

COLT Telecommunications

Wholesale Broadband Access Market Review

Introduction

Ofcom has rightly identified that there have been significant developments in the broadband marketplace since the 2003/04 market review was undertaken. However, COLT questions whether those developments have occurred as a result of the regulatory remedies which were put in place in the 2003/04 market review or whether they have resulted from other market and regulatory developments. COLT therefore encourages Ofcom to review the impact of the previous Wholesale Broadband Access Market Review in order to inform the decisions taken in this review.

The regulatory remedies applied in the 2003/04 review were limited to BT's DataStream offering. Subsequent market development has largely been driven by the use by competing communications providers of both upstream products (LLU) and downstream products (IPStream) which would suggest that the outcome of the 2003/04 review did not effectively address communications providers' issues with the wholesale broadband access market as defined at that time by Ofcom.

COLT believes that the regulatory remedies put in place cannot be said to have been effective in counterbalancing BT's SMP in the wholesale broadband access market. Competing wholesale access offers from other communications providers are extremely limited and simply do not meet the requirements of the market, particularly in terms of coverage, and this continues to be a concern. Consequently, and as a result of BT's regulated wholesale broadband access product not meeting market requirements, communications providers have turned to other BT wholesale products in order to provide competing services.

COLT also believes there is a huge opportunity to improve broadband services for UK businesses. 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 for two principle reasons: 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 believes that Ofcom must give further consideration to the inclusion of SDSL services within the wholesale broadband access market.

Retail Market Definition

Extent of services within the market

COLT has a number of concerns regarding Ofcom's definition of the retail market. In particular, defining the retail market as "asymmetric broadband internet access" seems to be equating broadband with internet access and nothing else, a definition which we believe is too narrow. Ofcom has argued that while there is evidence that broadband access will support the provision of other services such as VoIP, video on demand, IPTV and VPNs during the timeframe of the review, it is difficult to incorporate these services into the market analysis at this time. COLT believes that this needs further consideration, particularly in the market for the provision of broadband services to business customers where broadband access is regularly used to provide services beyond internet access.

We also note that in its definition of the wholesale broadband access market, Ofcom specifically states that wholesale broadband access must be capable of supporting broadband internet access and

“other multimedia applications”.¹ This suggests that these other applications do indeed form part of the relevant market and therefore should be considered at the retail level.

Exclusion of SDSL from the market

COLT appreciates that symmetric services are often provided to customers using leased lines or PPCs. But as Ofcom recognises, symmetric services can also be provided via SDSL. Ofcom has indicated that it believes that SDSL services remain outside of the wholesale broadband access market with demand-side substitution between symmetric and asymmetric broadband internet access limited by the large differences in price and the low value which asymmetric broadband internet access customers place on symmetric broadband internet access. Ofcom also concludes that supply-side substitution at the retail level would not provide a competitive constraint.

Ofcom’s conclusion is unduly influenced by BT’s pricing policy. Unfortunately, there is no incentive for BT to encourage take-up of a service based on a more efficient technology as it would simply cannibalise existing revenues. There is very little competition to BT in the provision of low bandwidth leased line tails, and so BT is best served by using older technology and maintaining higher prices. The result is a large price differential which prevents demand substitution.

COLT urges Ofcom to bring wholesale SDSL prices closer into line with the cost of an efficient operator, and we believe that the wholesale broadband access market review is the most appropriate place to do this. When SDSL was moved from into the wholesale broadband market review in France, the result was a greater than 50% reduction in prices. The main reason for its inclusion would be the similarities and common elements of the architecture of an ADSL and SDSL network. In a truly competitive market, these would tend to bring prices for the two services much closer together than those in the UK market today. In contrast, SDSL network architecture has little in common with that for leased lines. However, by regulating these services under the same market review, Ofcom provides credibility to the claim that SDSL should be priced very close to traditional interface circuits.

Additionally, in the 2003/04 market review Ofcom noted the potential for voice services to be provided over broadband (VOB) together with internet access using an ADSL based service. Ofcom’s conclusion was that in the future the supply of services in this way might have the potential to remove the cost difference between the provision of ADSL and SDSL broadband internet access. The common line costs associated with the SDSL service would also apply to an ADSL service where they were not being recovered from a customer taking a PSTN service.

No analysis of the impact of the development of VOB services has been given in the latest market review and COLT believes that this is an area which Ofcom should give further consideration to. VOB services have developed rapidly since the 2003/04 review was undertaken and wholesale “naked DSL” services are currently of interest to a number of communications providers. As the review is forward looking, COLT believes that it is appropriate that these developments are considered in the context of whether symmetric and asymmetric services form part of the same market.

Inclusion of residential and business in the same market

Ofcom has concluded that the relevant market is the market for asymmetric broadband internet access which includes both residential and business customers, claiming that there is an overlap in services used by residential and business customers with distinctions between services offered to each sector much reduced since the last review. Ofcom has also suggested that that it may be that suppliers will increasingly be unable to segment the market profitably between residential and business customers, an argument which COLT finds particularly concerning given the obviously segmented approach which has been taken by the majority of providers competing with BT.

¹ Paragraph 4.135

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. As Ofcom has noted, there are business customers who have and will continue to have a need for higher quality products relative to residential customers and that there are currently different asymmetric broadband access products targeted at business and residential customers. 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, particularly if Ofcom were to find that that BT did not have SMP in a defined geographic market.

Communications providers such as COLT that are focussed on the business users will continue to need access to a range of upstream and downstream products at the same time, for example because of considerations of economies of scale and density. COLT is often required to prepare proposals covering all the sites of a particular company and may not have the scale to use LLU even in densely populated areas, as the customer base would be too limited to justify the upfront investment. 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 business competition across the whole national market.

Bundling

Ofcom has concluded that there is insufficient evidence to suggest that broadband offered with other products such as line rental, calls, television subscription and mobile subscription constitute a separate product market.

While COLT appreciates that the review being undertaken is a review of the wholesale broadband access market and that the question of bundling is of most interest at the wholesale level, further consideration should be given to the bundling of services in the retail market and its potential impact on the wholesale market.

In research conducted in August 2006, Ernst & young found that 53% of those questioned already purchased broadband services as part of a bundle and that a further 24% were planning to purchase services as part of a bundle in the next 1-2 years.² This is not insignificant and as the review is forward looking further consideration should be given to the development and take-up of bundled offerings and their potential to constitute a separate market, together with their potential impact on the wholesale market.

We also understand that BT Wholesale has also announced plans to launch a wholesale converged access product in January 2008 and is currently consulting with industry on its proposals. These types of developments should also be considered in the context of this forward looking market review – as Ofcom itself notes in the consultation document, demand for wholesale broadband services is derived from retail demand.

COLT also believes that Ofcom should give further consideration to the types of bundles which are now being offered. Bundled offerings of voice and broadband internet access are now widely available and in many ways this begins moving the market much closer to SDSL, particularly where providers are taking advantage of ADSL based connections to offer VOB services. It is also important that the types of bundles offered in the business market are given full consideration. As well as offering voice and broadband internet access, these bundles very often also provide facilities such as managed services and IT. In the context of the growing availability and take-up of bundled offers, the differing needs of business customers are perhaps another indicator that there is a need to consider further whether residential and business customers really are in the same market.

² Ernst & Young, "The Bundle Jungle Navigating the UK multi-play market" January 2007

Wholesale Market Definition

Wholesale broadband access product

COLT would like Ofcom to provide clarification in terms of wholesale market definition, specifically in relation to the comment by Ofcom that the wholesale broadband access product must be capable of supporting broadband internet access “and other multimedia applications”.³ As noted above, at the retail level other services which can be provided over asymmetric access are not considered in the context of the retail market and no clarification is given as to what Ofcom means by “other multimedia applications” in the context of the wholesale market. Are these other multimedia applications part of the market and if so what are those applications?

COLT welcomes the inclusion of backhaul in the market, but believes that further clarification is needed where backhaul provided for any one access connection traverses more than one geographic market. This is discussed further below.

Bundling

COLT would like further clarification of Ofcom’s comment that over the period of this review in order to provide retail bundles it is likely that the wholesale elements will need to be obtained from different wholesale suppliers.⁴ Clearly whether this is the case will depend on the constituent parts of the bundle. If bundles consist simply of voice and broadband services then it is feasible that the necessary wholesale elements will continue to be sourced from one supplier, particularly should BT Wholesale launch a wholesale converged access product in January 2008 as planned.

Geographic Market Definition

COLT is concerned that there are a number of factors which require further clarification in relation to the conclusions which Ofcom has reached on the definition of geographic markets in the UK (excluding the Hull area).

Ofcom’s definition of the market is tied to BT’s local exchange footprint. While COLT understands the need to assess actual and potential differences in competitive conditions on a geographic basis, we are concerned that Ofcom’s approach opens the possibility of anomalies which may in themselves impact on competitive conditions within Ofcom’s defined markets. Specifically:

- COLT would like to see further analysis of the potential impact of NGN developments, particularly FTTX, over the timeframe of the review. While we appreciate that it may be difficult for Ofcom to accurately predict the full extent of these developments at this stage, the possibility of NGN developments impacting on the market is very real and needs to be fully explored and communications providers given some reassurance in terms of Ofcom’s ability to act.
- There is the possibility that the inclusion of “backhaul as necessary” will result in backhaul required for any one wholesale broadband access connection traversing more than one market. COLT believes that Ofcom should provide further clarification as to how this will work in practice should Ofcom conclude that BT has SMP in some geographic markets and not others.

³ Paragraph 4.135

⁴ Paragraph 4.138

- COLT is also concerned that Ofcom's proposed definition of geographic markets does not match the exchange banding used by BT in the commitments given in November 2006 in respect of the pricing of its wholesale IPStream product and its wholesale Broadband Connect product (when launched). COLT believes that further analysis of the potential for these differences to cause anomalies is necessary, particularly as Ofcom is not proposing that any price controls be imposed on BT.

In light of these factors and also the very limited supply of wholesale broadband access by operators other than BT, COLT also believes that Ofcom should have given consideration to the possibility of defining a national market with differential remedies, where appropriate. We note that no impact assessment has been carried out by Ofcom regarding the consequences of defining product and geographic markets as proposed. The potential impact of Ofcom's proposed changes, particularly in respect of the definition of geographic markets, is great. These impacts are relevant not only in terms of the market itself, but also in terms of the complexity and potential cost which a number of geographic markets will introduce to ongoing effective monitoring and regulation of the wholesale broadband access market.

Criteria used in assessing SMP in the markets for wholesale broadband access services

At paragraph 5.25 Ofcom discusses product/services diversification as one possible criterion for assessing SMP, however, concludes that it is not relevant to this assessment because competition in the market for wholesale broadband access is largely based on self-supply either based on BT provided inputs (LLU) or by construction of an access network (cable), with limited bundling at both the retail and wholesale levels. COLT believes that Ofcom should give further consideration to this point in light of the fact that bundled offers at a retail level are now commonplace.

In paragraph 5.28, Ofcom lists evidence of previous anti-competitive behaviour as a possible criterion for assessing SMP and concludes that it is not aware of any recent directly relevant evidence of anti-competitive behaviour in the relevant markets. Ofcom has been undertaking an ongoing Competition Act investigation into the pricing of BT's residential broadband pricing since June 2002 which has yet to be closed and in respect of which Ofcom has indicated that it believes there has been an infringement of the Competition Act. COLT believes that this ongoing investigation and its findings are relevant in the context of this market review and should therefore be considered further in Ofcom's SMP assessment.

In paragraph 5.32 Ofcom suggests that recent changes to BT's DataStream and IPStream prices are likely to reflect changes in competitive conditions. COLT believes that this conclusion requires further investigation. Given the very limited wholesale offerings available from alternative communications providers, COLT believes that competitive conditions in the wholesale broadband access market are likely to have had a limited impact on BT's decision to change its prices.

Ofcom's approach to market power assessment in Market 3

Third party supply

In paragraph 5.123 Ofcom notes that there are a number of LLU operators providing access products to third parties without any regulatory obligation to do so, however, Ofcom also notes that these LLU operators are currently only supplying wholesale products to larger ISPs. Ofcom concludes 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 states that it may be appropriate to require BT to continue to provide wholesale broadband access throughout the proposed Market 3.

COLT supports this view and specifically would point to research recently published by Ofcom in respect of niche ISPs.⁵ That research showed that niche ISPs provide connection services for approximately 1.3 million customers and serve approximately 30% of total enterprises in the UK. Given the percentage of UK enterprises Ofcom's research has shown niche ISPs serve, Ofcom's conclusion that LLU operators are currently not addressing this market and that it would take time for a merchant market to emerge, it remains imperative that such players are provided with certainty in terms of supply of service.

We would therefore urge Ofcom at the very least to ensure continuity of supply by BT throughout market 3.

Economies of scale/scope

As Ofcom has noted, 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 is concerned that Ofcom has not addressed this potential for leverage across markets, particularly should BT be found to have SMP in markets 1 and 2 but not in market 3. This is discussed further in relation to Ofcom's proposed regulatory remedies.

Countervailing buying power

The need for continued supply of services by BT 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.

Additionally, there remain a number of issues to be resolved in respect of BT's LLU product in order for alternative operators to provide an "equivalent" wholesale broadband access product. A lack of equivalence of the LLU product itself and continuing issues with service and migration would suggest that even should LLU operators choose to supply wholesale broadband access to other communications providers, it will be some time before a truly competitive offering is available.

Regulatory Remedies

COLT has a number of concerns regarding the proposed regulatory remedies and the potential impact of a finding of no SMP in market 3.

Further guidance is required as to how regulatory remedies would apply in a situation where SMP is found in some, but not all markets. For example, how would accounting separation and financial reporting requirements work where the wholesale broadband access and necessary backhaul were to traverse SMP and non-SMP markets? COLT is particularly concerned about the potential for leverage between SMP and non-SMP markets, both between wholesale markets and between wholesale and retail markets. In this respect transparency and accounting separation provisions will be vitally

⁵ Ofcom, The Communications Market Special Report Niche ISPs, 25 January 2007

important and COLT believes that at the very least accounting separation provisions should be retained in a market in which no SMP is found but which is closely related to markets where BT continues to have SMP.

COLT is also concerned that Ofcom has not assessed the impact on BT's Undertakings of a finding of no SMP. 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 important that Ofcom provide further clarification.

Ofcom has mentioned the possibility of introducing transitional measures if there is a finding of no SMP in market 3. COLT welcomes this, but would like to understand better how those measures might work. In particular, whether a sunset date would be set for removal of obligations or whether a further less extensive review would be undertaken before regulatory controls are removed. COLT believes that the latter option would be preferable as it would give the opportunity to assess whether market 3 is developing in the manner forecast by Ofcom.

We note that in the previous market review, a remedy requiring the publication of quality of service information was imposed, however in this review this remedy has not been proposed in relation to any of the markets defined. Quality of service information is particularly important to communications providers in identifying possible discrimination and COLT believes that a publication requirement should be imposed.

Alternative Broadband Technologies

COLT believes that there is a need for further consideration of FTTX, Ofcom having dismissed FTTH as "not currently being offered to broadband end users in the UK." Developments in other European countries such as Germany, The Netherlands and France would suggest that FTTX might well be more widely available during the period of the review than anyone would at the current time estimate. Even where it does not become sufficiently widespread or utilised within the period of the review to constrain prices in the wholesale broadband access market, there remain concerns regarding how fibre rollout might be used to stifle competition. In particular, if Ofcom were to conclude that different geographic markets exist and SMP was not found in all of those markets, there is a very real danger of fibre build being concentrated in non regulated markets with no clarity as to how or indeed whether it will be regulated.

While we understand that Ofcom currently considers that mobile internet access is in a separate market, we are interested that Ofcom has not identified mobile internet access as an alternative broadband technology. We believe some analysis of its effectiveness as a demand side substitute should be undertaken.