

# REPLICABILITY & THE REGULATION OF BT'S LOW BANDWIDTH DIGITAL LEASED LINES

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Cable&Wireless

## 1 SUMMARY

Cable&Wireless is one of the world's leading international communications companies. It operates through two standalone business units – Worldwide and CWI.

The Worldwide business unit provides enterprise and carrier solutions to the largest users of telecom services across the UK and the globe. In October 2008 Cable&Wireless strengthened its position when it acquired UK business communication provider THUS. With experience of delivering connectivity to 153 countries – and an intention to be the first customer-defined communications service business – the focus is on delivering customers a service experience that is second to none. More information on Cable&Wireless can be found at: <http://www.cw.com/>

Today Cable&Wireless has the necessary scale to meet the needs of UK enterprise customers and we are a strategic provider of voice services to both the UK public and private sectors, offering a range of innovative and market leading voice products. Our customers include most of the UK's top companies and public sector organisations, each of whom has placed its trust in Cable&Wireless to deliver an array of business critical services. Wherever possible we try and service our customers using our own infrastructure, however in many cases we remain reliant on products from BT to ensure that our customers have the connectivity that they need to do business.

This consultation is of fundamental importance to our business and our customers. If competition is to flourish we need to ensure we have a level playing field. We feel that Ofcom have not made the case for BT's Retail low bandwidth digital leased lines to be considered replicable and in light of the December 2008 market review finding confirming SMP in lower bandwidth retail markets we believe that existing remedies should remain in force.

Our starting point is that the concept of replicability is economically flawed and vulnerable to legal challenge. Despite being promoted as a regulatory concept in 2003, Ofcom has never provided a coherent explanation of how replicability differs from a finding of effective competition. Replicability is explained in paragraph 1.2 of the Summary as follows.

*“Replicability is an important regulatory threshold. It reflects the availability of fit for purpose wholesale inputs from BT which allow its competitors to replicate effectively BT’s retail prices, terms and conditions of supply. Therefore, in the presence of replicability we would expect competition to improve significantly, with benefits for customers in terms of lower prices and more choice of services and providers. “*

It is our submission that if BT’s retail prices, terms and conditions of supply were capable of being effectively replicated by BT’s competitors, it follows that there would be no material barriers to entry to the retail leased lines market. If that were the case, it would be logical to expect BT’s retail share to be falling, such that even if it remained high in absolute terms, Ofcom would likely be justified in finding that the retail leased lines market was effectively competitive.

Yet this is not Ofcom’s position. Ofcom cites replicability as a ‘regulatory threshold’ and uses it to justify the relaxation of regulatory remedies. This fundamentally undermines the legal certainty which was the aim of European legislators in designing the market review process. The European regulatory framework establishes a single threshold and a single process which national regulators must use “to determine whether to impose, maintain, amend or withdraw obligations on undertakings”<sup>1</sup>. That threshold is a finding as to whether competition is effective (i.e. whether an undertaking has SMP), and that process is a

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<sup>1</sup> Article 16(2), Directive 2002/21/EC on a common regulatory framework for electronic communications networks and services

market review. The replicability threshold and the underlying analysis is not an adequate subject and we urge Ofcom to abandon the concept.

Even if Ofcom is not minded to abandon the concept of replicability in general terms, it is hard to see how any such finding of replicability can be justified in the retail leased lines market.

Barely eight months ago, Ofcom conducted a detailed review of the retail leased lines market, and concluded, rightly, that BT continued to have SMP in retail markets at lower speeds, and that SMP conditions were necessary in order to remedy the effects of that SMP.

Ofcom is not suggesting in this consultation that the SMP finding has changed but it is proposing to vary the remedies that were put in place as a result of that finding. The apparent justification for the change is that circumstances have now changed such that other Communications Providers are now able to replicate BT's retail leased line products whereas eight months ago they could not. We do not agree that leased lines are replicable and we explain why below. But further we note that many of the so called developments on which Ofcom's proposed replicability finding rests have not been during the last 8 months since the SMP finding. Indeed BT wrote to Ofcom in November 2008, before the market review was published. We do not understand why Ofcom did not consider the matters which BT put before them in the context of that market review, since they seem highly relevant. And we are at a loss to understand why Ofcom would consider varying the remedies it put in place only eight months ago on the basis of a detailed market review when little has changed since then, and without reviewing the market again.

We believe that where market conditions have changed materially since the last review then Ofcom should consider rolling back regulation, but it should do this on the basis of a market review. In this case Ofcom's market review concluded in December 2008 that BT

has SMP in the retail market for low bandwidth leased lines and that SMP conditions were necessary to remedy BT's SMP. Ofcom prides itself on being an evidence-based regulator and in our view the evidence that has been presented to demonstrate that market conditions have changed is inadequate. The consequences of deregulating prematurely could have a wide ranging impact on customers and we believe Ofcom shouldn't take any chances when it comes to customer welfare. While we acknowledge that progress has been made in some areas, there are many important issues which remain outstanding.

We face higher costs than BT and neither BT nor Ofcom have offered anything to adequately address the issues relating to the cost disparities between BT's internal use of private circuit components to provide retail leased lines and PPCs themselves as a result of the PPC pricing model. The consultation ignores the higher costs faced by alternative CPs as a result of the need to interconnect, including infrastructure charges, buying separate Points of Handover from BT and not forgetting the additional network costs we incur, including the duct to the relevant Points of Handover. We also offer our view on the nine issues previously identified by Ofcom in 2006 as a barrier to replicability.

In the remainder of this response we articulate why we believe any retail deregulation at this point in time would be ill judged and we would urge Ofcom to reconsider its approach in light of the concerns raised by stakeholders.

## 2 BT'S POINT OF HANDOVER ADVANTAGE: A BARRIER TO REPLICABILITY

We are disappointed at Ofcom's failure to recognise in the consultation the clear cost advantage that BT has over other CPs when selling retail private circuits, namely their ability to avoid Point of Handover (PoH) charges. The price BT currently charges to external customers for a PPC local end is higher than the assumed charge for internal usage of the same local end. In the regulatory financial statements internal use is set at a price 23% lower than that for PPCs, this is equivalent to external customers paying 30% more than the price assumed for all internal use.

In our response the Leased Lines Charge Control<sup>2</sup> we explained in detail why we felt the current treatment of PoH charges was both unfair and did not lead to the best outcome for consumers. We don't propose to repeat those arguments in here, but we believe this is a clear form of price discrimination which results in an outcome that holds back competition and prevents replicability.

In many cases BT's cost base is significantly below that of CPs. For example if a CP was to provision a 2MBit/s retail private circuit between two sites in the same urban area (a typical customer requirement) using a PPC delivered solution where the CP does not have interconnect at the correct serving exchange (there are several thousand of them) a CP would have to purchase the following:

- 2 x PPC Locals Ends
- 2 x PPC New PoH rental charges
- 2 x Main Links
- 2 X Distance Charge (per KM) (a distance of 10km would not be unreasonable)
- A share of a Point of Handover including the connection and rental charges to BT and its own infrastructure to support that PoH

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<sup>2</sup> <http://www.ofcom.org.uk/consult/condocs/llcc/responses/CandW.pdf>

In contrast BT would only have to purchase 2 x PPC local ends. The cost to BT Retail based upon private circuit transfer charges would be a little over £1300 per year, the cost to the CP would be around £3300 per year plus a share of the Point of Handover costs. Under these circumstances we cannot commercially replicate BT's offering.

Ofcom's proposals in the Leased Lines Charge Control Statement effectively delegate to BT responsibility for the reform of PoH charging, setting a date for this to be achieved of 2<sup>nd</sup> October 2009. At the time of writing we have little confidence that BT will deliver any meaningful reform and therefore we do not expect this issue to be resolved without further regulatory or legal intervention. Even if BT does surprise us by making a reasonable proposal, it will take sometime before the benefits are felt in the market (for example it remains to be seen how easy any migrations to new PoH will be). We are fully committed to working with BT to try and achieve the best outcome for our customers, however the scope of the proposed reforms are no substitute for a regime which shares PoH costs equitably over all internal and external supply. Until such time as this occurs then a level playing field does not exist and BT will have an advantage in the retail market as a result.

### **3 BT'S OVERWHELMING MARKET SHARE**

In making its proposals Ofcom appear to have ignored BT's overwhelming market share in the retail market for low bandwidth digital leased lines. The last available market share data presented by Ofcom indicates that BT has a market share of 80%, with little sign of any real decline in recent years. While Ofcom point out that BT's market share in the Digital SDH sub 2Mbit/s appears to have fallen to around 50% and in Digital SDH 2 – 8Mbit/s is sitting around 89%, we consider these figures merely underline BT's dominance in this important retail segment. As we approach the twenty-fifth anniversary of BT's

privatisation the lack of any real erosion in BT's position in this market remains a cause for concern.

With BT dominating this market and little sign that its competitors can make any major inroads, we have to question why Ofcom are proposing to relax some key remedies which are designed to protect the consumer interest. As this consultation has been conducted at BT behest and BT is the only CP seeking to gain from it (through a relaxation of retail remedies) we can't see how it would be anyone's interest, other than BT's, for retail deregulation to occur at this point in time.

The impact on consumers in the medium term could be considerable as BT seeks to use any new found freedom to grow its market share further. The issues which remain in the wholesale product market and the economies of scale BT is able to leverage from its retail operation is likely to make it even harder for competitors to make a dent in BT's market share.

## **4 TIMING OF THE CONSULTATION**

We think this consultation has been conducted prematurely. It comes just months after a market review concluded that BT had SMP in this important retail market and sets a number of important remedies designed to safeguard the consumer interest. By consulting now on this topic we don't believe Ofcom has sufficient evidence to safely conclude that sufficient changes have occurred to justify a variation of the remedies. In the next section we'll set out our views on the nine issues that Ofcom identified in 2006 preventing replicability, it will come as no surprise to Ofcom that we don't share BT's perspective on a number of points. These, along with the PoH issue lead us to conclude that Ofcom has insufficient evidence at this point in time to deregulate. At the very least we would expect a

reasonable trading period to have elapsed from the time when all BT's proposed 'fixes' were in place before Ofcom commenced the process of establishing if services are truly replicable. And as we have said above, this 'process' should be a full market review.

We believe Ofcom should use this consultation to inform its position on the replicability issues that affect CPs. Having gathered this information Ofcom should then investigate the key points raised. Only once there is sufficient confidence to suggest that these issues have been materially addressed should Ofcom instigate a further review of the market to look again at the appropriateness of existing remedies, and assess the actual impact that replicability is having the impact, rather than just looking at any theoretical benefits.

If any changes were to be made in market remedies we would expect Ofcom to present evidence to support the view that BT's retail services were being successfully replicated by BT's competitors and that BT's market share had declined by the expected amount. If this were not to be the case then we would urge Ofcom to look into why BT's market share wasn't being eroded and the accuracy of any replicability finding.

Ofcom should not be amending SMP remedies less than 12 months after they were re-imposed without very strong reasons and undertaking a proper review of the market. The products under discussion are sufficiently complex and important in an economic sense to justify undertaking a review of the relevant market. We believe these products are an order of magnitude more complex than WLR services and BT participation in the market is different (as unlike the WLR market they don't order the same products or follow exactly the same processes as CPs) and as such we don't believe Ofcom should be trying to follow the same path.

We note the Commission's concerns with Ofcom's approach and we share their nervousness over both the timing and extent of Ofcom's proposed variation of remedies outside the market review cycle.



## 5 OFCOM'S NINE REPLICABILITY ISSUES

In 2006 Ofcom considered that there were nine issues that needed to be addressed prior to deregulation. BT has pointed to changes in these areas to justify its request to deregulate. We consider that many of these issues haven't been satisfactorily addressed. We give our perspective on each of these issues below.

### 5.1 ADDRESSING COST DISPARITIES BETWEEN RETAIL LEASED LINES AND PPCS AS A RESULT OF THE PPC PRICING MODEL;

We do not believe that Ofcom has properly captured this issue in its consultation. The issue is whether the routing and pricing issues that impact the cost other CPs incur when using PPCs to provide retail leased lines act as a barrier to their ability to compete with BT retail businesses. BT's regulatory financial reports are just one source of information that helps us to understand whether or not this is the case. In 2005/6 the accounts highlighted some problems, but it was also clear that they were not giving us a true picture of private circuit component usage which prevented a thorough understanding of the issue. The fact that the accounts have been restated merely means that we should now be better able to assess the issues, although we note there remain material gaps in BT's statements which make it impossible to be certain that whether these problems have been resolved.

We've already highlighted our concerns over the discriminatory impact that the PoH issue has on the retail market, however there are a large number of other issues in this area which in our view haven't been satisfactorily resolved. We detailed a number of these concerns in our response to the Leased Lines Charge Control and we would refer Ofcom back to these when considering this issue.

The fundamental problem identified in 2005/6 concerned significant items of cost in the purchase of PPC that did not appear in the financial statements, where BT had confirmed that the cost was included. The regulatory statements do not use actual revenue as BT's internal use is not invoiced on a traditional basis and so revenues are reported using a price X volume calculation. In 2006 Ofcom asked BT to provide a comparison of its actual revenues from PPCs in 2005/6 with those reported in BT's regulatory financial statements.

Ofcom found that several significant areas of external PPC revenue were not included within the statements including 3<sup>rd</sup> party equipment, resilience and ancillary services and there were some other differences. However, the important finding was that in 2005/6 BT's actual revenue from PPCs was 10% higher than the revenue reported in the regulatory statements. Although the errors and omissions explained this difference in part it was not possible to account for all of the difference.

It was this finding that led to the problems with the regulatory financial statement being uncovered and ultimately to BT's restatement of the 2006/7 statements. The restatement covered both internal and external volume and hence revenues, but for external sales of PPCs the net change was very small, it increased from £261m to £262m, an increase of only half a percent.

A significant portion of low speed retail leased lines are circuits of between 64Kbit/s and 1024kbit/s. These circuits are routed over BT's DPCN network and despite the restatement of BT's regulatory accounts they remain both inadequate and incorrect when it comes to reporting usage of some of the key components of these circuits. There are several problem areas:

- The statements fail to show any use of DPCN trunk. DPCN trunk distance is approximately 4 times the price of terminating segment and until it is possible to see how BT itself uses this service in comparison with other CPs it is not possible to understand whether this massive price difference has an impact on replicability;

- The statements do not show any DPCN bearer revenues but external CPs incur significant cost in paying connection and rental prices for these bearers. It is not clear whether or not BT themselves use these or similar bearers and if they do whether they incur similar cost. Until this is known it is not possible to understand the impact upon replicability;
- Ofcom has uncovered the fact that BT reports some sub 2MBit/s local end rental services within the 2MBit/s services, and although they have made an adjustment for this for internal use it is not clear whether or not internal and external circuits are treated in the same way.

We believe none of the work BT, Ofcom or any external auditors/consultants have done in recent years has adequately addressed these issues. Collectively we are still no further forward in our understanding the use of DPCN components and no evidence has been presented that the restatement has fixed the underlying problem that the regulatory statements understate the real revenue.

Ofcom must look into these issues further. It is the fundamental symptom that drew attention to the problem in the first place and it must be fully investigated before there is any hope of restoring any confidence in the regulatory financial statements. Ofcom are about to embark on a fundamental review of regulatory accounting as it is clear to all stakeholders that the current system isn't fit for purpose. The large number of additional adjustments that Ofcom have had to make to BT's base regulatory accounting information in order to set the charge control model is to a large extent as a result of the inadequacy of the current system.

At a time when our confidence in regulatory accounting is at an all time low and in the wake of an unprecedented restatement of BT's regulatory financial statements and ahead of a fundamental review of BT's regulatory accounting practice we cannot share Ofcom's

view that '*regulatory financial reporting issues are no longer a barrier to a finding of replicability*'.

While we acknowledge that some progress has been made in this area, it is clear to all those closely involved in Regulatory Accounting that the work completed to date just scratches the surface, and all of it has been conducted due to the pressure from the UK's alternative operator community. In our view BT's restatement is no justification of a replicability finding, it is testament to just how bad things have got.

While we are optimistic that things from cost reporting and regulatory accounting perspective will improve, reaching a finding of replicability in this area at this time is wholly inappropriate and Ofcom must wait until the fundamental regulatory accounting review has concluded prior to reaching a conclusion on replicability over cost disparities.

However, the issue for replicability is not the accuracy, or not, of the regulatory accounts. The issue is whether or not the way in which PPCs are routed and priced acts as a barrier to CPs providing effective competition with BT Retail in providing private circuits.

In section 2 we provided an example of how the requirement to interconnect impacts the relative cost between BT and other CPs. This is clearly a very significant issue for short distance circuits; it reduces for longer distance circuits but is never eliminated. It arises from two main issues:

- The cost of interconnect that CPs face but BT does not. This includes the new PoH rental surcharges, the setup and ongoing rental for the points of interconnect themselves and the infrastructure CPs themselves have to provide;
- The fact that without massive investment in interconnects at a vast number of BT serving exchanges circuit routings will normally be longer via an alternative CP than over BT's network, particularly for short circuits.

These issues will be the same for all circuit bandwidths. It is possible (and indeed likely given their even more complex routing) that even greater issues exist for sub 2MBit/s circuits but the lack of any transparency over BT's internal use prevents us from understanding these issues despite our repeated requests for Ofcom to investigate them.

## 5.2 IMPLEMENTATION OF REVISED FORECASTING PENALTIES

C&W strives to provide accurate forecast information to BT. We believe too much importance is placed on individual CP forecasts, when a better reflection of anticipated demand is likely to be available in-house within BT (as it sees most UK demand through BT Retail & CP orders). One CP's loss is usually another's gain and the vast majority of circuits will require a PPC or BT Retail circuit. From this data BT is able to formulate a clear idea of demand by region. CP forecasts are most useful when planning CP specific point of hand over requirements and it is very much in CPs interests to give BT accurate forecast information to avoid potential customer affecting delays.

The PPC forecasting penalty regime should not be another revenue opportunity for BT, instead it should be truly cost reflective. We believe BT Retail should have to follow exactly the same process as other CPs when submitting forecasts. BT Retail should also be subjected to the same charges and restrictions which apply when a forecast is over or under shot (ie. charges levied for failing to meet forecast volumes and restriction on the number of circuits that are able to be expedited when over ordering has occurred). It is not clear from the consultation that any progress has been made to align internal and external processes and we believe that in order for this issue to meet the criteria for replicability then alignment (as far as is reasonably possible) needs to occur.

It is not sufficient for BT to allocate some level of charges in its regulatory financial statements. BT needs to take account of these soft internal charges when it is considering the profitability of its retail services (from a practical pricing and compliance perspective).

It is not clear if BT's restatement of volumes has affected the calculation of the penalty charges themselves and we would seek an assurance from Ofcom that the current charges are genuinely cost reflective. If there is any doubt over the level of the charges we would urge Ofcom to review them as soon as is practical.

### **5.3 IMPLEMENTATION OF AN OPTION TO RE-DESIGNATE/GRANDFATHER MUXES ON COST-ORIENTED TERMS;**

We are content that this issue has been resolved to our satisfaction and confirm our support for Ofcom's findings on this issue.

### **5.4 SUCCESSFUL CONCLUSION OF THE MASTER SERVICES AGREEMENT ('MSA') OR PPC CONTRACT REVIEW PROCESS;**

Cable& Wireless can not share Ofcom's enthusiasm for the outcome of the PPC contract review process. We view the conclusion of the 07/08 PPC contract discussions as more of a fait accompli and while it would be disingenuous of us not to acknowledge that steps were made in the right direction, the conclusion of the discussions only came about because of the pragmatic approach taken by the alternative operators in the negotiations.

There remain a number of points in the contract which we believe create an asymmetric bias in BT's favour but not wishing to delay progress any further a settlement was reached. The conclusion of this agreement should not be considered as confirmation that contract can now meet the criteria for replicability and a number of these issues are still the subject of debate at the current round of PPC contract discussions and at this point in time it would appear unlikely that many of these issues will be address to our satisfaction this time around.

We would urge Ofcom to look at the following outstanding issues, ensuring that Ofcom does not consider the issue of replicability on contract terms closed until such time as these issues have dealt with appropriately by BT:

- **Credit Vetting** – BT's insistence at the inclusion of clause enabling them to instruct an unspecified withhold following late payment (something that is clearly not replicable to BT's downstream lines of business).
- **Limitations of liability** – BT have failed to move at all on this issue. Given the considerable amount spent on these products, BT has taken a completely unreasonable stance on this issue. CPs are only able to claim a minimal amount from BT, yet these services are of vital importance to CP businesses and their customers.
- **SLA performance** - In December 2008 BT changed its validation rules on how it calculated SLA performance on PPC and RPC faults. It made two major changes: (a) time spent proving a fault to the customer's site without access was now excluded from the total out of service time if BT had to park up the fault awaiting access and (b) if BT were unable to get out to site in the time available and had to

re-attend the next day they would deduct all the time spent on the fault on the first day. Since these changes were made BT's SLA and mean time to repair performance have improved considerably but overall cycle times have been static. BT has effectively improved the appearance of its performance by excluding what we see as valid carrier handling time but our customer experience has remained the same. We are unclear if any similar changes have hit downstream BT or its customers, but we believe this issue should be looked at by Ofcom before any judgement on replicability is made.

## **5.5 PROVE ADEQUATE BILLING ACCURACY AND BILL VERIFIABILITY;**

Things have undoubtedly improved, however it should be noted that this was from a very low starting point. We do not consider that these issues have all been resolved in a satisfactory manner and we have continued to experience a high number of dispute claims arising since the launch of the new billing system. Typical problems include:

- Circuits being billed beyond their cease date
- CLZ circuits not being billed at the correct rate
- Connection charges being placed on live circuits that are being moved between accounts
- invoice backup still contains inaccurate POH(ISH & CSH) data . It appears that any MOVE, SHIFT, or rearrange where there is a change in addresses are not being updated on BT ECO system of the invoice backup. This then results in distance calculation dispute.
- One off charges being incorrectly billed (eg. a B end shift being charged as moving to another exchange which would be the cost of a new connection, the circuit is



actually moved within the same exchange so the charge should be much lower). This arises because these charges are being calculated manually and entered into BT systems.

- Circuits not being charged at the correct distance: some circuits distances are not updated after the shift charge was applied. Also the shift can take some months to appear on the invoice after it has occurred, this then results in prior periods being credited and rebilled at the correct rate.

Cumulatively all these issues make the job of reconciliation very difficult and as a business we have to devote a significant amount of resource to checking BT's invoices and correcting their mistakes. We would be happy to share further details of these issues with Ofcom.

We therefore cannot support Ofcom's conclusion on this issue and believe a great deal of improvement is still required on BT systems and processes before we would consider their billing accuracy and verifiability anywhere near the pass mark for replicable. BT continue to make improvements (indeed their current Re-Alignment project demonstrates they recognise they bill incorrectly) and we would urge Ofcom to look again at this issue and take the time to understand what improvements are still required.

## **5.6 IMPLEMENT RELEVANT PRICE CHANGES FOR IN SPAN HANDOVER ('ISH') EXTENSION CIRCUITS;**

We do not purchase this particular product and therefore have no comments to make regarding this issue.

**5.7 INTRODUCE KEY PERFORMANCE INDICATORS ('KPIs') TO ALLOW THE PERFORMANCE OF THE BT RETAIL CUSTOMER MANAGEMENT CENTRE ('CMC') TO BE COMPARED TO THE WHOLESALE CMCS;**

We are satisfied that BT has made sufficient progress in this area to justify Ofcom concluding that the KPIs produced are indeed replicable. We would urge Ofcom to continue to monitor BT's KPI output to ensure they are published on time and remain reliable.

**5.8 AVAILABILITY OF PRIORITY PROMPT AND TOTAL CARE SERVICE LEVEL AGREEMENTS ('SLAs') ON PPCS DESIGNATED FOR USE IN SAFETY OF LIFE OR DEFENCE OF THE REALM APPLICATIONS; AND**

We concur with Ofcom's view that this issue has been resolved to the satisfaction of industry.

**5.9 POTENTIAL DOUBLE PAYMENT FOR EQUIPMENT CANCELLED AFTER THE FIRM ORDER CONFIRMATION ('FOC') POINT AND SUBSEQUENTLY DEPLOYED IN FULFILMENT OF ANOTHER ORDER.**

While Ofcom are correct to point out that some improvements have been made (from a grossly unfair and discriminatory starting point), this issue is far from fully resolved. In light of concerns from the industry charges have been altered but we are no further forward on a number of points of concern, which in our view completely undermine

BT's case for claiming replicability in this aspect of PPC pricing. We would be happy to discuss these concerns in more detail with Ofcom.

In summary while BT used to charge CPs on a % scale depending on how close to the order completion date when an order was cancelled, with charges relating to the kit itself, from April '08 this reverted to the "cost to supply" which in some instances reduces and other increases the amount paid in order cancel situations. In principle we welcomed this move, however questions remain over the legitimacy of BT's cost stack. It remains vague and in our view is worthy of further investigation to ensure charges are genuinely cost reflective. We have also failed to be adequately compensated for previous BT over-recovery and we believe CP repayment should be a prerequisite of any replicability finding. We are also aware about other discussions within the industry around equipment reuse and are keen to ensure BT Retail does not gain any advantages over other CPs.

## 6 REGULATORY OPTIONS FOR DEREGULATION

As we have articulated above, we do not believe it would be justified to remove regulation from BT in the retail market for low bandwidth circuits at this point in time. We would therefore advocate Option 1 until such time as there was compelling market evidence available to support the view that digital retail low bandwidth services were indeed replicable.

When services are truly replicable and the appropriate time is reached when some form of deregulation can take place we would offer the following thoughts on the methodology that should be used.

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## **6.1 THE STAGES OF DEREGULATION**

As a matter of policy we believe Ofcom should always take a gradual approach to deregulating any market, ensuring that regulation is removed in stages and giving the market sufficient time to adjust to any future changes. It is important for all market participants, suppliers and purchasers that any changes in market dynamics are signalled well in advance. We would always caution against any radical overnight deregulatory initiatives and believe Ofcom should set out a number of stages to the process, rather than selecting the most radical option at the outset.

This approach allows Ofcom to adequately gauge the effectiveness of its approach, ensuring that the risk of consumer harm is minimised. This approach is especially important in circumstances such as these, where the evidence presented on both the impact on the market and the replicable nature of the product set is borderline (although in this case we are quite clear that retail private circuits are not even close to being replicable) and the undisputed information on market shares underlines BT's dominance in this retail market.

## **6.2 OFCOM'S ROLE AS A COMPETITION AUTHORITY**

In our view Ofcom's current proposals do not adequately take account of concerns around enforcement and compliance. In circumstances where deregulation is being imposed for the first time it is crucial that adequate regard is paid to both preventing and detecting future anti-competitive behaviour. This is particularly true of the first few years of any deregulated market.

Ofcom has raised concerns about the robustness of BT's LRIC numbers and is proposing a governance process in an effort to mitigate this risk. At this stage with so little detail available about the accuracy of BT's Retail LRIC and how Ofcom envisage the compliance process working in practice we have little confidence that Ofcom will have sufficiently

reliable information from BT and enough visibility from the rest of the market to be truly effective. As BT's systems have no requirement to capture retail LRIC data, the retail LRIC numbers prepared could well miss out a number of costs, thus enabling BT to exploit its position without formally breaching the compliance process. In the event that Ofcom does decide to look at BT's retail LRIC numbers we would welcome the opportunity to participate in the debate over what should reasonably be included.

We also note that BT has set up internal compliance processes in the past for other product areas and we would argue these have not been sufficiently robust and have not prevented CPs referring matters to Ofcom for investigation under the Competition Act (eg. Wholesale Calls, where Ofcom's investigation is ongoing).

We also believe BT should not only look at its own costs, but should base compliance on the costs of an efficient CP and take into consideration the costs for CP specific charges like PoH. This is the only fair way to ensure that BT's retail pricing isn't anti-competitive. We also believe Ofcom must take into account the relevant economies of scale available to BT in its retail operation, again making an adjustment to better reflect the (higher) retail costs of smaller scale alternative provider.

We note the complexity faced when looking into the cost stack of bundled products (of SMP and non-SMP services). We see little in the consultation that gives us any comfort that Ofcom has considered this issue in detail. We believe Ofcom must set out up front a number of principles relating bundled cost stacks to prevent BT from picking the most advantageous division of costs which would have the potential to be judged anti-competitive.

BT must have a clear incentive to comply with its obligations, being left in no doubt of the consequences of non-compliance. The recent case of regulatory accounting restatement

has highlighted the limited action open to Ofcom in cases where BT hasn't properly fulfilled its obligations.

We are keen understand what chain of events would be triggered by Ofcom should concerns arise over BT's non-compliance in this area. The time, effort and resources required to secure a commitment from Ofcom to open an investigation under the Competition Act is considerable and we believe Ofcom should be much more explicit at this stage over what sanctions would result in the event that BT is suspected of failing to comply with its obligations, with further sanctions imposed should that finding be upheld after an investigation.

To ensure there is sufficient deterrent in place to encourage BT to take its obligations seriously, Ofcom should make clear the consequence of non-compliance (or suspected non-compliance) from the outset. We would suggest that as a condition of de-regulation, at the point where BT was suspected of not complying with its obligations then it should be required to resume price publication. Ofcom should also make its views known about how it is likely to treat a finding of non-compliance, detailing the likely financial consequence of a breach. Although any final action would have to be directed by Ofcom following the conclusion of a formal investigation, it would strengthen Ofcom's hand and act as a far stronger deterrent if Ofcom were to set out at this stage how it is likely to approach any incidence of BT pricing below its retail LRIC floor.

## 7 CLARITY REQUIRED ON THE DEFINITION OF RETAIL LEASED LINES

It isn't clear to us how Ofcom are proposing to define Retail Leased Lines. There are a number of examples where Retail circuits are actually used to supply wholesale customers at a discount on standard rates. Ofcom covered this in the BCMR. This ambiguity potentially opens up an opportunity for BT to get around some of the restrictions which are in place to prevent discounted and bespoke pricing being offered in the wholesale market. We need a much tighter definition to prevent BT from circumventing existing safeguards and exploiting any potential loop holes which may open up as a result of any Ofcom initiative to deregulate the retail market. Ofcom need to consider the unintended consequence of their current proposals and in the event that they press ahead with plans to deregulate a satisfactory definition of retail services should be enforced. We would welcome further discussion with Ofcom on the scope of any retail definition.

## 8 ANSWERS TO CONSULTATION QUESTIONS

*Question 1: Do you agree with our assessment of the relevant competitive issues? Are there any other issues Ofcom should consider?*

Ofcom has missed the biggest single issue of all, the routing and pricing issues that arise out of the need for other CPs to interconnect. Although Ofcom has made reference to the issue, the consideration of it only covers the changes to the regulatory accounts which BT has made. The regulatory accounts are a source of data that help us to understand the issue, not the issue itself. In fact the regulatory accounts remain deficient in some key respects and so it is not possible for us to properly understand the magnitude of the issues.

Ofcom have captured many of the relevant competitive issues, however given the risk associated with deregulation little time has been devoted to properly understanding those risks and the negative market consequences that may arise if Ofcom get this wrong.

BT is the only CP that stands to benefit from retail deregulation and any moves that give them more flexibility is only likely to result in BT consolidating its position. Ofcom appear to be taking a very theoretical approach to this issue and if indeed replicability does now exist you would expect that to be borne out by market share evidence (with a noticeable drop in BT's market share). We haven't witnessed this in the market, nor would we expect to as replicability has in our view not been achieved.

While much of Ofcom's theoretical arguments hold water, they all hang on the premise that replicability has been achieved. This isn't the case and Ofcom must pay closer attention to the negative consequences that will result if SMP remedies are rolled back without justification.

*Question 2: do you agree with our assessment of the preferred option?*

No. We believe Ofcom should take a phased approach to deregulation. Please refer to the main body of our response.

*Question 3: Do you think that a more cautious approach should be adopted for the segment at and above 2Mbit/s than for the lower bandwidth segment?*

While we cannot support Ofcom's finding of replicability, we would advise adopting a cautious phased approach to deregulation. There is sufficient evidence to suggest weaker retail competition for services of 2Mbit/s and above and we believe Ofcom should take steps to safeguard consumers in this market segment by retaining regulation.

*Question 4: do you consider the proposed governance is adequate? Should we consider other options or variations?*

No. We believe Ofcom need to be more explicit about the consequence of non-compliance. Please refer to the main body of our response for more information.

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