 1: Do you agree with our revised geographic market definition? If not please explain why.

1. We continue to believe the economic evidence justifies a straightforward move to defining Market 3 as exchange areas with three major providers. This position is also supported by SPC Network who have reviewed Ofcom's comments on their first submission (see attachment to this response). However, as a matter of principle we would support the introduction of a market share threshold if all price constraining influences were taken into account and fully assessed. In this instance we do not believe that Ofcom has either done this or taken a proper forward look. In view of this, we do not agree with the 50% threshold.
2. Ofcom are required by the European Commission's SMP Guidelines to ensure market reviews are forward looking and to take "*into account expected or foreseeable market developments over the course of a reasonable period*". However, Ofcom's forward look is limited to firm rollout plans up to December 2010 and recognises that the analysis:

   > *"may under-state the development of competition particularly towards the latter part of the forward look" [3.38].*

   It is not only the latter part of the forward look that will be understated as within weeks of publication of the Final Statement Ofcom's analysis will be out of date.
3. We suggest that a market share threshold of at least 60% is more appropriate. The underlying reason for this is that in these exchanges an additional (committed) CP entry will inevitably materially lower BT's market share within a comparatively short period. It is inevitable and totally foreseeable now that our share will fall well below the 50% threshold within the lifetime of the market review for many exchanges in Market 2. Additional support for this view is contained in Annex 1 and the (second) report by Professor Nankervis on the effect of entry of competing LLU CPs on BT Wholesale's share.
4. We are not able to fully assess the implications of such a change but believe that a considerable number of exchanges would potentially be moved to Market 3 on this basis. Ofcom is however in a position to identify these exchanges and could pragmatically, for example, deregulate those exchanges where: i) BT and one other provider are currently present; ii) where an additional provider will enter by December 2010; and iii) BT's share at June 2010 was below 60% (post migration on-net of all providers' off-net customers). We believe this would be entirely feasible and appropriate.

QUESTION 2: In light of the revised geographic market definition presented in this consultation, do your previous comments on SMP remain appropriate?

5. Our comments provided in response to the first consultation remain appropriate in this consultation[1].

QUESTION 3: Do you have any further comments to add in relation to the SMP assessment?

6. We would like to raise the three specific matters set out below.

(i) Where BT is designated with SMP where we are not present as a provider of wholesale broadband access.

7. As highlighted in section 3.4.2 of our 1 June response, there are 26 exchanges in Market 1 where BT is not present as a broadband operator. This is either because:
   - the exchanges are served by a wireless operator following a procurement exercise; or
   - the exchange area was excluded from the 2004 Scottish Rural Broadband initiative as there was already a publicly-subsidised wireless operator present; or
   - early unbundling by an LLU Operator made broadband enablement by BT uneconomic.

8. Ofcom defines Market 1 as "exchanges where only BT is present" but these are exchanges where BT is not present as a broadband operator. Therefore these exchanges do not fall within Ofcom's definition of Market 1. It is illogical for BT to be found to have SMP in exchanges where BT has no presence[2] and another operator is present.

9. Further, whilst Ofcom *"do not propose to require BT to supply service at these exchanges unless it receives a reasonable request to provide Network Access at these locations" [4.29]*, for BT to have any requirements in these exchanges is inconsistent with Ofcom's duties under the Communications Act to ensure regulation does not impose burdens which are unnecessary.

(ii) The matter of the wholesale product boundary

10. Whilst this second consultation focuses on geographic market definition, it is equally important that Ofcom provide absolute clarity on the (wholesale) product market definition.

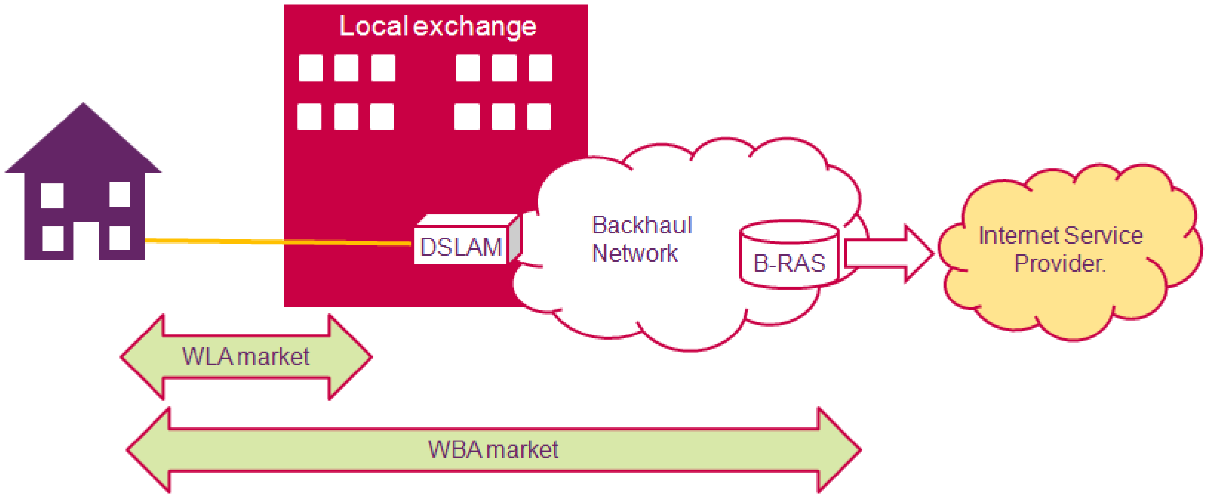
11. In particular, we suggest that to avoid any confusion, the Final Statement should confirm that wholesale broadband access covers services between the End User and the Broadband Remote Access Server (B-RAS). This is a continuation of the policy set in 2008 and is consistent with Figure 3.1 in the March 2010 Consultation (reproduced overleaf).

---

1 http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Consultativeresponses/Ofcom/2010/Wholesalebroadbandaccessmarkets/index.htm

2 and therefore zero market share

Figure 3.1: WBA products using current generation copper access network



12. We would strongly object to any expansion of this definition beyond the BRAS as a result of this market review given that: (a) Ofcom has provided no evidence that the current arrangements are in any way unsatisfactory; (b) to the best of BT's knowledge, no other party has proposed this or argued for it; (c) there is no reason to suppose that small SPs will be in any way disadvantaged by the absence of regulation; (d) other CPs could wholesale this service in any case if BT tried to raise prices above the competitive level.

(iii) The impact on NGA services

13. The result of Ofcom's market power assessment in the March 2010 Consultation [5.184 and 5.302] is that WBA fibre services (i.e. NGA services) downstream of Openreach's GEA/VULA product would not be regulated where the Point of Handover from Openreach is in Market 3, given no SMP has been found in Market 3. As Ofcom's latest consultation does not refer to the impact of the proposed remedies on NGA, to avoid confusion Ofcom should confirm in the Final Statement that the revised geographic market definition does not affect this conclusion on WBA fibre services.

QUESTION 4: In light of the revised geographic market definition and SMP analysis presented in this consultation, do your previous comments on remedies remain appropriate? If no please explain why.

14. Our views on the proposed remedies in Market 1 and Market 2 are broadly unaffected by Ofcom's revised geographic market definition and SMP analysis. A summary of these is outlined below.

15. We broadly agree with Ofcom that for markets where SMP is designated, it is appropriate for general access and non discrimination remedies to be imposed. However we believe it is unnecessary to have two parallel notification requirements for changes to our terms and conditions: the Requirement to publish a Reference Offer specifies a 10-day period and the Requirement to notify charges, terms and conditions) specifies a 28-day period (see section 4.2 BT response).

16. We still believe Ofcom has not demonstrated that BT can price above the competitive level in Markets 1 and 2 to warrant the introduction of additional layers of pricing regulation such as cost

orientation and formal charge controls. Our view remains that a more proportionate remedy would be the continuation of a voluntary cap (see section 4.3 BT response).

17. If Ofcom does not accept this, then as an alternative we strongly urge Ofcom to give consideration to the option of combining Markets 1 and 2. We accept there could be some degree of heterogeneity between exchanges where only BT is present and those where there is some (growing) presence. However the existence of such variations is not a sufficient reason to maintain the differential between Markets 1 and 2. This proposal was also supported by SPC Network on the basis of solid defensible economic analysis.

18. Market 2 is already limited to 660 exchanges, and BT believes that Ofcom should exclude at least an additional 150 of these exchanges on the basis of the inevitable loss of BT share over the review period from market entry which will take place by December 2010. This will be followed by further loss of share as a result of entry after 2010. It is also likely that there will be entry into at least some Market 1 exchanges. Combined with public sector fibre developments potentially into Market 1 (and certainly into Market 2 exchanges), this strengthens the arguments against continuing to regulate separate geographic markets which are shrinking. A combined geographic market with the continuation of the current arrangements, i.e. the existing SMP obligations possibly supplemented with a voluntary price commitment, would form an appropriate and measured set of remedies.

19. We believe it is inappropriate for Ofcom to introduce a cost orientation obligation for individual broadband services in Markets 1 and 2 both in principle and on the grounds of practicality and proportionality, especially in Market 2 where competition clearly exists (see section 4.4 BT response).

20. We disagree with Ofcom's over simplistic interpretation of cost orientation and in particular the use of DSAC as the relevant test. This question is currently being considered by the Competition Appeals Tribunal (see section 4.4.1 BT response).

21. Ofcom's proposals to regulate WBA fibre based services (NGA services) in Markets 1 and 2 are unnecessary and potentially counter-productive. At this point in time, Ofcom should not regulate these nascent services, regardless of the location of the Point of Handover, at least whilst fibre is an overlay to copper based services. This would ensure fibre regulation is focused at the deepest level within the network (i.e. Openreach) in line with the underlying economics, the spirit of the Undertakings and the European Commission's SMP Guidelines (see section 4.6 BT response).

22. We can confirm that page 24 of our first response contained an error (as highlighted in paragraph 4.17 of the consultation). Ofcom is correct in footnote 42 of the consultation: what we intended to convey is that the trend to full LLU will *increase* pressure on prices at any given market share and any given level of unbundling which will be a mixture of SMPF and MPF.

QUESTION 5: Do you have any further comments to add in relation to remedies in Market 1 and Market 2?

23. Under Ofcom's revised proposals, seven exchange areas would move from Market 3 to Market 2 and therefore be re-regulated. This could cause practical problems for BT and its wholesale customers in two respects.

24. First, prices for services in these areas within existing contracts could potentially become non-compliant immediately the proposals come into force. We believe the most pragmatic solution to this issue would be to allow existing contracts covering these exchange areas to run their course unchanged.

25. Second, immediate re-imposition of re-regulation when the Final Statement is published would require us to change the prices applying in the seven exchange areas without giving the 28 days notice required by Conditions EAA4 and EAA11. To avoid this, we suggest that Ofcom should allow a two month period to implement the appropriate changes in these areas.

QUESTION 6. Do you have any further comments to add in relation to the period of notice that should apply to exchanges that move from Market 2 to Market 3?

26. We continue to believe that the proposed transitional obligations following the removal of SMP are unnecessary, unjustified and inconsistent with the revised Framework Directives which member states must implement in 2011. If transitional arrangements are imposed, they should only involve the continuation of the obligation to provide Network Access on reasonable request: this is the approach that Ofcom took when geographic markets were first introduced after the 2008 Market Review.

27. We would also note that TalkTalk Group broadly agreed with our position in their response to the first consultation, stating that:

    "We are not convinced that there is any real need of having a transitional period for regulation of exchanges that would move from Market 2 to 3 (at least as long a period as 12-months as suggested by Ofcom). It is hard to believe there would be any significant risk of BT suddenly increasing the IPStream prices for those exchanges or somehow ceasing supply. For instance, we are not aware of BT having made any such decisions in 2008 when Market 3 was first created. And if the economic theory is accurate, BT should have an incentive to supply IPStream in a competitive market at reasonable prices based on marginal cost."

Annex 1

BT's Detailed Response On The Economic Assessment Of Geographic Markets

1. The comments below broadly follow the order of discussion set out in Section 3 on Market Definition in Ofcom's consultation document.

Response on BT's comments

The econometric evidence

2. In outline terms, We consider that the external peer review of the econometric modelling is broadly fair and are comforted to read that any concerns Professor Verboven makes would not 'affect the substance of the findings'. In his Report, Professor Nankervis has provided some additional explanation of the modelling. He has also extended his analysis along the lines Professor Verboven suggests and finds the conclusions are robust. Specifically, in response to the comments which Professor Verboven makes regarding the econometric modelling:

    - The form of logistic diffusion model was chosen for good reasons as some of the analysis was carried out on earlier data periods and for CPs where the model would be more appropriate.
    - Sensitivity testing of the upper bound reveals no changes to the models for BT and for the models where other CPs are considered, the generality of the findings are broadly replicated (magnitude of impact on growth rates from additional entry for example).
    - Additional modelling of total broadband penetration using an alternative functional form allowing for heterogeneity in growth as well as level effects shows that the original findings remain valid and the impact of entry on the total market becomes lessened under most scenarios. (This issue was also raised by Ofcom [3.27-3.28].)
    - The specification of the models changes slightly and this reflected the availability and reliability of data to a degree.

3. Professor Verboven states that his main concerns 'related to the conclusions that BT draws from the econometric results'. We can only discern one specific concern which is in the final sentence of the last paragraph of Professor Verboven's report and deals with the Supplementary Report (unpublished) and the impact of additional CPs on growth rates beyond the second CP.

4. In this context, we consider that while for all the models additional CPs generally add some additional competitive impact, mostly this is small. The Supplementary Report in any case deals with competition amongst other CPs and not BT directly and the purpose of this Report was to see whether the strength of competition amongst them was as appreciable as for BT. The analysis demonstrated that competition is fierce between all the CPs providing broadband services and as such, we do not believe that this inference is unreasonable.

5. The division of CPs into 'Tier A' and 'Tier B' was purely a descriptive device reflecting the unarguable fact that some CPs have been more successful than others in capturing end-users in terms of level and growth rates. It made sense therefore to focus the econometric analysis on those CPs who would be able to demonstrate the impact of competition with a higher degree of statistical confidence than smaller CPs. At the margin however and forward-looking, it is quite possible for smaller CPs to enter and thrive and this has been the experience of broadband over the past decade.

The use of statistical indicators of competitiveness and the SPC Network Report

6. Ofcom appears to doubt the relevance of the HHI calculations and quotes values used by competition authorities indicating that broadband access would be potentially regarded as 'highly concentrated' in all three geographic markets.

7. We believe that the calibration of the HHIs across time and exchanges has greatly illuminated the scope and depth of competition. It is not only the level of the indices which matters in a merger but also the likely change in its value along with consideration of other factors and particularly barriers to entry. In this instance, the upstream inputs are regulated under strict Equivalence Of Input conditions which makes any parallel with the sorts of HHI values used in other industries somewhat debatable. The SMP assessment is in any case not a merger review and such reviews are on the merits of the case for the services in question.

8. For broadband services, the HHI values can be used as a benchmarking indicator of homogeneity of competition (concentration) across exchanges. In this instance it is clearly the case that there is unlikely to be sufficient homogeneity across the exchanges which Ofcom proposed to be in Market 2. The HHI charts over time do mirror the growth of competition and we believe that within its natural limitations, the indices do serve a useful purpose.

9. Regarding the churn data, the use of retail-based information is again but one factor which may reasonably be cited given the inextricable link between wholesale and retail activity for broadband access. Ofcom [3.80] appears to suggest that SMP regulation has actually been advantageous to BT in extending its volumes beyond what might occur absent regulation. This is a curious argument for it suggests that SMP regulation is not only not a binding constraint, but that it is actually a positive benefit. If that were to be the case, one would imagine other CPs would seek to be attributed SMP status for themselves. For the record, BT has always offered wholesale services for broadband access prior to any obligation as it was always in our commercial interests to do so.

10. We have commissioned SPC Network to respond to Ofcom's critique [3.33] in particular regarding the academic research and to other aspects of Ofcom's Consultation. The report by SPC Network is attached to this response.

11. The key points made by SPC Network are the following:

- Ofcom has taken a restrictive interpretation of the use of HHI values and they are relevant as comparators across exchanges and over time.
- The churn rates are relevant given the link between retail and wholesale services.
- There are many examples in the literature and in practice of three competitors being sufficient for effective competition.
- The impact of pricing on-net will be felt over time in Market 2 and shares adjust accordingly which does not detract from the relevance of pricing 'spillovers'.
- Ofcom is maintaining a mechanistic approach in its assessment of takeovers which fails to address the appropriate response for regulatory purposes.

Future rollout

12. We agree with Ofcom [3.37] that some judgement is required regarding the potential for future rollout. However, we note that Ofcom's analysis has changed materially even within a space of 6 months such that it appears that the size of Market 3 has increased by approximately 5% of delivery points. This is an enormous change which if continued into the review period, will materially undermine the appropriateness of cost orientation in Market 2 exchanges.

13. BT notes that Ofcom accepts that it is likely to under-state competition '*particularly towards the latter part of the forward look*' [3.38]. Ofcom is required by the European Commission's SMP Guidelines[3] to ensure market reviews are forward looking and to take "*into account expected or foreseeable market developments over the course of a reasonable period*". However, Ofcom's forward look is limited to firm rollout plans up to December 2010

14. This means that it is not only the latter part of the forward look that will be understated as within weeks of publication of the Final Statement Ofcom's analysis will be out of date. Ofcom claims that *"basing an assessment on speculative deployments that are not based on firm rollout plans may result in exchanges being incorrectly allocated to Market 3"* [3.37]

15. We think that basing the regulated footprint on a forward look that at most extends only one month into the future, with any "speculative" rollout beyond that period being ignored would be contrary to Ofcom's own regulatory principles[4] that:
    - *Ofcom will operate with a bias against intervention, but with a willingness to intervene firmly, promptly and effectively where required.*
    - *Ofcom will always seek the least intrusive regulatory mechanisms to achieve its policy objectives.*

16. For a variety of reasons we believe that Ofcom's methodology understates competition for the entirety of the review period and not just at the end and the treatment of rollout is but one

[3] European Commission's *Guidelines on market analysis and the assessment of SMP* ("SMP Guidelines")
[4] http://www.ofcom.org.uk/about/sdrp/

factor. We do not believe that Ofcom should just have taken firm plans into account but could have reasonably assumed at least some additional roll-out will take place over the following regulatory period. For example, a simple means of projection would be to take a time series of roll-out and project that forward. It is simply not adequate to freeze rollout for a 4 year forward look. This remains a material point given the magnitude of the revision which has occurred between the two consultations.

17. We therefore urge Ofcom to make a proper allowance for the likely understatement of competitive pressures by firstly adopting a higher threshold for exchanges to be attributed to the competitive footprint and second, to apply less severe remedies in both remaining markets (and preferably to combine them).

Competitors' pricing

18. Ofcom [3.39] appears to accept the possibility of 'spillover' but argues that the link between Market 3 and Market 2 may not be 'automatic' and that any effects will be tempered by the number of direct competitors which BT faces in Market 2 exchanges. Separately, Ofcom [Footnote 30] cites complexity of retail offers as a compounding factor.

19. We do not accept these arguments. Market 2 exchanges where either 1 or 2 other CPs are present include a variety of combinations of CPs and there can be few if any combinations of competitors in exchanges in Market 2 which are not (at least) replicated in exchanges in Market 3. Given that: (a) on-net prices are primarily set in Market 3 as the vast bulk of the on-net customer base are located there; (b) there is a consensus of strong enduring competition amongst all CPs in Market 3; and (c) BT cannot discriminate between exchanges in its own pricing in Market 2, there cannot be anything other than a strong 'spillover' impact irrespective of BT's market shares in any particular Market 2 exchanges.

20. For these reasons, we consider that the threshold of 50% which Ofcom cites as based on competition law standards is misleading as an individual exchange will not be an economic market in its own right (BT Annex 1 first submission). Ofcom would therefore be fully justified to adopt a higher share threshold in any case and (as discussed below) especially bearing in mind the impact of the inevitability of many exchanges becoming eligible for deregulation within a short period after the review has concluded.

21. We agree that it is difficult to speculate on pricing policies [3.41] but this does not really say anything one way or another on relative prices or the extent of competition. For the many reasons which we have set out, the strength of competition has intensified and there is no obvious reason why this should be reversed in the review period.

The competitive effect of Virgin Media

22. We also raised some specific more technical aspects of the coverage of Virgin Media. We agree with Ofcom [3.42] that expansion of Virgin Media requires sunk costs which are not experienced by LLU operators and that expansion will be based on broad market developments and not short term considerations. However, we do not agree that these factors detract in any way from our position.

23. Firstly, if Ofcom believes that LLU operators experience a competitive advantage from purchasing a regulated input below the true economic cost which reflects 'real options', then that is a distortion resulting from LLU price regulation alone. Secondly, Virgin Media is able to target its customer base at a much more granular level than a BT exchange area and so gains advantages of flexibility. Thirdly, there are arguments for treating Virgin Media more stringently than LLU operators given that: (a) its network was developed on the basis of exclusive franchises and special rights; and (b) it is a very modern network and benefits particularly from economies of scale and scope.

24. Ofcom states that the large reduction in the number exchange areas where Virgin Media was counted as a Principal Operator was due to a review by Virgin Media of their network coverage in August 2007 and not a change in Ofcom's methodology. However, Virgin Media's review of their network resulted in their ability to provide Ofcom with premise-level coverage data, and it was Ofcom's decision to change to counting coverage at the level of premises rather than the postcode level. This was indeed was a methodological change. Reverting to a postcode-level assessment would be one way that Ofcom could account for potential network expansion. Postcodes generally cover between 15 and 30 premises and in suburban areas where cable networks have been installed, are geographically small. As Virgin Media already have network covering some of the premises in a postcode its further expansion to cover the whole postcode would be relatively low cost and so an analysis at the postcode level can be used as a proxy for potential future roll-out.

25. Ofcom have chosen not to address the fact that whilst Virgin Media expanded their network covering an additional 100,000 homes during 2009, the number exchanges where they are counted as present has actually reduced and this expansion in network coverage is continuing. In their 2nd quarter results published in July 2010, Virgin Media stated they have passed an additional 72,000 homes[5]. This supports their announcement in 2009 that they would build out to an additional 500,000 homes by the end of 2012[6].

26. We still believe that Ofcom have understated the presence and strength of Virgin Media. To address this we believe Ofcom should alter their methodology to reflect the actual and likely expansion of Virgin Media, and the potential for them to in-fill areas within their current footprint.

[5] http://pressoffice.virginmedia.com/phoenix.zhtml?c=205406&p=irol-newsArticle&ID=1452728&highlight=
[6] http://media.corporate-ir.net/media_files/IROL/13/135485/Virgin_Media_Annual_Report2009.pdf

The implications of TalkTalk Group’s acquisition of Tiscali

27. We cannot discern from the discussion [3.44-3.45] whether Ofcom considers that the acquisition has resulted in more or less competition; our view is that the net impact would be more competition rather than less.

28. In parallel, we argued that the outsourcing by Orange which was undertaken in highly competitive conditions also reflected strong countervailing buyer power and would also continue to promote competition at the retail layer. We believe that the exchanges which were deregulated when Orange was a PO should remain deregulated in any case.

The status of Updata

29. We view that the fact that Updata has a targeting policy for a specific group of customers [3.47] is not a good enough reason to exclude this company as a PO. All CPs engage in targeting to some degree and while in terms of pure numbers of end-users it is inevitable that the consumer mass market is largest, this does not detract from important entrants who can target businesses. Ofcom defines a single market in that regard.

30. As noted, Ofcom [3.29] argues that our division of POs into ‘Tier A’ and ‘Tier B’ gives an impression of subjectivity in analysis. The same criticism could equally be levelled at Ofcom for the treatment of Updata. In fact, the exclusion of Updata and the precise manner in which Virgin Media is treated combine to materially understate competitive constraints on BT.

Modifications to geographic definition

The appropriate market share threshold

31. As noted above, we have a number of reservations concerning Ofcom’s economic assessment and we do not accept that the threshold of 50% is appropriate. The primary reasons are the following:
    - We do not agree that ‘spillover’ impacts will be limited in the way that Ofcom suggests.
    - The roll-out plans by CPs (LLUOs and Virgin Media) are effectively in the public domain and predictable for all SPs including BT Retail, so the market impact is immediate.
    - Ofcom provides no assessment of the impact of bundling and consolidation into the strength of indirect constraints which have increased over time.
    - It is inevitable that there are exchanges in Market 2 associated with BT’s service share higher than Ofcom’s threshold simply due to the time taken to build up the entrant’s customer base and many of the exchanges where BT has a market share as at June 2010 above 50% will rapidly fall to below that level.

32. We estimate that of the 660 exchanges in the proposed Market 2, ✂exchanges are associated with presence of ✂and ✂with ✂as at June 2010. We are not able to establish

precisely which CPs will have entered by December 2010 but we believe that as ✂expands its footprint it will very likely be entering many of the exchanges where ✂is already present.

33. It seems very likely that many of the exchanges where ✂is already present and ✂will (or already has entered) will also be associated with the cohorts of exchanges which Ofcom identifies in Figure A7.6 where BT's service share is in the range of 50% to 60% or 60% to 70%. Figure 1 below reproduces our assessment (as an illustration) of the service shares pre and post migration ✂.

34. While the diagram indicates that some exchanges would in theory then be classified as Market 3 exchanges (as BT's service share would be below 50%) this suggests they are exchanges which ✂is not planning to unbundle before December 2010. These aside, it does indicate that there are likely to be many exchanges which would nevertheless 'remain' in Market 2 as BT's share would be above the 50% threshold.

Figure 1

✂

35. We do not feel that it is reasonable for exchanges in the two cohorts of 50% to 70% to be classified in Market 2. BT commissioned Professor Nankervis to extend his analysis to look at the likely impact on BT's service share and his Report is attached to this submission. He shows that specifically where ✂and ✂are present, BT's service share (in absolute terms) can be expected to decline by of the order of ✂ per annum where ✂.

36. Bearing in mind that this set of regulations will likely apply for 3 to 4 years, taking a mid-point period of two years from point of application (and CP entry could have occurred at any time between June 2010 and December 2010) - would indicate that using a threshold of 40% service share as the point of deregulation suggests that a service share at June 2010 of 70% is more appropriate.

37. We accept that it is the case that there will be other combinations of CPs where BT+2 CPs will imply less drastic loss in market share. However, the most likely combination is that of ✂and ✂and those combinations (as at December 2010) where ✂is not present, do not allow for the very strong possibility that ✂will enter nevertheless in 2011 or later.

38. There are of course other reasons to argue that the 40% threshold is too low in any case and these have been elucidated at length in our first response (Annex 1) and in this response. To the extent that these are valid, they would support a correspondingly higher threshold for BT's service share at June 2010 to trigger deregulation.

39. Our suggestion therefore of a threshold of 60% as at June 2010 can be seen as extremely conservative and disadvantageous to BT; the use of 50% is demonstrably too low.