

EXECUTIVE SUMMARY

1. Cable&Wireless recognises the extensive effort that Ofcom has undertaken in conducting this important Market Review and the inherently difficult judgements which Ofcom has been required to make. Given the continuing evolution of the wholesale broadband market, it is not easy to predict with any certainty how the next phase of this evolution will unfold and therefore what the appropriate regulatory response should be. This is always an issue when trying to take a forward view and we recognise that hindsight often proves us wrong - whether industry or regulator. Three years ago the consensus was that companies like Energis could use DataStream to compete with IPStream, and Ofcom and the rest of the industry wrestled with the intricacies of the DataStream/IPStream margin squeeze rule. A year on, Ofcom announced its commitment to LLU and the world had changed.

2. So now, as Ofcom approaches this market review, it is LLU that is changing the market, offering the prospect of sustainable market entry, reducing BT's market power in wholesale broadband. LLU has reached 1.5m lines; unthinkable even two years ago. We firmly believe LLU based competition can be sustainable. There is a real danger with Ofcom attempting to make forward-looking projections about the market power of wholesale broadband players on the basis of relatively recent history, at a very early stage in the development of this market.

3. We must not forget that the success of LLU is down to considerable regulatory intervention. Ofcom's charge-setting work and the Office of the Telecoms Adjudicator have played a crucial role. But so has the regulation of IPStream and DataStream (albeit the former only 'informally regulated' through voluntary pricing commitments and the margin squeeze rule). In this nascent market, it is not clear whether the growing competition from LLU Operators has yet removed BT's ability to act independently of its competitors, or if it is the regulation of Datastream and IPStream that is constraining its ability to abuse a dominance it still has. It follows that there must be a real concern that deregulation will drive a reduction in competition.

4. The information we have to hand suggests that Ofcom should proceed with the utmost caution before removing regulation, partly because the impact of the removal of regulation is unknown, and also because the evidence on which Ofcom relies to define markets and designate SMP (or not) is

not necessarily reliable e.g. Ofcom relies quite heavily on the trend in market shares, but the actual market shares suggest a presumption of dominance.

5. One answer to this uncertainty is for Ofcom to delay its consideration of these issues another 12 months or so. This will provide another year's worth of data on the basis of which Ofcom can place sufficient store to make decisions. We will also have far more information regarding the new BT 21CN wholesale broadband products and their implications in terms of impact on network interconnection and commercial competitiveness of market players.

6. If Ofcom is unwilling to delay, Cable&Wireless is of the view that Ofcom needs to revisit its analysis to address the following points:

a) The market for wholesale broadband access is national in scope – Cable&Wireless remains unconvinced that the market is no longer a national market. We agree there are fluctuations in the levels of competitiveness and that pricing varies across the country. But do these factors suggest that separate markets are in existence? We would say no. The retail and wholesale products available across the UK are essentially homogenous. We advocate that Ofcom deals with the different competitive conditions within the UK by defining a national market (as it has historically done) and varying the remedies in a more fluid and less prescriptive manner. In this way, it can react to the evolution of the market on firmer foundations, based on a solid understanding of what has happened and not just what is predicted to happen.

Cable&Wireless also has concerns regarding the assumptions that have been used to firstly find the sub markets and then consider the existence of SMP. In some instances, the assumptions used appear arbitrary and lacking clear evidence. For example exchange size, number of suppliers, cable overlap and the presence of four network players are important factors used to determine separate markets. Whilst Ofcom gives its reasons for choosing these criteria, there is little clarity around why alternatives were discarded and evidence for the criteria chosen.

b) We believe that Ofcom overstates the competitive constraints of LLU operators who 'self-supply' only and do not therefore offer a direct alternative to BT in the wholesale broadband access market. The timing of data collection to assist in the assessment of market power is essential. We would encourage Ofcom to err on the side of caution with respect to industry forecasts given their track record for accuracy.

c) If Ofcom maintains its proposal for a sub-national markets, Cable&Wireless believes there are a number of additional steps that Ofcom needs to undertake in completing its market analysis. We suggest that greater emphasis needs to be placed within the analysis regarding the competitive benefits that BT enjoys as a national supplier of wholesale broadband services and the economies of scale and scope that arrive from ownership and management of a single national conveyance infrastructure, shared information systems (order handling gateways, billing etc) and shared people resources (product and network management). The review needs to take full account of the implications of the leverage of these factors between markets and in particular how this could (if at all) be countered.

d) Finally the remedies proposed in Market 1 (or the equivalent within a national market) are insufficient; Ofcom must consider imposing a cost orientation obligation, and associated cost accounting and accounting separation remedies.

TABLE OF CONTENTS

| | |
|--|----|
| Executive summary | 1 |
| Table of contents | 4 |
| 1. Introduction and background | 5 |
| 2. Determining the market | 6 |
| (a) geographic markets versus national markets with varying remedies | 6 |
| (b) separate wholesale broadband access markets | 7 |
| (c) assessing market power | 10 |
| (i) market share | 10 |
| (ii) the development of LLU and transition to 21CN | 11 |
| (d) conclusion | 14 |
| 3. Remedies | 16 |
| (a) accounting obligations | 17 |
| (b) transitional measures | 18 |
| 4. Response to ofcom's questions | 20 |

1. INTRODUCTION AND BACKGROUND

The wholesale broadband access market is of extreme importance to Cable&Wireless. Historically Cable&Wireless has not been a significant player in the wholesale broadband arena primarily using limited amounts of broadband access to support access to business services. Our current plans, through our Cable&Wireless Access business, firmly focus Cable&Wireless on providing wholesale broadband services in competition to BT. Utilising our LLU capability, primarily to large ISPs, but looking towards exploiting competitive alternatives in the corporate space, we are geared to enter the wholesale broadband access market as a credible alternative to BT Wholesale. *[text removed]*

Ofcom is conducting this review against a backdrop of continuing evolution. This is nothing new; the one constant in this market is the speed of change. This leaves Ofcom with a difficult task. If it over-estimates the progress of competition, and regulation is removed (or reduced) as a result, this may offer the opportunity for BT to regain its dominance of the market. Conversely, it is inappropriate for Ofcom to continue with regulation where the competitive conditions are such that this is no longer necessary.

One answer to this uncertainty is for Ofcom to delay its consideration of these issues another 12 months or so. This will provide another year's worth of data on the basis of which Ofcom can place sufficient store to make decisions. Ofcom recognises this level of uncertainty and has proposed to revisit its assessment of whether BT has SMP in Market 3 at a (slightly) later stage in this market review. To the extent that this provides more time for Ofcom to assess this market, we support this approach, but we remain concerned that the upstream LLU market may still be in a period of transition at this point and therefore forecast data will still be only that; a forecast. We understand that Ofcom will consider the robustness of LLUOs' forecasts based on historical accuracy and we applaud this approach. The communications industry has historically over-forecasted its own success and the LLU industry is no exception. Indeed, if you look at the latest report from the OTA, it shows a growing divergence between the forecasts provided in March 2006 and actual

throughput. The same discrepancy can also be witnessed in CPS and WLR. Ofcom's proposal to 'sense check' the latest data provided against historical accuracy is therefore an important and vital one. However, this may still not take us to a point at which the LLU market has stabilised sufficiently for robust conclusions to be drawn.

Of course, the industry is also in a period of transition to BT's Next Generation Network and the impact of this migration remains highly uncertain. There is still considerable uncertainty around the details of the products and commercial arrangements that will underpin the new regime which will have implications for the broadband market moving forward. Again, this suggests that it may be advisable to postpone the current review until later in 2007 or arguably at some point during 2008, when the industry, including Ofcom, will have greater clarity around 21CN developments and the potential implications of those developments. This also avoids the incentive on BT to design its products to 'game' the regulatory conclusions from this review.

In Section 2, our response considers the issues and ramifications of the approach Ofcom has taken in determining the markets. Section 3 looks at remedies, accounting obligations and transitional measures and Section 4 then addresses Ofcom's specific questions.

2. DETERMINING THE MARKET

(A) GEOGRAPHIC MARKETS VERSUS NATIONAL MARKETS WITH VARYING REMEDIES

Ofcom's approach to dis-aggregation of this market into geographic sub-markets was anticipated and we recognise the desire to identify the success of LLU and reflect different competitive conditions, particularly in respect of the remedies that may be appropriate to protect that part of the market. What is less clear from its consultation and from our subsequent discussions with Ofcom is why Ofcom has not explored further the approach of identifying one national market, with different remedies being applied to different parts of that market to reflect those varying competitive conditions.

[Text removed]

We recognise that there are fluctuations in the levels of competitiveness across the UK and pricing also varies. But do these factors suggest that separate markets are in existence? We would say no. In our view, the retail and wholesale products available across the UK are essentially homogenous. Variation occurs as a result of i) technical capability due to the subscribers' proximity to the local exchange building (with respect to bandwidth), ii) availability due to commercial economics dictating that more profitable areas will be served first, iii) BT offering a discount on exchanges that are cheaper for it to serve. In our view, BT clearly remains dominant in a national market. We advocate that Ofcom deals with the different competitive conditions within the UK by defining a national market (as it has historically done) and varying the remedies in a more fluid and less prescriptive manner. In this way, it can react to the evolution of the market on firmer foundations, based on a solid understanding of what has happened and not just what is predicted to happen.

(B) SEPARATE WHOLESALE BROADBAND ACCESS MARKETS

Cable&Wireless has concerns regarding the assumptions that have been used to firstly identify the sub markets and then consider the existence of SMP.

Whilst Cable&Wireless follows the logical approach that has been undertaken to examine the national market in order to seek evidence of any separate markets, we are concerned that Ofcom appears to have made a number of isolated judgements, without proper consideration of the cumulative effects of these judgements. In some areas, this is compounded by an apparent lack of evidence supporting Ofcom's conclusions. We fully recognise that it is not an easy task, but Cable&Wireless suggests that Ofcom revisits the assumptions it has made and reconsiders its proposed conclusion that genuinely competitively distinct markets exist. It is this cohesive view that we lack; whilst taking the analysis step by step we may see logic in the approach Ofcom has taken, when we stand back and review the process, assumptions and conclusions as a whole, we are unable to substantiate the results.

Ofcom commences its analysis by looking at the alternative modes of supplying broadband services; BT via its national copper network; LLU, again via BT's national copper network; and Cable. LLU is acknowledged to be commercially viable only in certain circumstances and as such, Ofcom looks only at the LLU exchanges that LLU operators have unbundled or propose to unbundle. The relevant LLU exchanges are then re-examined to include only LLU operators that Ofcom defines as Principal Operators, i.e. those that plan to serve a significant proportion (10%) of the population. Given that this breakpoint eliminates all of the niche LLU operators from the analysis and that the number of players serving between 10% and 40% of the population remains steady, Cable&Wireless does not challenge this assumption. Ofcom, however, ignores whether the Principal Operator actually provides wholesale broadband services, choosing to include operators that use LLU for self provision alone. We discuss the appropriateness of this later.

The next phase of the analysis combines two important assumptions:

1. the appropriate number of players at any given exchange location and
2. the appropriate size of an exchange in order for it to be considered as more likely to attract competition than a smaller exchange.

Ofcom presents data which illustrates the number of operators present at exchanges and the proportion of the population covered by these exchanges.

Justifying a split between Market 2 and 3 Ofcom states "*The geographic areas where there are only two Principal Operators present are unlikely to have similar competitive conditions as those geographic areas where there are ten Principal Operators present. Whilst it is difficult to identify a definitive and unambiguous break in the competitive conditions, Ofcom believes that it is appropriate to define a further break between these extremes for this reason. Ofcom believes that this break falls between areas where there are three Principal Operators and those areas where there are four. The rationale for this proposal is that, as the number of Principal Operators competing with one another increases, the incremental effect on competitive conditions of an additional competitor is likely decrease.*"

As a first step, we do not think Ofcom has provided convincing evidence for its assertion that four operators is the appropriate 'break point'. In a mature market, where barriers are high and products are homogenous, it is highly feasible that the number of players required for effective competition will be relatively small. But in

a newly developing and changing market it is to be expected that there will be a higher number of operators entering the market, some of whom will probably leave over time as the market matures and prices become less elastic. In an immature market with developing competition, some degree of regulatory protection is essential to ensure that the market can find its own level without the restraints imposed by one operator having very high levels of market share and no regulatory constraints.

The number of operators in a market is obviously important, but the relative market shares of those operators is a key indicator of the level of competition in that market. Ofcom does not at this point in the analysis look to the market share indicator. If it did, it would find that the competitive conditions between the four operators it deems that are necessary to form a more competitive market were far from homogenous. BT's market shares for Market 3, across all the time frames examined, are around or above levels considered to be dominant. Presently BT has a market share of 56% across Market 3. Cable has a market share of 34% and the remaining LLU operators between them share 10%. However, this 10% does not necessarily equate to 5% for each of the two LLU operators required to make up the 4 operator market definition and indeed in some exchanges there are eight LLU operators present, resulting in insignificant shares for each of those operators. Ofcom's projected market shares for Market 3 show that even in the worse case, BT's market share remains within the realms of dominant levels (around 40%) and could realistically continue to be around 50% in the medium term. Ofcom fails to address the relative insignificance of the (minority) market shares of each of the LLU Operators, which we suggest demonstrates the limited competitive constraint offered by those LLUOs and the lack of homogeneity in the market. Cable&Wireless therefore seeks further evidence as to the competitive homogeneity in the proposed sub markets.

The second important assumption that Ofcom makes is that exchanges which have 10,000 or more connected subscribers fall into Market 3. Again Cable&Wireless is unable to determine from the information provided why the figure of 10,000 has been selected. *[Text removed]*

Cable&Wireless would welcome further clarity as to how Ofcom came to the choice of 10,000 subscribers per exchange in this context.

(C) ASSESSING MARKET POWER

(i) Market share

When considering the evidence of SMP, the first indicator that Ofcom reviews is the level of BT's market share. This is only one of many indicators, but it is clearly a significant one. Ofcom concludes that BT has SMP in Market 1 in part due to the fact that it has 98% market share. Ofcom concludes that BT has SMP in Market 2 in part due to the fact that BT has 73% (possibly falling by Jan 2008 to between 60 and 67%) market share. Cable&Wireless agrees with Ofcom's conclusions.

Whilst Ofcom does not at this stage of consultation attempt to make a SMP finding with respect to Market 3, Cable&Wireless would like to provide a view as to our expectations of any future finding based on the information we have today, in particular evidenced by market share indication and the current market evolution.

As touched on previously in this response, Ofcom determines that four operators are sufficient to determine a competitive functioning market. However, the relative market shares of those operators are the key indicator of the level of competition. Presently BT has market share of 56% (considerably beyond the level presumed to dominant and beyond what is regarded by established case law as very large market share, in excess of 50%). Cable has a market share of 34% and the remaining LLU operators between them share 10% (in some exchanges there are eight LLU operators present!). Ofcom's projected data for Market 3 estimates BT's market share, at between 40% and 50% - still indicative of dominance. Most worryingly these reductions in BT's market share are all reliant upon the success of LLU operators who in turn are reliant upon BT for this upstream input.

One issue that Ofcom does not explore is that of sustained competition over time. The market share of some of the operators in Market 3 is quite small. Maintaining a presence in the market over time may become difficult if obligations on BT are removed prematurely, not least of all if there is no obligation not to discriminate. Once operators leave the market it is very unlikely that they will re-enter at a later date. Whilst this may be a sign that operators are inefficient, it is also a characteristic of a market where one operator has SMP and is able to squeeze competition out of the market to the detriment of consumers.

Whilst a declining market share of BT in Market 3 implies increased competition, it is important that regulation is not prematurely removed. Ofcom itself makes the point that should it decide that there is not a finding of SMP, operators will be provided with sufficient notice to avoid any detrimental effects on consumers in the short term.

On a practical level, it makes more sense for Ofcom to retain regulatory obligations on BT until such time as the market can be deemed to be competitive, rather than to remove regulation prematurely with the risk of having to re-impose it should levels of competition in the market decline and BT's market share start to increase beyond dominant levels.

(ii) The development of LLU and transition to 21CN

Ofcom considers the competitive constraint offered by alternative providers at any given exchange. Cable&Wireless believes that Ofcom overstates the competitive constraints of LLU operators who 'self-supply' only and do not therefore offer a direct alternative to BT in the wholesale broadband access market.

Whilst we recognise that 'self-supplying' LLU operators cannot be entirely ignored, we have significant concerns over the reliance on their ability to provide a competitive constraint when they do not offer their services on a wholesale basis – in our view they do not operate in the market but simply traverse it. The majority of LLU operators, and indeed the cable operator, are focussed solely on self-supply. Whilst we concur that self-supply LLU operators provide a level of constraint on the prices BT could charge for their own wholesale broadband products, (via, effectively, a constraint on retail prices that flows from self-supplying operators) they cannot provide the same level of constraint that would be witnessed with true wholesale competition.

[Text removed]

[Text removed]

[Text removed]

The costs and time associated with setting up inter-operator portals and processes are significant barriers to market entry and switching.

There is, of course, the potential that even where there are alternative wholesale providers present at any given exchange, those wholesale providers may not be prepared to offer their services to all retailers. This may be particularly relevant for smaller ISPs, or those looking to service niche markets. *[Text removed]*

This could leave a sector of the retail market with nowhere to go but BT. Ofcom recognises this as a potential issue, but dismisses it as a concern on the grounds that a merchant market will develop if the demand is there. Given our comments above regarding the cost of developing wholesale capability, we are

not convinced that this assumption will hold true. Ultimately, if this situation were to manifest itself, the detriment would be to consumers.

Whilst this position may appear extreme, there is no previous experience available of BT's willingness to supply products in the absence of a regulatory obligation to do so.

Cable&Wireless remains of the view that the current national market for wholesale broadband access is more accurately assessed based on geographies / exchanges for which there is alternative "wholesale" (not self supply only) competition and where there is not. The question mark to be addressed here is whether a single wholesale supplier alternative to BT at an exchange is sufficient or whether both alternative wholesale suppliers need to be present as a minimum. Indeed, using Ofcom's own assessment of an appropriate number of operators (for a competitive environment to be considered) it could be argued that a minimum of three alternative wholesale providers is required before competition can be considered effective and capable of delivering the best outcome for consumers.

In our discussions with Ofcom since the publication of the Market Review consultation, Ofcom has consistently argued the legitimacy of their approach to include self-supply. Cable&Wireless recognises that self-supply is not irrelevant in the consideration of the wholesale broadband market, but would argue that it must be considered as a lesser competitive constraint, which would significantly alter Ofcom's conclusions on the outcome of this review. We request that Ofcom reviews its analysis with a view to adopting a methodology which moderates the impact of operators not active in the supply of wholesale services, at the very least to understand the sensitivities of Ofcom's model. *[Text removed]*

In discussions with Ofcom, we have raised concerns at the mis-match between the geographic boundaries that have emerged from Ofcom's analysis of the market and the location of the 20 aggregation points required to support BT's new WBC product. The mis-alignment of these two factors results in a need for a purchaser of WBC to connect to all 20 points (or possibly the majority of those 20 aggregation points) even if they are a significant user of LLU, in order to in-fill in those areas where it is not unbundled. Similarly, a purchaser of wholesale broadband access would face the same dilemma, leaving it unlikely that they would combine their purchase with wholesale broadband based on another suppliers' LLU coverage even where available, in order to maximise their investment in these aggregation points. *[Text removed]*

Furthermore, unless a market emerges in aggregating traffic from the 20 WBC interconnection points into one wholesale product, BT will gain a de-facto dominant position in conveyance between these areas, which will impact on their dominance of the WBA geographic markets¹.

(D) CONCLUSION

If Ofcom maintains its proposal for a sub-national markets, Cable&Wireless suggests there are number of additional issues that Ofcom needs to give further consideration to in completing its market analysis.

Cable&Wireless believes Ofcom pays insufficient consideration to the market share distribution between the relevant players and that two additional criteria for assessing SMP must be included with the analysis;

- i) the impact of having a highly developed distribution and sales network; and
- ii) the capability of BT to leverage from adjacent horizontal markets.

Opportunities for leverage between the proposed three markets occur at multiple levels:

1. information systems – order handling gateways, billing systems,
2. BT's network topology – conveyance routes,
3. people resources – product management, network management (provisioning and repair)

These functions do not (currently) conform to regulatory boundaries. Each of the regulatory markets identified share these resources and the economies of scale and scope they present. Clearly there is cost leverage advantage of these functions between the proposed markets.

Ofcom must give further consideration to the benefits and opportunities BT enjoys from these functions as a result of its national ubiquity, as compared to its competitors.

¹ Our understanding to date evidences significant obstacles within the commercial design of the WBC product which do not facilitate easy switching between wholesale / backhaul and core suppliers

Exploring each of these in turn, BT requires a single ordering interface with its upstream division in order to provide a national broadband service. To achieve the same, an LLU operator requires its internal ordering interface (to Openreach) and then at least one other interface with BT. However, should BT decide to not offer supply in areas where it may become deregulated, additional interfaces could be required with other LLUOs in order to fill in black holes of supply. The cost and time associated with establishing, maintaining and operating these multiple provisioning interfaces does not appear to have been considered in Ofcom's analysis.

Next we turn to BT's network topology. Ofcom has chosen to group the markets by exchanges. This, on the face of it, would appear to be a reasonable basis on which to dis-aggregate markets. However, exchange sites are connected together via trunk routes. There is no discussion around the building up of the exchange locations into a service proposition that brings together broadband origination, backhaul and conveyance. Ofcom discusses the removal of the distinction between these three service elements for the future wholesale broadband access product solution. Cable&Wireless suggests that far greater consideration be given to the manner in which individual exchanges sites share conveyance routes and the manner in which conveyance routes are shared between the proposed regulated markets. We are already aware that BT's proposed 21CN wholesale broadband access solution will have 20 points of aggregation / interconnection and that customers will be homed randomly on these points. This means that customers that fall within Market 3, for example, could be homed on an aggregation point located within the geographical reach of exchanges in Market 1 and / or 2. Ofcom does not offer any view as to how we can be assured that the costs associated with serving Market 3 are somehow not attributed to serving Market 1 and / or 2. This is a situation unique to BT.

Finally we identify the ability to leverage via people resources – product management, network management (provisioning and repair). BT requires a single product management resource, the costs of which can be proportioned between the entire national market, whereas other providers will face the costs of BT's PPP, in addition to their own product management costs, within their LLU footprint.

In our view, BT's opportunity to leverage its economies of scale and scope between the three markets goes to the heart of this review. The prospect of a deregulated Market 3 against this backdrop is a cause for concern. Without some *ex-ante* restraint, there will be considerable opportunity for BT to inappropriately

allocate costs to Market 1 (and possibly 2) to enable it to cut its costs and by default undermine competition in Market 3.

This issue of leverage is further complicated by the move to 21CN. In this transitional phase, any inappropriate cost-allocation may not be immediately apparent. BT's own voluntary price commitments are just that: voluntary. They are also opaque. BT has not made available details of the price floors that apply to these commitments, leaving the opportunity for leverage clearly on the table. And in any case, they expire shortly after the likely completion date of this market review.

We would also be interested in Ofcom's views on potential opportunities for vertical leverage in the absence of continued regulation, which is not discussed in the consultation. Cable&Wireless was interested to note that in its Q3 results (published 9th February 2007), BT announced that its retail arm secured 34% of new DSL-based broadband connections during the reporting quarter. This is higher than BTR's latest market share for the broadband market overall and highlights the ongoing incentive for BT as a whole to 'game' its wholesale costs in order to favour its Retail business.

Ofcom also touches on the issue of bundling in relation to BT's economies of scope and suggests that other providers have equal (albeit different) opportunities to benefit from such economies through bundling. However, we would welcome Ofcom's more detailed consideration of this issue in light of BT's current proposals for its Wholesale Converged Access product. There is a very real danger that in the absence of regulation, BT could exploit the pricing of this product to the detriment of competition in those unregulated markets.

3. REMEDIES

Cable&Wireless has expressed concerns with respect to the completeness of the market analysis and market power assessment. Laying these views to the side, we provide comments on potential remedies.

(A) COST ORIENTATION

We are surprised that Ofcom has not proposed to introduce a cost-orientation obligation, particularly in Market 1 where competition is unlikely to develop. It is vital that BT is required to base its charges on properly allocated costs, with an appropriate mark-up to reflect its cost of capital. It is only with this constraint that Ofcom can ensure that BT does not leverage either its dominance in this market, or its own vertical integration to the detriment of competitors and more importantly, consumers.

Ofcom does not explain its dismissal of cost-orientation obligations. Rather, it categorises such obligations under the broader heading of Price Controls and makes its arguments on the potential detrimental effects of Price Controls at this stage in the evolution of the WBA market. We agree that Price Controls *per se* would be inappropriate at this time. However, cost orientation is a distinct requirement and we strongly believe it has an important role in this market

We recognise that a cost-orientation obligation may be less appropriate in markets where there is at least some prospect of competition, namely markets 2 and 3 as currently proposed, although other remedies, including non-discrimination and transparency obligations, are vital across all geographies.

(B) ACCOUNTING OBLIGATIONS

We welcome Ofcom's proposals to include an obligation to account separately. The areas of cost accounting and accounting separation are particularly important and will need some development with the introduction of separate geographic markets or even varying remedies between geographies. Cable&Wireless believes that this is an area where Ofcom should give further consideration.

It is worth considering the current reporting with respect to this market. Several things stand out:

- BT made 26% return on capital employed in this market last year;
- No external sales were reported from this market last year;
- There is very little detail behind the internal sales (e.g. volumes);
- No details of how BT has allocated costs to broadband conveyance were provided.

The high return on investment may be explained by BT's commitment not to decrease prices until 1.5m lines had been unbundled. However, there is no way to determine whether this excess profit is

indeed earned in those popular exchanges where LLU is to be encouraged or whether some comes from small exchanges where competition is unlikely to exist. Furthermore, with IPStream sales excluded from the market and no detail provided on internal sales there is no prospect of confirming that no undue discrimination has taken place. The existing reporting is inadequate and Ofcom must address that in this market review.

Ofcom suggests that by imposing a requirement to account separately it will be possible to ensure that BT does not discriminate in favour of its own downstream business or that it is earning excessive profits. There are some key issues that we believe Ofcom should address:

- Whether an accounting separation obligation is sufficient to require the necessary cost information, such as overall cost and any cost differences between internal and external supply. Alternatively, a cost accounting obligation may be required in addition;
- How BT will be expected to provide information relating to specific geographic regions (or markets) in a manner that can clearly demonstrate that common costs between different geographies are allocated appropriately;
- Should Ofcom find that BT does not have SMP in Market 3 how it will use its powers to require the accounting information is provided for that market that gives the complete picture required to ensure compliance in other geographies;
- Ensuring that the existing inadequacies in the reporting of internal and external sales are resolved.

(C) TRANSITIONAL MEASURES

In the event that Ofcom find that BT does not have SMP in Market 3, it has commented that it would consider imposing transitional measures to provide a glide path towards deregulation.

C&W concurs that some form of transitional measures will be crucial in this scenario. This would allow operators to consider and implement any change in strategy considered appropriate to counter the anticipated effects of the withdrawal of regulation from this market.

In order to determine the appropriate glide path towards full deregulation, Ofcom must consider the manner in which the current products are being used and forthcoming changes within the wholesale broadband access market, i.e. the move to 21CN services. In the event that BT was no longer required to provide its existing (or future) products in a given market, we may face a significant task of agreeing and deploying an alternative form of supply for each and every customer. Given the complexity of this undertaking, it seems appropriate that any transitional arrangement include, as a minimum, a requirement upon BT to give a period of 24 months notice that it no longer intends to supply wholesale broadband access services to a given customer in a given location.

4. RESPONSE TO OFCOM'S QUESTIONS

- 1. Do respondents consider that the regulatory remedies put in place in the 2003/4 market review were effective in counterbalancing BT's and Kingston's SMP in the relevant markets?**

Cable&Wireless understood the objective of the last market review to ensure that i) companies were able to enter the market at economically efficient points i.e. via LLU further upstream, intermediate wholesale DataStream and resale via IPStream, ii) offer their services nationally, iii) be able to fully utilise their own network infrastructure and iv) differentiate their service proposition.

In our view the remedies that Ofcom put in place were the best that could have been conceived at that time. With the advantage of hindsight we now understand that the economics of DataStream means that even this product is rendered (in addition to LLU) unviable in certain geographies. The UK topology is such that a variety of supply mechanisms will be used in order to ensure an end user has broadband access.

An important development since the market review has been the requirement for EoI for IPStream and BT's voluntary acceptance of EoI for DataStream. EoI for the 21CN successor will be equally important.

Looking forward, we would hope that we can learn from the importance of building regulatory remedies at the outset that provide efficient mechanisms that enable simple end user migration, simple backhaul and core conveyance migration (with minimal and ideally no disruption or need for physical migration by the end user).

- 2. Do respondents agree with Ofcom's definition of the retail asymmetric broadband internet access market in the UK?**

Yes

3. Do respondents agree with Ofcom's definition of the wholesale broadband access product markets?

Cable&Wireless largely agrees with Ofcom's assessment.

However, we believe the issue of bandwidth will prove to be a significant one over the period of this review. Whilst in its consultation document Ofcom states that higher bandwidths are considered to be included within the scope of the market, subsequent discussions have left us with less certainty that this would be the case. We would welcome Ofcom's further assurance that any regulatory conditions resulting from this review would apply to any bandwidth and any change to this position would be subject to a further market review.

4. Do respondents agree that the Hull area should be defined as a separate geographic market on the basis of the presence of common pricing constraints?

Yes

5. Do respondents agree with Ofcom's methodology for assessing geographic variations in the competitive conditions in the wholesale broadband access product markets?

Cable&Wireless has a number of concerns with the approach that Ofcom has adopted in order to assess geographic variations in the competitive conditions in the wholesale broadband access product market. Our detailed comments can be found in Section 2.

6. Do respondents agree with Ofcom's analytical framework for defining geographic markets in the UK?

Cable&Wireless agrees with the logical approach that Ofcom has undertaken but has reservations regarding the number of assumptions that one is required to make in order to arrive at Ofcom's conclusions. We seek from Ofcom further discussion on these assumptions accompanied with greater evidence supporting their selection. Our detailed comments can be found in Section 2.

7. Do respondents agree that Ofcom has used relevant criteria for assessing SMP in the markets defined?

Cable&Wireless believes in addition to the criteria already used by Ofcom in assessing SMP several extra important criteria warrant greater attention / inclusion. Cable&Wireless believes Ofcom pays insufficient consideration to the market share distribution between the relevant players and that two additional criteria for assessing SMP must be included with the analysis i) the impact of having a highly developed distribution and sales network and ii) the capability of BT to leverage from adjacent horizontal markets. Our detailed comments can be found in Section 2 / Conclusions.

8. Do respondents agree with the approach set out by Ofcom for its market power assessment in the Hull area and its conclusion of finding Kingston to have SMP?

Yes

9. Do respondents agree with the approach set out by Ofcom for its market power assessment in Market 1 and its conclusion of finding BT to have SMP?

Cable&Wireless has a number of concerns around Ofcom's approach in assessing market power which we explore in detail in Section 2.

However, we concur with its conclusion that BT has SMP in Market 1.

10. Do respondents agree with the approach set out by Ofcom for its market power assessment in Market 2 and its conclusion of finding BT to have SMP?

Cable&Wireless has a number of concerns around Ofcom's approach in assessing market power which we explore in detail in Section 2.

However, we concur with its conclusion that BT has SMP in Market 2.

11. Do respondents agree with the approach set out by Ofcom for its market power assessment in Market 3?

We have a number of concerns around the apparent lack of evidence that underpins some of Ofcom's conclusions, which in turn impacts on the robustness of those conclusions themselves. We explore these concerns in detail in Section 2.

In light of these concerns, we do not support the approach set out by Ofcom for its market power assessment in Market 3.

12. Do respondents agree with Ofcom's proposed regulatory remedies on Kingston in relation to the market for wholesale broadband access in the Hull area?

Yes

13. Do respondents agree with Ofcom's proposed regulatory remedies on BT in relation to the market for wholesale broadband access in Market 1 and if so are there any particular implementation or compliance issues that you believe need to be considered?

We concur with the inclusion of those remedies Ofcom proposes to impose in Market 1. However, we do not agree with Ofcom's conclusion that there is no requirement for Price Controls, specifically a cost-orientation obligation, in this market. This market is, by

definition, one where competition is unlikely to develop and as such, it is vital that BT is required to base its charges on properly allocated costs. Ofcom may argue that the other proposed remedies (such as accounting separation and regulatory financial reporting) will address any concerns over the proposed lack of cost-orientation obligations. However, we are not convinced by the arguments Ofcom offers in its consultation and indeed, Ofcom does not explain its dismissal of cost-orientation obligations at all; rather, it categorises such obligations under the broader heading of Price Controls and makes its arguments on the potential detrimental effects of price controls at this stage in the evolution of the WBA market. We don't disagree that Price Controls *per se* may be inappropriate at this time. However, cost orientation is a different requirement and we strongly believe it has an important role in this market.

We consider this issue in greater detail in Section 3.

14. Do respondents agree with Ofcom's proposed regulatory remedies on BT in relation to the market for wholesale broadband access in Market 2 and if so are there any particular implementation or compliance issues that you believe need to be considered?

Again, our concerns with the remedies proposed for Market 2 primarily reflect our underlying concern that Ofcom has not properly assessed the true level of competition in the wholesale broadband market and as such, the remedies propose for Market 2 may not be sufficiently inclusive. We would repeat our arguments made in response to question 13 (above), that it is vital that Ofcom considers a cost orientation obligation in this market, given the limited competition that currently exists and the resultant ability for BT to leverage its dominance from this market to other markets, and its own vertical integration.

15. Do respondents agree that the alternative broadband technologies referred to in this annex are unlikely to be sufficiently widespread or utilised within the period of this review to constrain prices in the market for wholesale broadband access services?

Even though there will always be uncertainty about the future of emerging technologies, we agree with Ofcom's judgement at this stage. We cannot see any of these technologies used to an extent that would cause transformation of the broadband environment in the next few years. The main reasons, covering most of the technologies mentioned, are:

- significant investment required to deploy infrastructure for new technologies
- customer resistance for use of wireless methods, often perceived as unreliable
- existing carriers' lack of interest and scarcity of resources, with LLU or Next Generation deployment taking precedence