

# OFCOM REVIEW OF THE WHOLESALE BROADBAND ACCESS MARKETS 2006/07

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Cable&Wireless

## Executive Summary

- Cable&Wireless believes that Ofcom is mistaken in its identification of a single retail market for all broadband internet access services as we identify a distinct separate market for “large business” broadband access
- At present the “large business” broadband access market is not recognised by either Ofcom’s Wholesale Broadband Access Market Review or Ofcom’s Business Connectivity Market Review. This market is reliant upon the availability of regulated wholesale inputs. Failure to acknowledge the market leads to the risks of regulatory remedies being removed.
- Ofcom fails to recognise a distinction between the wholesale products required to serve the residential and small business broadband access market and those needed to support services to “large business” users. We regard Datastream and its 21CN successor WBC/WBMC DDQ as representative of the distinction between the products suitable for “large business” users’ broadband access services and those for internet access services targeted at residential and small business users.
- In our view, there is limited constraint on BT’s behaviour in either the wholesale or retail markets for “large business” broadband access users from LLUOs.
- Ofcom’s proposals for regulatory remedies shy away from any explicit obligations regarding reasonable pricing for Markets 1 and 2. This is at odds with the finding of SMP and in contradiction with the proposals for symmetrical broadband access which have cost orientation obligations and may become subject to charge controls in the future. Cable&Wireless is of the view that both symmetrical and asymmetrical broadband services need consistent regulatory treatment.
- Ofcom’s proposes a notice period to enable parties to seek alternative arrangement for the supply of services that are currently offered under regulation. As currently proposed, this notice period does not provide a glide path to deregulation and is wholly inadequate.

## Introduction

Cable&Wireless fully understands that Ofcom's aim, and indeed obligation under EU regulation, is to remove ex-ante regulation where markets permit and fall back to an environment based on Competition Law. However, in making this move Ofcom needs to be certain that the removal of ex-ante regulation will not reverse the level of competition achieved by the regulation and that the market is sufficiently mature so that the need for recourse to Competition Law is minimised. This is essential because experience to date shows that reliance on Competition Law is not a speedy remedy - NCCN500 is a case in point.

With regard to Market 3 we do not believe that the evidence shows that there is sufficient maturity at this time to remove ex ante regulation. BT's market share in the retail market is showing an upward trend and the risks of market consolidation are high. Indicators suggest that BT's market share is likely to continue to rise going forward.

Development of a wholesale / merchant market is essential if competition in the retail market is to continue. We don't believe that Ofcom has demonstrated that this is a likely outcome in the immediate or short term. Our concern is that if market failure does occur, for example an inability to obtain supply at wholesale level at a competitive price or quality of service, there will not be a sufficiently speedy remedy available to put the failure right.

This is a particular concern as large business customers increasingly require national coverage. Inability to supply in some geographic areas would result in the loss of those contracts and irreparable harm to our business. The timescales for addressing any failure to obtain supply, are too long to prevent any immediate loss of business. The hurdles for bringing Competition Act cases are too high for this to be an effective constraint on BT's behaviour and the cost and resource implications render it prohibitive in most cases. Ofcom needs to have sufficient resources available to take these investigations on and must be quick in turning the investigation around. During this period there is no commercial certainty and business is lost.

**Question 1: Do respondents have any comments, additional to those made in their responses to the November consultation, on Ofcom's approach and conclusions on market definition as set out in Section 3 of this document?**

Cable&Wireless believes that Ofcom has mistakenly:

1. identified a single retail market for all broadband internet access services as there is a distinct separate market for "large business" broadband access
2. concluded that LLU operators offer a constraint to all downstream markets reliant upon LLU inputs – in particular the wholesale inputs required to serve the "large business" broadband access market.

**Retail market definition**

The 2006/07 review determines that there is a single market for retail broadband access. This is based on the proposition that the broadband internet access services sold to business and residential users are in essence the same. Ofcom acknowledges that services targeted at businesses may offer a greater range of features such as more web space, more email addresses and faster repair times for service failure. Ofcom concludes that there is a continuum of services (residential through to business) which consumers can switch between and in terms of economic market definition, a chain of substitution exists between all of these services. As a consequence it has concluded that a single retail market exists.

To establish the scope of the retail market for the purposes of the economic market definition, Ofcom firstly determines that at the retail level broadband services are predominantly provided by *asymmetric* broadband internet access. Ofcom recognises broadband access has the potential to support a number of services including internet access, voice, TV and virtual private networks (VPNs) and that more services will be developed during the lifetime of the review. Ofcom does not exclude these future services from the market. Consequently we are led to the conclusion that a broadband retail market could include a wider range of *asymmetric broadband internet access* and *asymmetric broadband access* services.

Presently the predominant retail service is internet access. Cable&Wireless agrees that a single retail market exists for residential and small business users which buy "access to the internet" broadband services. However, we contend that a separate retail market exists for "large business" users broadband access (by this we mean large multi site, generally national corporations) who use broadband access for VPNs. Whilst home workers will use their "residential" or "small business" broadband internet access services to access their corporate VPN, there is another group of users that use broadband for VPN access such as Supermarkets to connect point of sale equipment, IP video conferencing, SAP, fixed mobile converged services and CCTV. These users have distinct requirements.

Typically the residential and small business user will purchase a broadband access service which provides internet access, email addresses, web space etc and is offered with a target minimum assured rate (MAR). For example for 2Mbit/s ADSL this is presented as a target MAR of 40Kbit/s (for highly shared service) or 100Kbit/s (for a moderately shared service)<sup>1</sup>.

In contrast a “large business” user will buy a broadband access service linking a site onto his VPN cloud and VPN hosted applications. His service comprises of guaranteed, secure bandwidth contentions such as 10:1, 5:1 and 1:1. In effect, the broadband access service acts as a leased line rather than to offer “internet” access. It is this service differentiation that leads to a break in the chain of substitution between residential and small business internet access services and “large business” broadband access services.

The retail broadband access market therefore contains two sub markets; one for the provision of *retail broadband internet access* to residential and business customers and another for the provision of *retail broadband access* to large business users.

Ofcom rightly identifies that large business customers may demand products with significantly higher specifications and quality levels than those currently offered by asymmetric broadband internet access products, for instance higher and more predictable speeds (possibly dedicated capacity) and very short repair times which are supported by service level guarantees. However, Ofcom concludes that such services will often be supported by PPCs or leased lines and accordingly Ofcom does not consider these business customers to be in the asymmetric broadband internet access market. This simply ignores the fact that many large business customers do indeed use asymmetric broadband access. Retail services based on asymmetric broadband access are actively provided for large business users. The rationale is clear – ADSL access can meet the needs of many business sites at much lower cost than related “leased lines” symmetrical services. At present, the large business broadband access market is not recognised by either Ofcom’s Wholesale Broadband Access Market Review or Ofcom’s Business Connectivity Market Review, which poses significant risk for the services it provides.

Large business users are multi site corporations that have office sites spread nationwide. Their purchasing requirements are typically for services that cover the geographic breadth of the UK. A single supplier is required to provide the VPN cloud network and the individual connections from the cloud to the local office site. The retail market for large business users is national in scope. The supply side substitution as identified by Ofcom for the residential and small business broadband internet access market does not exist for the “large business” user broadband access market. The provision of national retail VPN services is highly specialised. This market is supplied by national telecommunications providers and

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<sup>1</sup> prior to rate adaptive services this would have discussed as contention ratios of 50:1 or 20:1

specialist systems integrators. Consequently a provider of retail residential and small business broadband *internet* access is simply unprepared to swiftly enter a national market for a much broader range of services and competencies. This is recognised by Ofcom within its Business Connectivity Market Review where it is stated *“an alternative question is whether other suppliers, for example LLU operators or cable companies (potentially using LLU as an input to its VPN service) could easily supply-side substitute..... the overall conclusion is that although it is possible to upgrade these services, doing so would take considerable time and cost, such that it would not represent supply-side substitution over a relatively short timeframe.”*

The distinction drawn by Ofcom between retail services within the Wholesale Broadband Market and those within the Business Connectivity Market has failed to capture a group of retail services that are present in the market and will continue to grow in volume. Which ever retail market these users' services are included within (a sub market of the retail asymmetric broadband internet access market – the market for large business broadband access as Cable&Wireless proposes or the business connectivity market), the important fact is that they exist and the customers using them require protection in order to assure continued competitive supply.

## **Wholesale market definition**

In defining the wholesale market Ofcom includes both services that are “wholesaled” and imputed wholesale inputs that are used by vertically integrated LLU organisations.

The wholesale market currently has two distinct product offerings serving two distinct markets. Using BT's products we explain the difference in the wholesale services and why there are two separate wholesale product markets. Whilst theoretically Datastream is the regulated input following the 2004/5 market review, in practice IPStream is also within the wholesale market.

IPStream is offered at target minimum assured rates (MAR) 100kbit/s (for a moderately shared service) and 40kbit/s (for highly shared service) and targeted at mass market usage. This wholesale product is essentially broadband access. Together with this input a retailer will add access to the internet plus a variety of combinations of email and web space in order to create residential or small business broadband retail services. A retailer of internet access could not construct a retail service for “large business” users from the wholesale service IPStream as he does not have access to the Layer 2 functionality provided by the Datastream product which is in turn used by retailers supplying the large business market to flex quality of service options and obtain a guaranteed contention ratio.

Datastream is the wholesale input that retailers wishing to construct retail services for “large business” users (by this we mean large multi site, generally national

corporations) will buy. (Whilst some residential and business retailers also purchase this wholesale input, this is for reasons other than to access Layer 2 and control of MAR). Datastream allows a retailer to aggregate his own traffic, obtain access to Layer 2 of the service and control the contention of the service to a given user. This product offers more than just broadband access it also offers control of service parameters. A company requiring the inputs (Layer 2) of Datastream could not substitute for IPStream. Should a supplier of Datastream increase the price, as per the SNNIP test, a purchaser would not switch to IPStream as this service does not offer comparable characteristics to allow production of the desired end retail service. Consequently there are two distinct products within the wholesale market and there is a break in the chain of substitution between them;

- a wholesale product (currently IPStream) that provides the inputs to the retail residential and small business broadband internet access market and
- a wholesale product (currently Datastream) that provides the inputs to the retail “large business” broadband access market.

Looking to the future when IPStream and Datastream are replaced by their 21CN alternatives Wholesale Broadband Connect (WBC) and Wholesale Broadband Managed Connect (WBMC), retailers wishing to replicate the services currently provided to “large business” users will require the WB(M)C Dedicated Downstream Quality of Service component (DDQ). DDQ enables management of traffic class / QoS and MAR which like Datastream enable access to features above and beyond just the broadband ie access to enable control of service parameters.

Whilst the wholesale product will merge onto a single product portfolio it will continue to be possible to distinguish between the product components that are applicable to the supply of residential and small business services and those for “large business” users. Those serving the large business market will require the product components which replicate the capabilities that Datastream has for serving large business customers. This is evidenced by BT’s 21Consult closure document for the consultation on DDQ. Cable&Wireless suggests that the wholesale product that is an input to large business broadband services be categorised as DDQ greater than 200Kbit/s and elevated Best Effort class.

Ofcom fails to recognise that there is a distinction between the wholesale services today or in the future that are used to serve the retail broadband markets that we distinguish.

Ofcom argues that the wholesale market analysis needs to include LLUOs that self-supply wholesale broadband access. Ofcom does not examine the services that the LLUOs self-supply to determine whether LLUOs are present (and capable of switching into, or having the intent to switch into) in retail markets beyond residential and small business broadband internet access. Cable&Wireless is of the view that there are very few LLUOs capable or intent on serving the downstream retail market for large business users. During discussions on its

proposals with industry, Ofcom has presented the view that even if a LLUO was not currently engaged in serving the retail broadband access market for “large business” users, it would enter the market should the opportunity present itself as a result of a change in the competitive position.

As we discuss earlier in the section on retail market definition “large business” users are multi site corporations that have office site spread nationwide. Their purchasing requirements are typically for services that cover the geographic breath of the UK. A single supplier is required to provide the VPN cloud network and the individual connections from the cloud to the local office site. The retail market for “large business” users is national in scope. Cable&Wireless suggests that the supply side substitution as identified by Ofcom for the residential and small business broadband internet access market does not currently or prospectively exist for the “large business” user broadband access market. The provision of national retail VPN services is highly specialised. This market is supplied by national telecommunications providers and specialist systems integrators. Consequently a provider of residential and small business broadband *internet* access is simply unable to swiftly enter a national market for a much broader range of services and competencies.

To summarise our response to this question, Cable&Wireless does not believe Ofcom has properly defined the market and as a consequence competition in the supply of services to large business users could be irrevocably harmed.

**Question 2: Do respondents have any comments, additional to those made in their responses to the November consultation, on Ofcom’s proposed market power findings for the Hull area, Market 1 or Market 2?**

Cable&Wireless is of the view that there are two distinct wholesale markets served by different wholesale products:

- a wholesale product (currently IPStream) that provides the inputs to the retail residential and small business broadband internet access market and
- a wholesale product (currently Datastream) that provides the inputs to the retail “large business” broadband access market.

With respect to Market 1 and 2 BT has SMP in both of these product markets.

**Question 3: Do respondents agree with the approach set out by Ofcom for its market power assessment in Market 3 and its conclusion that there is no SMP?**

As detailed in our response to Question 1, Cable&Wireless is of the view that separate wholesale markets and products exist for the supply of large business broadband access and residential and small business broadband access;

- a wholesale product (currently IPStream) that provides the inputs to the retail residential and small business broadband internet access market and
- a wholesale product (currently Datastream) that provides the inputs to the retail “large business” broadband access market.

These two wholesale products have distinct characteristics. Purchasers requiring the “large business” user inputs would not substitute for the inputs which meet the needs of the residential and small business market.

Cable&Wireless believes that the ability for LLUO serving the residential and small business market to enter the large business market has much higher barriers to market entry than Ofcom attributes. Of the Principal Operators that Ofcom identifies all but two are primarily focused upon serving the residential/business market. Whilst Ofcom believes that consumer focused LLUOs will rapidly enter the large business market should an opportunity for entry become evident, this ignores the focus that these companies are placing on their retail objectives to up-sell to existing users and the simple fact that these companies do not have access to the core competencies required to compete in the large business market. Ofcom attributes no value to the investment in next generation core networks or services that is being undertaken by business service providers or the difference in business to consumer versus business to business retailing. Ofcom’s analysis focuses solely on the opportunity / potential benefit to sweat the LLU asset without consideration of the wider market dynamics / requirements.

Ofcom has not assessed the “large business” broadband access wholesale market to determine whether significant market power is present. Cable&Wireless believes that an assessment of the wholesale market which serves large business users would result in the finding of a national market. BT would be found to have SMP in this national market.

Currently Datastream is the wholesale product which serves this market and this service will be replaced by the 21CN services WBC/WBMC DDQ.

**Question 4: Do respondents have any comments, additional to those made in their responses to the November consultation, on Ofcom’s proposed regulatory remedies for the Hull area, Market 1 or Market 2?**

Ofcom’s proposed regulatory remedies make a modification to the obligation requiring network access to be provided on fair and reasonable terms. Previously this requirement included charges, which are specifically excluded from the proposed new conditions.

Condition EA1.2 currently in force reads:

**EA1.2** The provision of Network Access in accordance with Condition EA1.1 shall occur as soon as reasonably practicable and shall be provided on fair



and reasonable terms, conditions and charges and on such terms, conditions and charges as Ofcom may from time to time direct.

Ofcom proposes to replace this by:

**EA1.2** The provision of Network Access in accordance with Condition EA1.1 shall occur as soon as reasonably practicable and shall be provided on fair and reasonable terms, and conditions (not including charges) and on such terms and conditions as Ofcom may from time to time direct.

Ofcom does not provide any justification for this change. Cable&Wireless is of the view that at a minimum the previous wording should be retained. Symmetrical broadband services have been subject to cost orientation obligations since June 2004 and that the proposals under the Business Connectivity Market Review are for symmetrical broadband services to be subject to charge controls going forward. Cable&Wireless is of the view that symmetrical and asymmetrical broadband services need consistent regulatory treatment.

Ofcom notes, that due to the new market definitions that BT will need to prepare regulatory financial statements on a geographic basis. We look forward to further discussions in order to understand how this will be achieved. In particular we are interested to learn how future regulatory accounting / cost allocation transparency will be implemented in order to prevent cross subsidy between the newly defined geographic markets.

**Question 5: Do respondents agree with Ofcom's proposals in relation to providing affected parties with a period of notice prior to the removal of certain SMP services conditions in Market 3? In particular do respondents agree with the proposed notice period and the proposed SMP service conditions to which the notice period applies?**

In light of our comments earlier we do not believe that SMP status should be removed from BT as it remains dominant in the provision of wholesale "large business" broadband access. However we respond to this question as though Ofcom were to proceed with its current proposals and in relation to the removal of regulation of BT in Market 3 for the wholesale supply serves for the residential and small business broadband markets.

Cable&Wireless agrees that it is appropriate to provide a period of time for any necessary change – commercial negotiation with the existing supplier, commercial negotiations with potential alternative suppliers and potential physical migration to take place following the removal of SMP regulation which forces the provision of wholesale services on particular terms. Ofcom proposes a period of 12 months.

Cable&Wireless understands that Ofcom's proposals to retain the SMP obligation for the extended period are extremely limited. Ofcom proposes that connections that Cable&Wireless currently has installed remain protected but that additional connections for existing customers may not be and that new customers with new connections will not be covered. These proposals are wholly inadequate.

The obligations that continue during the notice period must include obligations to continue to supply existing customers (Communications Providers) with both incremental connection to their existing (end) customers and with new connections for new customers. For clarity, Cable&Wireless would expect during the notice period to be able to continue to operate business in the same way that it operated in advance of the market review conclusions. We continue to require the ability to add incremental sites to existing customer contracts and install sites for new customers we are in negotiations with currently.

This is essential to enable purchasers of Datastream and IPStream within Market 3 to adequately source the provision of service for this geographic area. Ceasing the obligation from the point of publication of the final statement will ultimately mean that service providers are unable to retail in that market area until such time as commercial negotiations have concluded and where necessary new business interfaces established and tested. Without adequate protection during the notice period Cable&Wireless may be unable to honour current contract commitments or sign new business until such time it has resolved its supply issues. This is not a feasible position. Ofcom may have received assurances from BT that it will continue to support existing and new connections during the 12 month transition period, but this is not enough. As currently worded, Ofcom's proposals for a transition period simply does not go far enough. BT must be required to offer new connection to contracted Communications Providers at published rates for the duration of the transition period across the UK.

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