Viatel's response to Ofcom's consultation on its review of the Wholesale Broadband Access markets

Executive Summary

The regulation of wholesale broadband access both at an EU level and at a national level in the UK has tended to focus on facilitating investment in local loop unbundling and the provision of mass market products to consumers. Whilst this focus on consumers is understandable, we believe that Ofcom could do more to develop and strengthen competition in the provision of business services by encouraging the provision of low cost, fit for purpose access products for business providers.

The aim of the European regulatory framework is to foster competition, investment and innovation to help meet the objectives laid down in the i2010 Agenda[1] and the Lisbon Agenda[2]. Businesses of all sizes increasingly depend on data communications services, and they are a key driver of productivity growth in the UK.

We do not believe that Ofcom's assessment of the competitive conditions in the wholesale broadband access market reflects the current state of the market, nor that which is likely to develop throughout the period of the review. In Viatel's view, the competitive conditions in the wholesale market are sufficiently homogeneous in all parts of the UK (except Hull) as to indicate a national market.

A finding of sub-national geographic markets could lead to the removal of necessary "rungs" on the ladder of investment, which would disproportionately impact niche providers. Providers for business customers, unlike those serving the residential market, often have to provide the same service to a single customer across a number of geographic regions. Dividing such regions into separately regulated geographic markets is only likely to undermine the ability of alternative providers to procure the provision, from a single supplier, of a generic, cost-effective access product.

We would additionally welcome more discussion about the point in the network at which wholesale broadband access should be supplied and the extent to which Ofcom intends to issue specific directions to BT where SMP is found. This applies not only to new products on BT's 21st Century network, but also to existing products that should continue to be regulated during the lifetime of this review. Further consideration should be given to the regulation of both IP Stream and Datastream given that, in a post-Undertakings environment, IP Stream does not "consume" Datastream. IP Stream is a bitstream product, not a resale product, and should be regulated accordingly.

[1] The Commission's strategy to promote the digital economy and to boost efficiency throughout the economy through the wider use of ICTs
[2] Europe's programme to encourage growth and jobs.

When assessing the extent of BT's market power, Ofcom has taken into account self-provisioned sales of other operators. We believe that Ofcom should give more consideration to the actual likelihood (both technically and strategically) of BT's competitors releasing wholesale capacity to third parties.

Finally, we will be making the following more specific points:

(i) In addition to the remedies proposed in this consultation, Ofcom should impose price controls where SMP is found.

(ii) BT should make available wholesale broadband products with the option of service level guarantees for a reasonable additional charge.

(iii) The market for wholesale broadband services should include both symmetric and asymmetric products.

(iv) Viatel believes that the broadband market includes cable at the retail level but not at the wholesale level.

Question 1:Do respondents consider that the regulatory remedies put in place in the 2003/04 market review were effective in counterbalancing BT's and Kingston's SMP in the relevant markets?

In the 2003/4 review, Oftel found BT to have SMP in the asymmetric broadband origination and broadband conveyance market in the UK. Amongst other remedies, Oftel required BT to provide ATM interconnection (Datastream) on a "retail minus" basis. Oftel chose not to impose regulatory obligations on BT in respect of IP Stream. This was justified on the basis that IP Stream was a "resale" or "intermediate" product, rather than a product falling within the wholesale broadband access market.

Viatel believes that IP Stream was and is part of the wholesale broadband access ("WBA") market and that Ofcom should have conducted an SMP assessment accordingly. The ERG's Common Position on Bitstream Access[3] defines "simple resale" as :

> "the incumbent provides the DSL access link plus a backhaul service and also provides the *connectivity* to the public IP network of the World Wide Web. … The new entrant does not need to run his own infrastructure, the only thing he has to do is to market (brand), distribute and bill the product."

This is not an accurate description of IP Stream, which does require the Communications Provider ("CP") to own its own infrastructure and to provide internet access.

When defining bitstream, the ERG also explains:

> "In order to be able to differentiate their services (including such services as VoIP) from those of the incumbent, new entrants must have access at a point where they can control certain technical characteristics of the service to the end-user and/or make use of their own network … thus being in a position of altering the quality (e.g. the data rate or other features) supplied to the customer."

IP Stream does allow a certain amount of differentiation - for example, it could be used to provide a private circuit for an end user or as part of an IP VPN; the CP is also able to apply overbooking to the central connection. Pure resale would be more akin to BT's "Managed Broadband" product.

Viatel purchases both Datastream and IP Stream from BT Wholesale and uses both products as an input to services provided to both resellers and end users. IP Stream can be used to provide a (differentiated) VPN service, whereas Managed Broadband cannot.

Ofcom's application of the margin rule, and the voluntary pricing commitments given by BT, put purchasers of IP Stream at an unfair disadvantage to both BT's retail arms and to other CPs who were able to use LLU as a cost base. Whereas Ofcom has described IP Stream as an "intermediate" product, we would argue that IP Stream and Datastream are both intermediate wholesale products, sitting as they do between resale and full access to infrastructure.

[3] ERG (03) 33rev2

It may have been envisaged at the time of the 2003/4 review that Datastream would be purchased by CPs and used to provide an intermediate wholesale product to ISPs in competition with BT's IP Stream. However, this did not happen to any material extent and the two products now exist side by side. We therefore believe that BT should have been and should now be required to offer IP Stream on a retail-minus basis, without reference to Datastream pricing.

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

2.1 **Ofcom finds cable in the same market as ADSL**

Viatel agrees with Ofcom in the case of the retail market only.

2.2 **Ofcom finds narrowband to be a separate market from broadband**

Viatel agrees with Ofcom.

2.3 **Ofcom finds asymmetric and symmetric broadband in separate markets**.

In Viatel's view, asymmetric and symmetric broadband are in the same market – the market for broadband access, at both a retail and wholesale level. In the retail market place, the line between symmetric and asymmetric services is becoming increasingly blurred. Most residential customers who buy ADSL products may not be aware that their upstream capacity does not does match their downstream speed. However, demand is likely to increase over time as awareness and use of bandwidth-intensive applications increases. Although residential customers would be unlikely to want to use SDSL in its current form (mainly due to its higher price), products such as ADSL Max and ADSL 2+ will give consumers greater upstream speeds.

For business customers, we believe that the chain of substitution runs all the way from asymmetric broadband, through SDSL, to leased lines and Ethernet connectivity and beyond. All these products may be substitutable to some degree depending on cost, speed/ bandwidth, quality, security, availability and so on.

BT may take the view that, over time, the demand for SDSL will be eradicated as products such as ADSL 2+ come on line[4]. However, ADSL 2+ will probably only be rolled out in line with BT's 21st Century network, so that it will not be available nationwide until 2012. This market review is likely to cover the period until 2010 only, during which time a regulated SDSL product should be made available.

Although there is some substitutability at the retail level between uncontended SDSL and leased lines, there is also substitutability between uncontended SDSL and uncontended asymmetric Datastream, especially when supplying VPNs.

At the wholesale level, SDSL is purchased as a variant of both IPStream and Datastream. It is an add-on to these products and no additional interconnect link is

[4] ADSL 2+ with Annex M allows the CP to allow greater upstream bandwidth, by reducing the downstream bandwidth, thus shaping the product to offer a symmetric service.

required. So, given that this market review is considering the market for wholesale broadband access, it would seem spurious to exclude a product that is, in reality, a wholesale broadband product.

Ofcom cites the fact that SDSL costs “considerably more” than an ADSL service. However, we believe that, were BT required to offer SDSL at cost-oriented prices, then the difference in price would not be as great as it is today. (It is less clear whether this benefit would be felt if a retail-minus approach were to be applied.)

BT may feel that the demand for SDSL is not high enough to justify roll-out to further exchanges. However, we have found that demand for SDSL is increasing as customers are becoming more aware of it and much of that demand is unsatisfied because of the lack of availability.

2.4 **Ofcom finds that residential and business asymmetric products are in the same market**.

Ofcom bases this finding on the fact that some businesses purchase products aimed at residential customers and the fact that there is a chain of substitution linking products of higher quality and higher price with products lower down the quality/ price scale. We accept Ofcom’s point that, as upstream speeds continue to improve over the period of the review, the substitutability between business and residential products will increase.

However, practical experience in the market place suggests that the product features and service wrap required for the business and residential markets are, and will continue to be, very different. At the present time, we are experiencing unacceptable levels of service in respect of all of the IP Stream products (be they “Home”, “Office” or symmetric) in terms of provisioning and fault repair. Customers are able to purchase “Enhanced Care” packages, but we are finding that BTW and/ or Openreach are simply failing to meet the commitments in the Service Level Agreements. Business providers need wholesale broadband products with the option of service level *guarantees* provided at a reasonable additional charge.

Further, we believe there is a strong distinction between residential and business products (and the wholesale access products on which they rely) in terms of the geographic scope of the market. As has been noted by the European Regulators Group (“ERG”):

> “…while city suburbs are generally thought to be fertile territory for market players which seek to offer broadband services to residential consumers via unbundled local loops, the same may not be the case for providers which address only the corporate market. There may be insufficient density of corporate customers to justify the overheads of using unbundled loops in such areas. In these cases, the competitor would need to rely on bitstream services.”[5]

In our view, this clearly underlines the fact that the features that led Ofcom to consider that the market for residential broadband should be divided along geographic lines (in

[5] Revised ERG Common Position on the approach to appropriate remedies in the ECNS regulatory framework; ERG (06)33

particular population density and availability of LLU or alternative access products) do not readily apply to the business market.

In order to ensure the further development of competition between broadband providers to the business community, focus needs to remain on ensuring the availability of nationally regulated wholesale access products, enabling in particular the ability for wholesale products to be sourced from a single provider.

One illustration of the importance of such an approach is the case where a CP may be bidding for the business of multi-site customers. The CP will know the *number* of sites that require connection (for example to an IP VPN) but will not know the location of those sites. They would not be able to quote an accurate price unless they could be sure of their input costs from a single provider for all the sites. The CP would not be able to match different sites (which could number several thousand) to different supplier footprints at the time of bid.

This example also illustrates that the retail products sold by CPs to business customers (such as IP VPNs) are, more often that not, different from those sold to residential customers (broadband internet access).

Question 3: Do respondents agree with Ofcom's definition of the wholesale broadband access product market?

Inclusion of both ADSL and cable

Market 12, as defined by the Commission's 2003 Recommendation on Relevant Markets, covers "bit-stream access … and other wholesale access provided over other infrastructures, *if and when* they offer facilities equivalent to bit-stream access".

In its comments on the UK's Article 7 notification in 2004[6], the Commission felt that Oftel should have provided evidence of a potential *direct* constraint from cable-based supply and not merely have referred to the *indirect* pricing constraint based on the assumptions of substitutability at retail level. However, it was felt that, at that time, the exclusion of cable-based wholesale services from the market definition would not have led to a different result in the SMP analysis.

Given that there is now a real possibility that BT may not be found to have SMP in Market 3, it is of some concern that the presence of cable-based products in the retail market is deemed to constrain BT's market power at the wholesale level, despite cable companies offering no wholesale alternative to BT[7], and despite the fact that cable-based retail products provide negligible substitutability for corporate end-users[8].

[6] SG-Greffe (2004) D/200485
[7] See Section 4 of Confidential Annex.
[8] Cable networks tend to have been rolled out in residential areas, such as housing estates, and tend to have neglected business parks. This is due to the initial focus on the supply of television services.

We therefore believe that, in the absence of a direct constraint from cable-based wholesale supply, it should be excluded from the wholesale broadband access market.

Ofcom proposes to define the market as being "*asymmetric access and any backhaul as necessary to allow interconnection with other Communications Providers*"

We would appreciate greater clarity regarding the phrase "any backhaul as necessary to allow interconnection". We note that BTW's proposed Wholesale Broadband Connect product on 21CN requires connection to 20 aggregation points, in order to obtain national coverage. To the extent that CPs are unwilling or unable to connect to all 20 core nodes, the downstream product, "Wholesale Managed Broadband Connect" will be available to provide access to customers not served by those aggregation points. This WMBC product would appear to fall within the ERG's definition of bitstream (rather than resale) and so we would be interested in Ofcom's views as to whether WMBC would have to be provided as a regulated product where SMP is found, especially in the absence of a specific direction.

Ofcom proposes to impose (inter alia) a requirement to provide Network Access and an obligation not to discriminate unduly. We would welcome further clarification as to whether or not Ofcom intends to publish a direction requiring BT to offer certain "basic services" or specific forms of access, as it did previously with the ATM direction.

For the period of this review, it is likely that BT Wholesale will continue to provide Datastream and, to some extent, IPStream. Ofcom says in paragraph 6.9 that it intends to revoke the direction setting the margin between IP Stream and ATM interconnection pricing. It would be helpful if Ofcom would give its views on the effect, if any, that the new remedies would have on the provision and pricing of these existing products.

Question 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?

Given that neither BT, cable, nor LLU operators are present in the Hull area, we agree that it should be defined as a separate geographic market.

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

Ofcom has identified four distinct geographic markets:

- The Hull area
- Market 1 (exchanges where BT is the only operator)
- Market 2 (exchanges where there are 2 or 3 operators, including BT and cable)
- Market 3 (exchanges where there are 4 or more operators, including BT and cable)

Ofcom will make an assessment on whether BT has SMP in Market 3 in the second consultation document planned for May 2007. Market 3 comprises 784 exchanges covering 54% of UK delivery points.

According to the European Commission[9]:

> "the relevant geographic market comprises an area in which the undertakings concerned are involved in the supply and demand of the relevant products or services, in which area the conditions of competition are similar or sufficiently homogeneous and which can be distinguished from neighbouring areas in which the prevailing conditions of competition are appreciably different."

Although Ofcom purports to follow this approach (see below) we believe that Ofcom should examine the competitive conditions in the **wholesale** market, not the retail market. In Viatel's view, the competitive conditions for the supply of *wholesale* broadband access products *are* homogeneous throughout the UK (excepting Hull). We therefore believe that there should be only two geographic markets for wholesale broadband – Hull and the rest of the UK.

Ofcom bases its finding that there is no longer a national market for *wholesale* broadband access on two factors:

a) since April 2005 BTW has geographically de-averaged prices for wholesale broadband products by reducing its prices in 561 "dense cell" exchanges that serve more densely populated areas; and
b) the roll-out of LLU-based services has increased local competition pressures and has led to ISPs offering *retail* prices and products that vary by geography.

In fact, both of these factors pertain to the competitive environment in the retail market, not the wholesale market. Although BT has reduced its *wholesale* prices, this was not in response to competition from other wholesalers, but in response to competition that its own downstream arms face in the retail marketplace.

Ofcom proposes that the most appropriate (i.e. smallest possible) geographic unit for assessing the wholesale broadband access geographic market definition is BT's local exchange footprints. It then analyses the "conditions of competition" in each local exchange so that exchanges can be grouped together into areas where the competitive conditions are sufficiently homogeneous.

With regard to demand-side substitutability, we do not believe this is relevant in this instance, because, as Ofcom notes, customer mobility between geographic areas is virtually zero – end users cannot seek a provider outside of their exchange area. We therefore agree with Ofcom that, in order to assess the homogeneity of competitive conditions between geographic areas, we should examine factors such as:

a) the number of competitors; and

[9] Commission Guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services (2002/C 165/03)

b) the economic viability of entry in an area.

However, we disagree with Ofcom's methodology in paragraphs 4.176 to 4.199. Ofcom has focused on the availability of **retail** services, instead of the availability of **wholesale** services. Since we are looking at the competitiveness or otherwise of the market for *wholesale* broadband access services, we believe Ofcom should consider the number of actual competitors to BT in the provision of WBA.

The inability of BT to act independently of its competitors (because of their theoretical ability to enter the wholesale market) is more relevant to the SMP assessment, than to market definition or to the homogeneity of regional wholesale broadband markets. Indeed, if BT *is* found to have SMP in market 3 when Ofcom consults again in May, this would go to reinforce the fact that the "conditions of competition" are sufficiently homogeneous in the Hull area and markets 1, 2 and 3 as to indicate one national market.

It is true to say that LLU operators have an alternative to buying from BT, in that they can (notionally) purchase the wholesale products from themselves. But even they only have that one alternative (i.e. themselves) – they do not have the choice of "four or more operators" as Ofcom has identified in Market 3.

The experiences described in section 4 of the Confidential Annex show that there are signs that some providers have begun to offer wholesale alternatives. Moreover, it is apparent that BT's 21CN may give alternative network operators more scope to provide wholesale alternatives, particularly in backhaul. However, we believe that, given that the period of the review takes us until about 2010 only, it is premature to use self-provision as evidence that external wholesale supply is likely within the period of the review.

As Ofcom says in paragraph 5.41:

> "If no wholesale regulation were in force it seems likely that vertically-integrated operators (BT, LLU operators and cable operators) would compete at the retail level, and therefore the retail shares of these entities would equal the shares in the wholesale broadband access market as the offerings in the market would be pure bundles of retail broadband and self-provided wholesale broadband access."

Question 6: Do respondents agree with Ofcom's analytical framework for defining geographic markets in the UK (excluding the Hull area) and the conclusions reached?

In order to determine wholesale geographic market boundaries, Ofcom has looked at the number of "Principal Operators"[10] within each exchange footprint. Ofcom has found that there are 8 such operators (9 including the cable operator) who are expected to provide a material competitive constraint during the period covered by the review.

[10] Those LLU operators who plan to compete in the broadband internet access market and who intend to unbundled at exchanges able to serve at least 10% of homes and businesses in the UK by January 2008.

However, almost all of those 9 operators provide wholesale broadband access to their own downstream retail operations only.[11] In contrast, in a healthy, competitive market place, one would expect to see secondary trading at the wholesale level.

In its public consultation on the Relevant Markets Recommendation in June 2006, the European Commission said, when discussing the treatment of self-supply when delineating markets:

> "In [some cases] there are alternative firms that also self supply the necessary inputs. In these cases, third party access seekers could potentially move their business to such alternative operators. However, this is normally limited by capacity constraints, the potential lack of ubiquity of these networks, and the likelihood of the alternative providers entering the merchant market quickly. In general self supply by alternative operators will only be considered where these constraints are not present, which is unlikely in practice."

Whilst self-supply may provide a constraint on prices at a retail level, this does not justify removing rungs on the ladder of investment before products from alternative wholesale suppliers are *actually* available. This would amount to premature de-regulation on Ofcom's part.

In its revised common position on remedies, the ERG said in May 2006:

> "Especially in countries with large differences in population density between the various areas of the national territory, it may be that new entrants would need to serve either the whole country or none of it; they may be limited in their ability to just serve the high density areas. In such cases, it is not a serious option for them to use LLU (say) in urban areas unless bitstream is available in less densely populated (rural/remote) areas.
>
> Nevertheless, this does not imply that geographical limitation of the bitstream remedy would be appropriate as different players may be relying on national availability. Regulators in those countries should also bear in mind that in order to get competition across the national territory new entrants will also have to be able to serve low density areas economically, which may necessitate the availability of multiple access products.
>
> In the case of services to corporate customers, the removal of one rung may mean that a new entrant may no longer be able to make a multi-site offer based on different access products and would lose the customer seeking a single source supplier. This may have a significant detrimental effect on competition for the supply of services to such customers. For example, while city suburbs are generally thought to be fertile territory for market players which seek to offer broadband services to residential consumers via unbundled local loops, the same may not be the case for providers which address only the corporate market. There may be insufficient density of corporate customers to justify the overheads of using unbundled loops in such areas. In these cases, the competitor would need to rely on bitstream services."[12]

In order to provide service and connectivity to a corporate customer with multiple sites, a communications provider will need to utilise the most appropriate form of access for each site. As a pan-European network operator, we agree with the general objective of

[11] By Ofcom's own admission, "there is limited third party supply" and "the vast majority of non-BT supply is self-supply" – paragraph 5.39

[12] Revised ERG Common Position on the approach to appropriate remedies in the ECNS regulatory framework; ERG (06) 33

encouraging infrastructure investment and enabling operators to climb the ladder of investment. Thus, where our network passes close to a customer site with large capacity requirements, we are able to dig out to that site and provide our own fibre connectivity. Alternatively, business providers may be able to unbundle selected local loops where they have the customer density to justify that investment. However, without a mass market strategy, business providers are often slower than consumer-focussed providers to achieve the necessary economies of scale to make such investment viable.

Business providers may therefore need to purchase a combination of leased lines, PPCs, Ethernet, asymmetric and symmetric broadband access in order to provide service to all of a customer's sites[13]. Each site will have specific and differing requirements (based on the number of users in that site or the type of applications being utilised) and each site (be it head office, retail outlet or home worker) needs the most appropriate form of access and the most appropriate class of service.

In the Explanatory Document to the common position on remedies[14], the ERG explains that:

> "for the movement up the ladder it is not necessary to remove the rungs, but new entrants progressively move up the rungs out of "self-interest" once they have acquired the necessary customer base/ volume to make it economically sensible to move up, i.e. when the additional capacity can be filled."

Operators do have the incentive to climb the ladder of investment but they can only do so gradually whilst achieving scale, since an insufficiently large customer base would make capital investments too risky, especially when capital markets are relatively "dry".

In the meantime, WBA must be made available on a nationwide basis. Suppliers of multi-site customers need a *single source* of wholesale broadband, for two reasons. Firstly, it would not be possible to bid for business if costs and pricing varied according to exchange area, since the locations of sites (especially when very large numbers are involved) are unlikely to known at the time of the bid.

Secondly, it would not be economically viable to pay for multiple central connections to a variety of CPs that, in some instances, would be running at very low capacity. Once a wholesale market has begun and matured, CPs will be able to move chunks of broadband capacity from one wholesaler to another as they compete for business. But they should not be forced on to expensive, unregulated products before such competitive conditions arise.

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

Ofcom believes that the most important criteria for assessing SMP are:

- market growth and market shares
- future potential market shares
- barriers to entry and expansion

[13] See sections 1 and 2 in the Confidential Annex.
[14] ERG (06) 19

- economies of scale and scope; and
- countervailing buyer power.

However, Viatel believes that Ofcom should have taken more account of the following factors:

Vertical integration – Ofcom believes that the potential for leverage of BT's upstream market power to damage competition has already been addressed by the requirement for local loop unbundling products. We believe that Ofcom should give more consideration to BT's power to dominate the retail market, by controlling access to wholesale broadband, especially in the market for business services, where it may take longer for an operator to "climb on to the LLU rung" of the ladder of investment. We believe that, in the absence of third party WBA products from LLU operators for some or all of the period of this review, Ofcom should consider BT's vertical integration when assessing its ability to distort competition.

Evidence of previous anti-competitive behaviour – As the ERG says in its SMP working paper, evidence of previous anti-competitive behaviour such as predatory pricing and other market foreclosure behaviour can be an indication that a market is not effectively competitive. Ofcom says that is not aware of recent directly relevant evidence of anti-competitive behaviour in the WBA market. We find this to be a strange comment since BT was not willing to offer ATM interconnection until it was required to do so by Ofcom. Moreover, as Ofcom acknowledged in its Strategic Review, BT has demonstrated over a period of twenty years an unwillingness to provide fit for purpose wholesale products.

Access to capital markets – Ofcom believes that, because there are a number of scale players present in the market who are similar in size to BT, BT is not at an advantage. We believe that this is a crucially important factor, since it has a direct impact on the ability of market entrants to obtain access to BT's infrastructure. Even if some of BT's largest competitors have the same ability to obtain capital investment as BT, the point is that BT has already built its access network, whereas new entrants have to build their networks in today's market conditions, where there is very little new cash available. We believe that Ofcom should give this factor due consideration when evaluating BT's dominance in the provision of WBA.

Questions 8 – 11: Ofcom's Market Power Assessments

Market Share

Ofcom begins the SMP assessment of each geographic market with a table claiming to show the respective market shares in the WBA market. For example, the table for Market 3 as of July 2006 is as follows:

	BT	Ntl:Telewest	LLU operators
WBA volumes (000s)	3,765	2,292	642
Share of Market	56%	34%	10%

These “include those sales that are self-provisioned to the downstream business of each operator as well as to those sold to third party customers”. But by Ofcom’s own admission, there is very little evidence of any third party provision to date.

The OFT gives the following view in its guidelines on Assessment of Market Power:

> “Market share is usually determined by an undertaking’s sales to customers in the relevant market. Market share is normally measured using sales to direct customers in the relevant market rather than an undertaking’s total production (which can vary when stocks increase or decrease). Sometimes market shares will be measured by an undertaking’s capacity to supply the relevant market: for example, where capacity is an important feature in an undertaking’s ability to compete or in some instances where the market is defined taking into account supply side considerations.”

Whilst cable and LLU operators are currently supplying the needs of their retail organisations, it is by no means clear that they would have the capacity to supply the wholesale market. We therefore do not believe that Ofcom should use these figures as evidence of a share of the WBA market.

The OFT goes on to say:

> “In some cases, a supplier may be using some of its capacity or production to meet its own internal needs. In the event of a rise in price on the open market, the supplier may decide to divert some or all of its ‘captive’ capacity or production to the open market if it is profitable to do so, taking into account effects on its downstream business that is now deprived of the captive supply. The extent to which ‘captive’ capacity or production is likely to be released onto the open market (or might otherwise affect competition on the open market) will be taken into account in assessing competitive constraints.”

Based on experience to date, this “captive” capacity is unlikely to be released into the wholesale market by many of the “principal operators”. We think Ofcom should have taken this into account.

Ofcom foresees BT’s market share falling below 50% of WBA volumes. We do not believe that this view would be upheld by competition authorities, since it reflects only a growth in self-supplied alternatives, and does not take into account BT’s share of the number of DSL lines sold on the open market.

A possible alternative to a finding of SMP on the part of BT would be a finding of collective dominance, if in fact all of the broadband connections were controlled by vertically integrated companies, operating in the retail market, with virtually no external wholesale offerings.

In assessing SMP, Ofcom has taken account of the existence of cost-based unbundled local loops which can be used to assist entry into the relevant geographic wholesale markets.

Ofcom’s view is that, “if no wholesale regulation were in force, BT, LLU operators and cable operators would compete at the retail level, and therefore the retail shares of these entities would equal the shares in the wholesale broadband access market as the offerings in the market would be pure bundles of retail broadband and self-provided wholesale broadband access"[15].

If you take this to its ultimate conclusion, the existence of regulated LLU products, and their successful take-up and deployment, would ultimately lead to the removal of regulated bitstream products in all jurisdictions (in densely populated areas, at least). This, combined with the general absence of access to new capital, would probably mean an end to new market entry in the supply of retail broadband services, especially to businesses.

Ofcom notes the possibility that, if no SMP were found in Market 3, smaller ISPs may be unable to purchase wholesale broadband products from either BT or LLU operators and may therefore be forced to exit the market. Ofcom believes that the resulting "consumer detriment" would be short-lived since, over time, a merchant market would develop to fulfil the needs of niche consumer markets. It is unclear why Ofcom believes that it would become more attractive to supply WBA to small ISPs at a point in the future, when it has not been attractive to do so until now. We would appreciate further discussion from Ofcom on this point.

It is important to note that any consumer detriment caused by ISPs exiting the market would disproportionately affect business consumers since, according to Ofcom research, niche ISPs serve 5% of UK households, but 30% of UK enterprises. This illustrates the importance of specialist providers to "UK plc". As well as affecting ISPs, the absence of wholesale broadband products would also affect network operators who serve the business market and as such climb the ladder of investment at a slower pace than network operators serving residential consumers.

As we have stated previously, we do not believe there is a case to be made for the establishment of separate geographic markets. However, should Ofcom ultimately find this to be the case, we would certainly agree with the proposal in paragraph 5.128 that BT should be required to continue to provide WBA in Market 3 in order to provide continuity of supply for third parties prior to the development of a merchant market.

Ofcom refers to the time period for such measures would be "broadly in line with the period of the market review". We would welcome confirmation from Ofcom that such measures would remain in place at least for the period of this review, and until any subsequent market review has established that a merchant market *has in fact* developed.

Questions 12 - 14: Ofcom's proposed regulatory remedies

In markets 1 and 2 Ofcom proposes to impose (inter alia) a requirement to provide Network Access and an obligation not to discriminate unduly. We would welcome further clarification as to whether or not Ofcom intends to publish a direction requiring BT to offer certain "basic services" or specific forms of access, as it did previously with the ATM direction.

Ofcom proposes not to impose price controls in Markets 1 or 2 or against Kingston in Hull. Ofcom does not favour cost oriented prices on the grounds that the broadband

[15] Paragraph 5.41

market is still developing and other providers could enter the market using LLU. Ofcom believes that cost-oriented pricing by BT could act as a disincentive to the provision of WBA by other operators using LLU. We would appreciate Ofcom's views on the extent to which functional separation and Equivalence of Input would affect the setting of prices for WBA services.

Ofcom is concerned that geographic market boundaries could become fixed by regulation if price controls were imposed. Viatel does not agree with geographic markets in principle. Viatel believes that Ofcom should impose price controls where BT has SMP, whether it be a national market or a sub-national market. We believe that Ofcom should give due consideration to the danger of inefficient investment in LLU where there is no cost-effective WBA product.

In 2004, Ofcom's argument against cost-orientation and in favour of retail-minus pricing was that, given the immaturity of the market, a correct and reliable assessment of cost and rate of return would be difficult. However, it was felt that the absence of any price controls could lead to the imposition of a price squeeze by BT.

We believe that there is still a risk of price squeeze, given BT Group's continued vertical integration. We do not believe that non-discrimination and accounting-separation provisions will be sufficient to prevent excessive pricing on the part of BT or Kingston. In fact it is particularly hard to see how Ofcom believes conditions have materially changed in Hull since the last market review.

Ofcom should therefore give more consideration to setting price controls, if not on a cost-orientated basis, then on a retail-minus basis. We do not believe that conditions in the wholesale market have changed materially so as to justify the removal of the price control remedy.