REVIEW OF THE WHOLESALE BROADBAND ACCESS MARKETS SECOND CONSULTATION

SEPTEMBER 2010

Cable&Wireless Worldwide

Executive Summary

1. The wholesale broadband access market is a key regulatory market. It is essential for ensuring nationwide availability of competing retail broadband services and broadband access connections for retail business services.

2. We acknowledge the factors that have prompted a reconsideration of the market analysis procedure. Ofcom has proposed important additional steps into the geographic market analysis procedure but has rushed through our consideration of these changes by having a limited consultation period. Once adopted, this policy will set precedence for all future geographic market analysis procedure and therefore full consultation ought to occur.

3. We regard the resulting proposals to be overly prospective and over generous to BT. The judgement that Ofcom makes for each of the steps in the process take the most optimistic view possible; rollout, migration and service share threshold. The market designation occurs instantaneously due to the forward looking nature of the analysis while the events that the analysis incorporates will take place over the course of the coming years. The life time of this market review will only be three years. In our view a shorter market review life span requires greater precision in the forward looking view.

4. Of most concern to us is Ofcom's use of a 50% market share threshold. It is normal to regard shares of 40% as giving rise to a presumption of SMP. Ofcom should not depart from the 40% threshold. The use of 50% rather than 40% market share would have wide reaching precedence for future regulatory decision making. This in its self requires far more consideration than is covered within this consultation. More importantly we do not believe that the circumstances even warrant the setting of the share level above 40% to provide the scope for market share reduction due to the forward looking nature of the other criteria used.

Introduction

Cable & Wireless Worldwide is surprised by the radical change in competitiveness of the wholesale broadband access market put forward in this consultation document compared to that presented in the March 2010 consultation document.

Presently the competitive Market 3 contains 1,197 exchanges. During the March 2010 consultation Ofcom proposed that Market 3 increased to include 1,287 (a rise of 90) exchanges. Now Ofcom proposes a Market 3 of 1,539 exchanges which is an overall increase of 342 exchanges.

We responded to the March 2010 consultation in broad agreement with Ofcom that Market 3 appeared to be pretty static with only a small additional number of exchanges (90) becoming more competitive. We also highlighted our concern that the departure of Orange from the LLU market would see BT becoming more entrenched in this downstream market and with BT's market share rising once again to large / very large shares of the market.

Despite BT gaining Orange's market share Ofcom now presents a very different competitive outlook. We understand that LLUOs rollout plans have altered. However it would appear that the modified geographic market analysis procedure, (with the multiple forward looking criteria) is the primary reason for the conclusion that the competitiveness of Market 3 has increased.

Impact of removal of Orange as a Principle Operator

It is our understanding that the removal of Orange as a Principle Operator has had a surprisingly minimal effect upon the overall geographic coverage of the Market 3 area[1]. It appears that Orange in the majority of its exchanges was the fifth Principle Operator. Consequently removing Orange

[1] We understand that Market 3 on the pre existing criteria will have grown by 56 exchanges, post the removal of Orange, as there has been a surprise change in LLUOs rollout forecast.

predominately left the requisite four Principle Operators in situ. Cable&Wireless Worldwide would however expect that while the geographic scope of Market 3 itself may not have receded, the concentration of market shares within the market will have altered as a consequence of Orange's departure (ie we expect that BT's market share will have increased proportionately by the transfer of Orange's market share).

Ofcom's new approach

Getting the framework for the geographic market analysis process correct is absolutely critical. The result of applying the process is the deregulation of BT in a key communications market. It is fair to state that broadband has become a critical and fundamental need. Additionally and of equal importance is the fact that the approach for geographic market analysis adopted for this market review will naturally set precedent for subsequent geographic market analysis in other product markets. It is therefore important that it is adequately consulted upon.

Ofcom has been mindful of the points raised by the European Commission and BT in developing its new approach. The European Commission reiterated its view that geographic market definition should be based on more criteria than just the number of operators present in a local exchange, including the levels and trends in market shares. BT in its response to the first consultation presented information that suggests it may be necessary to examine the similarity in competitiveness of exchanges beyond the current Market 3 boundary.

Ofcom has reacted to these calls for wider consideration of the geographic market. Ofcom says at para 3.57 "In particular we recognise that there is some validity in the additional analysis carried out by BT which indicates that competition in some exchanges where three POs are present may be similar to that in exchanges where four or more POs are present (eg Market 3) when compared to other exchanges in Market 2 (eg those exchanges where only two POs are present) and that the approach to the forward look, based on firm rollout plans, may be conservative and may under-estimate the development of competition." Ofcom therefore proposes to introduce a geographic market analysis procedure which takes account of a) the number of Principle Operators at a given

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exchange b) future planned rollout of LLUOs c) that migration of offnet service to onnet service occurs d) the level of exchange service shares.

We regard the resulting proposals to be overly prospective and too generous to BT. The judgement that Ofcom makes for each of the steps (b) rollout c) migration and d) service shares) take the most optimistic view possible. The actual affect of these components will occur during the course of the review. But the remedy is based on the forward look view of their impact on the competitiveness of the market. The Market 3 designation occurs immediately but the increase in competition expected (to match the designation) will occur over the period of the review.

The existing geographic market analysis procedure includes only a single prospective criteria, that being LLUO's rollout plans. The new proposals incorporate three prospective criteria. The new EU Regulatory Framework requires that market reviews are conducted on a three yearly basis. Whilst the conclusions implemented continue to require a forward looking approach we would assert that three years provides a limited window for speculation and as such outcomes should be forecast with considerable accuracy. We are concerned that the proposals put forward by Ofcom in this instance include three prospective variables and that Ofcom is in each case overly optimistic.

Firstly LLUO's rollout plans. Ofcom will be using firm plans which we agree is preferential but even firm plans can change making this a variable rather than a dependable. Exchange rollout is prospective and accounts for the inclusion of circa 156 exchanges.

Next Ofcom presumes that current offnet services will migrate to onnet and then defines the geographic market on the basis that the migration has occurred. The relationship between exchange rollout and offnet migration is not identified[2]. Presently LLUOs are continuing to purchase offnet services despite having onnet capabilities. It is not clear what the barriers to migration are; whether migration will occur and when it will occur. Migration of offnet services is prospective and accounts for the inclusion of an additional 93 exchanges.

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[2] Are exchanges that are not even presently rolled out becoming qualifying exchanges as a result of the migration assumption?

Ofcom then plans to analyse the exchange level service share of exchanges which have 3 Principle Operators. Having obtained data on the exchange level service shares Ofcom needs to find a boundary point for the distribution of these exchanges into Market 3 or Market 2. For this boundary point Ofcom offers the option of a) BT having a service share of less than 50% or b) a service share of less than 40%. The difference in the two approaches is the inclusion into Market 3 of 59 exchanges.

At paragraph 3.92 Ofcom sets out "single firm dominance may be presumed where a market share is above 50% whilst it is unlikely to be found where market share is below 40%. Below 40% there is a presumption of no SMP whereas above 50% there is a presumption of SMP."

The European Commission guidelines on market analysis and assessment of significant market power state "single dominance concerns normally arise in the case of undertakings with market shares of over 40%", this is described as large market share. "An undertaking with a large market share may be presumed to have SMP". Whereas "according to established case-law, very large market shares – in excess of 50% are in themselves…… evidence of the existence of a dominant position."

Given that Ofcom is setting ex ante regulations in this context it is appropriate to observe and utilise the SMP criteria of 40%. We are confused as to why there would be deviation from the 40% figure. Bearing in mind that the point of the exercise is the removal or retention of ex ante regulation Ofcom will be alive to the concern of the premature removal of regulation to the detriment of harming emerging competition. If regulation is kept in place and competition exceeds expectation the market overall is not harmed. However if regulation is removed prematurely the reverse can be true.

Ofcom discusses the appropriateness of the 40% and 50% market share threshold at para 3.94 "In considering which of these is more appropriate we think the forward look needs to be considered. If BT's share is likely to remain constant it may be that a lower threshold is more appropriate. However, at the current time BT's market share is in decline and the information available to us suggests that this is likely to continue, particularly in exchanges where three POs are present (or forecast to be present). Therefore in order to properly incorporate a forward look assessment we believe that a 50 per cent threshold is more appropriate. This is also more consistent with the greater than expected potential for future rollout that is reflected in the updated figures we present in this document. By using a higher threshold we implicitly allow for further reductions in BT's actual share due to further rollout and the length of time necessary for LLU operators to grow market share once they have unbundled the exchanges."

We disagree with the presentation of a flexible SMP threshold. For ex ante regulation it is clear that 40% market share is the primary indicator of SMP. 50% market share applies predominantly in ex post competition law analysis. Ex post analysis of competition in a market may find varying degrees of market power at higher and lower percentages of market share. However this is not the situation here. Ofcom is in the process of setting ex ante regulation and as such the break point for such as assessment is 40%.

Leaving aside our concerns over Ofcom's application of the SMP threshold, we also doubt whether is it necessary to leave the margin for BT's market share decrease that Ofcom is attempting to build in via the 50% threshold. This is for five reasons:

1. the departure of Orange as a LLUO will have increased BT's market shares proportionately.
2. The assumptions that Ofcom makes about LLUOs rollout is prospective and therefore over estimates LLUOs competitive presence at the start of the new review period.
3. The assumptions that Ofcom makes about migration is also prospective and therefore over estimates the exchange level service shares at start of the new review period.
4. Ofcom will also have included the assumption of migrated services to exchanges that are planned to be rolled out but are presently not.
5. Virgin Media is counted as a Principle Operator when its exchange coverage is 65% although it is therefore unable to serve the entire exchange area. It is not transparent whether exchanges where Virgin Media is counted as one of the three Principle Operators have been included in Market 3.

In combination these numerous over estimations of LLUOs market shares and market coverage at the start of the period leave sufficient margin for any potential reductions in BT’s market shares without the need to invent SMP thresholds specific to this market review. Cable&Wireless Worldwide proposes that Ofcom proceeds with its Option 2 proposal (40% threshold) for inclusion of exchanges with 3 Principle Operators into Market 3.

Answers to Ofcom questions

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

We disagree with the use of the 50% market share threshold. We believe that Ofcom should follow its Option 2 and adopt a 40% market share threshold.

Question 2: In light of the revised geographic market definition presented in this consultation, do your previous comments on SMP remain appropriate? If not please explain why.

Yes

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

No

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 not please explain why.

Yes

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

No

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?

We continue to believe, and agree with Ofcom, that a 12 month notice period is appropriate.

Annex Response to BT's comments

BT's use of statistical indicators of competitiveness

We believe that Ofcom is right to treat BT's HHI numbers with a degree of caution as they appear to have been calculated subjectively and not in accordance to any recognised thresholds. BT has failed to demonstrate that Ofcom should lower the criteria and we would urge Ofcom to stick with the need to have 4 active players before meeting the competitive criteria.

Future rollout

Since the first consultation Ofcom has obtain more current data on LLUOs firm rollout plans. We agree that this is the correct approach to forming a forward looking view with regard to exchange rollout. We agree that plans can change. There is a risk that the plans may understate rollout. Conversely plans are impacted by actual exchange costs which are not fully revealed until detailed planning has occurred. Therefore plans can be just as easily overstated.

Competitors pricing

We agree with Ofcom that pricing trends need to be treated with caution.

The competitive effect of Virgin Media

Inclusion of Virgin Media at 65% exchange coverage already accounts for the presence of Virgin Media beyond the scope of their coverage. We support Ofcom's view that Virgin Media would have substantial investment costs to expand its coverage.

The implications of TTG's acquisition of Tiscali

We agree with Ofcom's present approach whereby consolidation leads to a reduction in the number of POs. We note that Ofcom states that further consolidation would lead to a review of the analysis criteria in a subsequent market review. We believe that Ofcom needs to establish criteria which is sufficiently robust and based upon the true competitiveness of each exchange. The need to redefine the methodology (in what appears like an attempt to retain the geographic reach of the deregulated Market 3) when changes to the structure of competitors occurs suggests that Ofcom has not yet found such a model.