

Cover sheet for response to an Ofcom consultation

BASIC DETAILS

Consultation title: Review of the wholesale broadband access markets 2006/07

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Name of respondent: COLT Telecommunications

Representing (self or organisation/s): COLT Telecommunications

Address (if not received by email):

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Name Christine Roberts

Signed (if hard copy)

COLT Telecommunications

Review of the wholesale broadband access markets 2006/07

Introduction

COLT welcomes the opportunity to provide further comment on Ofcom's review of the wholesale broadband access market and in particular Ofcom's conclusions regarding BT's SMP status and the associated remedies which should apply.

COLT's primary concern is that the deregulatory approach which Ofcom is proposing could have a considerable negative impact on the provision of communications services to UK businesses. Although Ofcom do consider the impact on business Internet access services, the consequences of geographic deregulation on business connectivity services more generally have not been assessed. Above all else, we believe Ofcom must address this issue before implementing the current proposals.

This omission stems from the fact that Ofcom defines the relevant product market solely in terms of Internet access. While this may be appropriate in the residential sector, it fails to capture the full spectrum of needs of the business market for different flavours of wholesale broadband access. COLT believes that there are at least two distinct product markets for broadband access: one which supports mass-market Internet access; and another which supports the provision of high quality business connectivity services.

COLT also has two other serious concerns with the proposals, both of which apply regardless of whether the product scope of the review is expanded. First, we believe that the transition arrangements proposed for Market 3 are insufficient to mitigate the risk that deregulation brings to the supply of services to existing customers. Secondly, there is considerable uncertainty over the impact of the proposed geographic deregulation on both the Undertakings and on the *ex post* regulatory regime. Both issues are discussed in more detail below.

While we understand that it is difficult for Ofcom to comment on such matters without fettering its discretion, we do believe some clarification and guidance is possible. COLT requests that Ofcom do all that it can to reduce uncertainty in this area, thus allowing operators to make the more informed investment decisions.

Impact of the market review on business connectivity services

Inclusion of residential and business in the same market

As Ofcom is aware, COLT has previously expressed serious reservations regarding the inclusion of residential and business ADSL access services in the same market.

We would reiterate our view that while there may indeed be some overlap in services used by residential and business customers, COLT believes that insufficient consideration has been given to the differences which do still, and will continue to, exist. Indeed, Ofcom's own customer research published alongside the consultation document found that when questioned the largest proportion of business customers using ADSL stated they were paying £30 - £79.99 per month for connectivity, while the largest proportion of residential ADSL users stated they were paying £15 - £19.99 per month. This is a not insignificant difference and suggests that there may be indeed be a break in the chain of substitution which requires further examination.

In particular, the requirements of larger businesses warrant separate consideration where connectivity requirements are more often than not driven by a range of data needs (not just internet access), with guaranteed bandwidth and differential pricing designed to reflect the value added nature of the services being offered and associated service levels. For further detail we would refer Ofcom to the joint response to this consultation submitted by UKCTA.

These differences in the retail market are reflected in the wholesale market. On the demand side there is a need for high availability, low latency, and guaranteed bandwidth access. Ideally, such services could be installed quickly, and would come with repair times approaching those found on leased line products. Ofcom should note that there is a gap in the wholesale broadband market for a product which offers these ideal characteristics. The closest available product is BT DataStream. One reason for this gap is the nature of supply in this market. It is not straightforward to move from offering a residential grade wholesale broadband access service to offering the ideal business grade service outlined above. The difficulties, and therefore costs, are not of a technical nature, but lie in the development of new business processes and systems required to support a much higher quality service.

The minimum efficient scale for a LLU operator rules out the option of a business only provider. Similarly, the case for a successful LLU operator to move into the high grade business access market is likely to require a substantial number of lines, and unfortunately, this is likely to be a very small market segment. For this reason, it may well be that this market will not support a sufficient number of competitors to deliver effective competition.

The conclusion is that while a merchant market may develop in the residential and business internet access market, this is no guarantee that one will develop in the provision of business grade access. COLT is often required to prepare proposals covering all the sites of a particular company. Some sites may require leased lines, but DSL may be suitable for others. Consequently, if a business grade wholesale broadband access product were withdrawn from a particular area, either because there was no longer a requirement to supply or because it was decided that residential products were sufficient, it could undermine competition for business connectivity services across the whole national market.

In the long run, it is clearly possible that successful LLU operators will move into the business market under discussion, and therefore retail business customers should still receive a service. However, even in this instance there will be little incentive to supply to a merchant market given the additional costs of doing so and the small size of this market segment. In residential (and to a lesser extent business) Internet access markets, the narrowing of competitive alternatives at the retail level due to the absence of a merchant market arguably will not have a detrimental impact on consumers. These consumers make choices based on core service characteristics: price and bandwidth. Indeed Ofcom's research report 'The Consumer Experience' published in November 2007 showed that the main reasons for residential broadband users switching services were price and quality of service (specifically for broadband services, speed of connection).¹

In contrast, business customers focus much more on the service wrap, and indeed the core feature of a business connectivity service is often the management of an entire network rather than the price and bandwidth of individual access circuits. To put this another way, there is great value to the customer in having competition between different value added services, and relatively less importance attached to the underlying network. In this context, the removal of a merchant market for the provision of the underlying network services is likely to have a very detrimental effect on consumers – drastically reducing both the range of choices and the number of competitors across all downstream markets for business services which require wholesale broadband as an input.

COLT believes that the need for these different products will continue during the period of this review and that further assurances regarding the provision of business targeted products should be provided,

¹ 'The Consumer Experience' 20 November 2007, Paragraph 4.6 <http://www.ofcom.org.uk/research/tce/ce07/>

in particular within Market 3. Our concerns regarding the proposed transition arrangements and continued supply of services are detailed further below.

Exclusion of SDSL from the market

COLT has previously expressed concerns regarding the exclusion of SDSL services from the relevant product market. In particular while COLT's experience across Europe has shown that it is possible to supply high quality leased line replacement services using SDSL technology at a fraction of the cost of traditional circuits, this opportunity does not exist in the UK. We believe there are two main reasons for this being the case: first, relative to leased line prices, the price of wholesale SDSL services from BT is far too high to encourage demand; and secondly, better service levels are available with wholesale leased line services. For that reason, COLT has previously argued that Ofcom must give further consideration to the inclusion of SDSL services within the wholesale broadband access market. We believe that this would encourage demand-side substitution between symmetric and asymmetric broadband internet access limited by beginning to address large price differentials and the low value which asymmetric broadband internet access customers place on symmetric broadband internet access.

Proposed solutions

Given the issues which COLT has identified with the inclusion of residential and business ADSL services within the same market and the exclusion of SDSL from that market, we believe that further serious consideration must be given by Ofcom to the possibility that there may indeed exist separate wholesale broadband access markets for the provision of residential and business services. This is not to say that all business services would sit within a separate WBA market, but rather that there is an argument for high-end business services and SDSL to comprise a separate market within the overall WBA market.

Geographic Market Definition

COLT remains concerned regarding Ofcom's geographic market definitions and would request that clarifications are provided on a number of points before the proposals are implemented. In particular the linkage of Ofcom's geographic market definitions to BT's local exchange footprint opens the possibility of anomalies which may themselves impact on competitive conditions within Ofcom's defined markets. Further explanation is required in the following areas:

- While Ofcom has discussed the issue of the potential impact of NGN developments, particularly FTTX, over the timeframe of the review, COLT remains concerned about how rollout of next generation access technologies within Market 3 will be treated. We would suggest that, in the event of deregulation within Market 3, there should be a carve-out within the market definition in order to ensure that next generation access is subject to SMP regulatory controls where appropriate and necessary.
- We believe that there is still a need for further clarification regarding the inclusion of backhaul within the definition of "Network Access", specifically what constitutes "backhaul as necessary". We also believe that the situation where backhaul required for any one wholesale broadband access connection traverses more than one market requires clear guidance as to how such backhaul will be treated for the purposes of regulatory controls where BT has SMP in one of those geographic markets and not the other.
- The consultation document does not appear to address the issue of whether the mismatch between the proposed definition of geographic markets and the exchange banding used by BT in the commitments given in November 2006 with regard to its wholesale IPStream product and its wholesale Broadband Connect product (when launched) creates any anomalies.

- The consultation contains no discussion or guidance on the impact of Ofcom's proposals on BT's undertakings. As Ofcom is aware, products which fall within the wholesale broadband access are subject to the equivalence requirements of the Undertakings and there is concern that these requirements will fall away if there is a finding of no SMP. It is vital that Ofcom provide further clarification on this matter.
- The telecoms market has so far operated under the assumption that in cases where *ex ante* regulation is relaxed or withdrawn, that there is still a backstop in the form of Competition Law. Although this clearly remains the case, the protection afforded by Competition Law clearly depends on whether or not an *ex post* market definition and dominance assessment would reach the same conclusions as Ofcom's present market analysis. Naturally, it is difficult for Ofcom to comment on such matters without fettering its discretion, but it is vitally important to help industry understand the rules of the game. For example, in one scenario BT would be free to make a loss in Market 3 should they wish to do so; in another this would almost certainly be deemed to be unlawful anti-competitive behaviour. As mentioned before, it is important for all parties to understand which regime is in operation *ex ante* in order to make appropriate investment decisions.
- Ofcom appears to have given no consideration to the possibility of defining a national market with differential remedies, where appropriate. While we welcome the fact that Ofcom has included an impact assessment in this second consultation, we note that there is no assessment of the complexity and potential cost which geographic disaggregation will introduce to ongoing effective monitoring and regulation of the wholesale broadband access market. This has the potential to be a very significant issue and at the very least we would have expected Ofcom to consider alternative approaches before pursuing the proposed option.

When considering Ofcom's approach to geographic market definition, the following issues are of particular concern for COLT in relation to Market 3:

- In its first consultation Ofcom recognised that LLU operators operating in Market 3 were currently only supplying wholesale products to larger ISPs and concluded that in the absence of regulation it could be expected that if BT were to offer wholesale broadband access products, it may also restrict supply of services to larger ISPs. Given the detriment which might arise from this Ofcom stated that it may be appropriate to require BT to continue to provide wholesale broadband access throughout the proposed Market 3. This remains a critical issue for smaller CPs and ISPs. COLT's experience is that LLU operators are not yet actively addressing this market, and even if there was a desire to supply it would take time for a merchant market to emerge. Ofcom must therefore do more to provide certainty in terms of supply of service. An inability to impose a requirement ensuring continuity of supply by BT throughout Market 3 because of a finding of no SMP would seem inconsistent with protecting the interests of consumers and promoting competition.
- The need for continued supply of services by BT (as the only single national operator) is reinforced by not only the lack of availability of services from alternative operators, but also the difficulties which dealing with multiple suppliers presents. If communications providers are to use alternative suppliers, inevitably they will need to deal with multiple suppliers because, as Ofcom has noted, BT remains the only operator providing ubiquitous coverage of the proposed Market 3. This will invariably lead to an increase in cost and complexity in terms of supplier management and ultimately may negate any advantage which a provider might gain through using an alternative supplier.
- BT continues to maintain economies of scale and scope in Market 3, particularly in relation to existing duct infrastructure, back office support and other shared functions which are used to

support a range of services, in addition to broadband, across all 3 of geographic markets which Ofcom is proposing to define. The existence of these common costs across the different product and geographic markets creates a clear opportunity for leverage. COLT raised this issue in its response to Ofcom's initial consultation and remains concerned that it has not been addressed.

Remedies

Markets 1 & 2

COLT is largely in agreement with the remedies which have been proposed for Markets 1 and 2 and we are pleased to see that Ofcom has also decided to impose a remedy requiring the publication of quality of service information. However, there remain some areas which we believe warrant further consideration/clarification.

Ofcom has reiterated its view that it would not be appropriate to impose a constraint on BT's pricing of wholesale broadband access services. While we agree that a requirement for cost orientation is not necessarily appropriate, we see no reason why there should not be a requirement for charges to be "fair and reasonable". This certainly would not force cost orientation on BT and would provide a useful backstop to the previous pricing commitments given by BT which we note are voluntary, time-limited and do not capture all of the products to which the definition of the wholesale broadband access market applies.

We also believe that further clarification regarding the requirement to provide regulatory financial statements. We recognise Ofcom's point that the preparation of these statements along with the underlying cost attribution methodologies on a geographic basis will require significant enhancement in order to deliver robust results. Ofcom has indicated that it will consider BT's proposals for enhancing its capability to report on a geographic basis and if necessary consult on changes to BT's reporting obligations. In order to ensure that this work is carried out in a timely manner we would urge Ofcom to place clear timescales around delivery of proposals by BT and for implementation of the necessary capabilities.

Market 3

On the basis of a finding of no SMP in Market 3, Ofcom is proposing that no regulatory remedies be applied but that transition arrangements are put in place in order to ensure continued supply of services for a defined period. We will limit our comments to the proposed transition arrangements but would reiterate our concern that Ofcom's approach to market definition will leave both consumers and CPs exposed to a degree of risk in Market 3.

Ofcom intends to continue to impose a requirement to supply under Condition EA1.2 in Market 3 for a period of 12 months. While we welcome a continuation of this requirement there is one point on which we believe Ofcom must provide further clarification.

COLT is concerned about the interpretation of what Ofcom is proposing should continue to be supplied and to whom. At paragraph 5.211 of the consultation document Ofcom states that it considers that "this Condition should only be maintained in respect of existing wholesale broadband access customers of BT in Market 3. BT would therefore not be required to provide new Network Access where requested by a third party."

COLT's interpretation of this as an existing wholesale broadband access customer of BT was that we would continue to have supply of existing connections for a period of 12 months, with BT also having an obligation to supply for new orders placed during those 12 months. However, Ofcom has verbally indicated this may not be the correct interpretation and it is possible that BT will have no obligation to

meet requests from existing customers for new wholesale broadband connections during the transition period.

COLT is very concerned regarding Ofcom's suggested interpretation of the transition obligations. If what Ofcom is suggesting is the case then there is a very real possibility that CPs will be left unable to continue to provide services to existing and new customers in Market 3. Should BT choose not to supply new connections from the date the outcome of the market review comes into force, or chooses to offer new connections on unattractive terms and conditions then CPs will be put in an impossible position. Ofcom itself admits that supply of wholesale service by LLU operators is limited. And it can take some time for CPs to negotiate and set up supply arrangements with alternative suppliers. This also assumes that CPs will have sufficient demand to establish these alternative arrangements – something that CPs may not have considered fully previously on the basis that they were able to rely on supply by BT. We also note that while BT has given voluntary commitments to continue to supply in its letter dated 10 November 2006 regarding ceilings for broadband pricing, these commitments are time-limited (until 31 December 2008) and do not relate to the whole range of products within the wholesale broadband access market as defined by Ofcom. As such, BT's commitments provide no real comfort for CPs.

For these reasons we would urge Ofcom to reconsider its interpretation of BT's obligation to supply in Market 3 to ensure that CPs are given a reasonable opportunity to assess market developments and take reasoned decisions regarding the future sourcing of wholesale broadband access.

Finally, we would again ask that Ofcom clarify the impact of deregulation in Market 3 on BT's undertakings. At the very least the market should be given guidance on the extent to which the undertakings will continue to apply to services in Market 3.