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15 August 2005

Dear

GEO RESPONSE TO CONSULTATION ON BT UNDERTAKINGS

Dear Dougal

I Introduction

Geo welcomes Ofcom's commitment to deliver a clear regulatory framework for the UK telecoms sector. We believe that the telecoms strategic review process has been a clear process of methodical analysis of the issues which has arrived at a sensible conclusion. We support Ofcom's proposed decision to accept the proposed undertakings from BT, subject to the concerns and issues detailed later in this response.

As a relatively new company, operating in a unique place in the value-chain, section II of this response describes Geo, what we do and how we contribute to infrastructure competition within the UK telecoms market. Building from this, section III outlines areas of particular concern for Geo that we want to highlight at the conclusion of the strategic review. Some of these issues feed directly into the undertakings, whilst others feed more into business as usual regulation.

II Geo

Who is Geo?

Geo (Hutchison Network Services UK Limited) owns the largest non-legacy national fibre network in the UK. The network was originally built by Lattice along gas pipelines to the highest technical standards and consists of over 2,400 km of fibre throughout the UK. Our network is secure, resilient and we have plentiful supplies of

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A Hutchison Whampoa Company



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duct, fibre and modules. The network assets were acquired by Hutchison Whampoa (who also own the mobile network 3) in 2003.

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Who are our Customers?

Customers include 3, Global Crossing, Fujitsu, VTesse/IBM (to support Lloyds TSB) and BT. We expect to secure significant additional large customers from the mobile, carrier, systems integrator and corporate space in the near future.

What is our Business Model?

We do not provide managed services. Our business model is to provide the underlying network assets to others - primarily dark fibre and collocation space. We think that the business of owning telecoms assets is about scale, low operating costs and excellent customer service. We are continuing to invest in network assets nationwide (including new fibre deployments) and would be happy to discuss our business plans with you on a confidential basis. By concentrating on a single layer of the value chain we are able to focus on running our business profitably.

As a result, we are cash-flow positive and expect continued growth in our business.

III Regulatory Issues

Introduction

In Ofcom's TSR consultation Ofcom set out 7 key regulatory principles which would guide its actions:

1. *promote competition at the deepest levels of infrastructure where it will be effective and sustainable;*
2. *focus regulation to deliver equality of access beyond those levels;*
3. *as soon as competitive conditions allow, withdraw from regulation at other levels;*
4. *promote a favourable climate for efficient and timely investment and stimulate innovation, in particular by ensuring a consistent and transparent regulatory approach;*
5. *accommodate varying regulatory solutions for different products and, where appropriate, different geographies;*
6. *create scope for market entry that could, over time, remove economic bottlenecks; and*

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7. *in the wider communications value chain, unless there are enduring economic bottlenecks, adopt light-touch economic regulation based on competition law and the promotion of interoperability.*

Geo fully supports these principles. However, because Geo has a unique market position and does not have a dedicated regulatory function we think that Ofcom may have overlooked some issues in its analysis to date. In order to inform Ofcom's thinking this response set these out below:

- BT BES and WES products are intermediate products and should not be priced to foreclose dark fibre competition;
- dark fibre is a potentially competitive market and should not be subject to intrusive ex-ante regulation; and
- the lack of effective behavioural incentives in BT's undertakings will require an ongoing intensive monitoring and implementation effort by Ofcom if the Undertakings are to be a comprehensive solution to the problem identified.

Each of these are discussed below:

BES and WES Are Intermediate Products

In Ofcom's 18 December 2003 *Review of the retail leased lines, symmetric broadband origination and wholesale trunk segments markets, Identification of market power and setting of SMP conditions: Explanatory Statement and Notification*, Ofcom concluded that BT had significant market power in the market for wholesale alternative interface symmetric broadband origination at all bandwidth and then imposed SMP obligations on BT in relation to this market which include an obligation to supply at cost-orientated prices.

At the time that market review was carried out Geo was not actively selling dark fibre. However, Geo has since commenced active commercial selling and it has become clear that BT's WES and BES products set the price ceiling for Geo's dark fibre products. In practice, Geo's potential customers look at the price they can obtain WES and BES services from BT. They then strip out their own costs of terminating equipment and operation and come up with a benchmark price per metre for dark fibre. In order to win business Geo needs to price below this benchmark.

At the time the market review was carried out it is our understanding that, in the absence of any alternative, competing carriers believed that driving BT's prices for WES and BES as low as possible would be a desirable outcome.

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However, now that we are in operation and actively investing in infrastructure we think that continued regulatory pressure on BT's WES and BES prices would be contrary to Ofcom's first and fourth regulatory principles. This is the biggest risk to execution of our business plan and future investment.

We therefore request Ofcom to consider carefully its future policy with respect to WES and BES pricing. We note that Ofcom has secured from BT, outside the undertakings, a commitment not to lower Datastream and IPStream prices until local loop competition has been established. We suggest that Ofcom should seek to obtain a similar commitment from BT with respect to WES and BES in order to give us the regulatory certainty we need for future investment. Further, we urge Ofcom itself not to mandate any further WES and BES price cuts.

Dark Fibre is a Potentially Competitive Market

Whilst BT's fibre assets will be owned by the ASD, we note that BT is under no obligation to offer dark fibre. As an active competitor in the dark fibre market we believe that Ofcom should forebear from obliging BT to offer dark fibre. Of course, we understand that this policy debate would take place in the context of a future market review, but as we have a unique position in the market, we want to ensure that Ofcom is aware of our concern as they wrap up the strategic review.

Lack of Behavioural Incentives in Undertakings will Require Intensive Monitoring

Finally, Ofcom in its review has identified that the problems in the UK telecoms market arise from BT's continued dominance of the local access market, coupled with its vertical integration. As a result BT has both the ability and the incentive to engage in discrimination against its downstream competitors.

The undertakings offered by BT will significantly constrain its ability to discriminate. The creation of a separate ASD, and the various constraints on BT's behaviour will make it much harder for BT to discriminate. However the undertakings do not in any meaningful way address BT's incentive to discriminate. BT's board remains under a fiduciary duty to act in the best interests of the company as a whole (i.e. BT's shareholders). The undertakings act as a strait-jacket and constrain what BT may do to maximise shareholder value. However, Ofcom should be under no illusion that BT, as a well managed company, will seek to maximise shareholder value as a vertically integrated company whilst staying within the letter of the undertakings.

As a result, the proposed undertakings do not represent a step change in regulation and, in our view, will require intensive monitoring and enforcement by Ofcom if they are effectively to constrain BT. We look forward to understanding more about Ofcom's work-plan to achieve this.

IV Conclusion



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We hope this response assists Ofcom in deciding whether to accept the offered undertakings, and its wider policy making in the telecoms sector. We would like to come and discuss with you issues raised in this response and we will contact you to arrange a follow-up meeting.

Please don't hesitate to contact me if you have any questions.

Yours sincerely

Chris Smedley
Managing Director