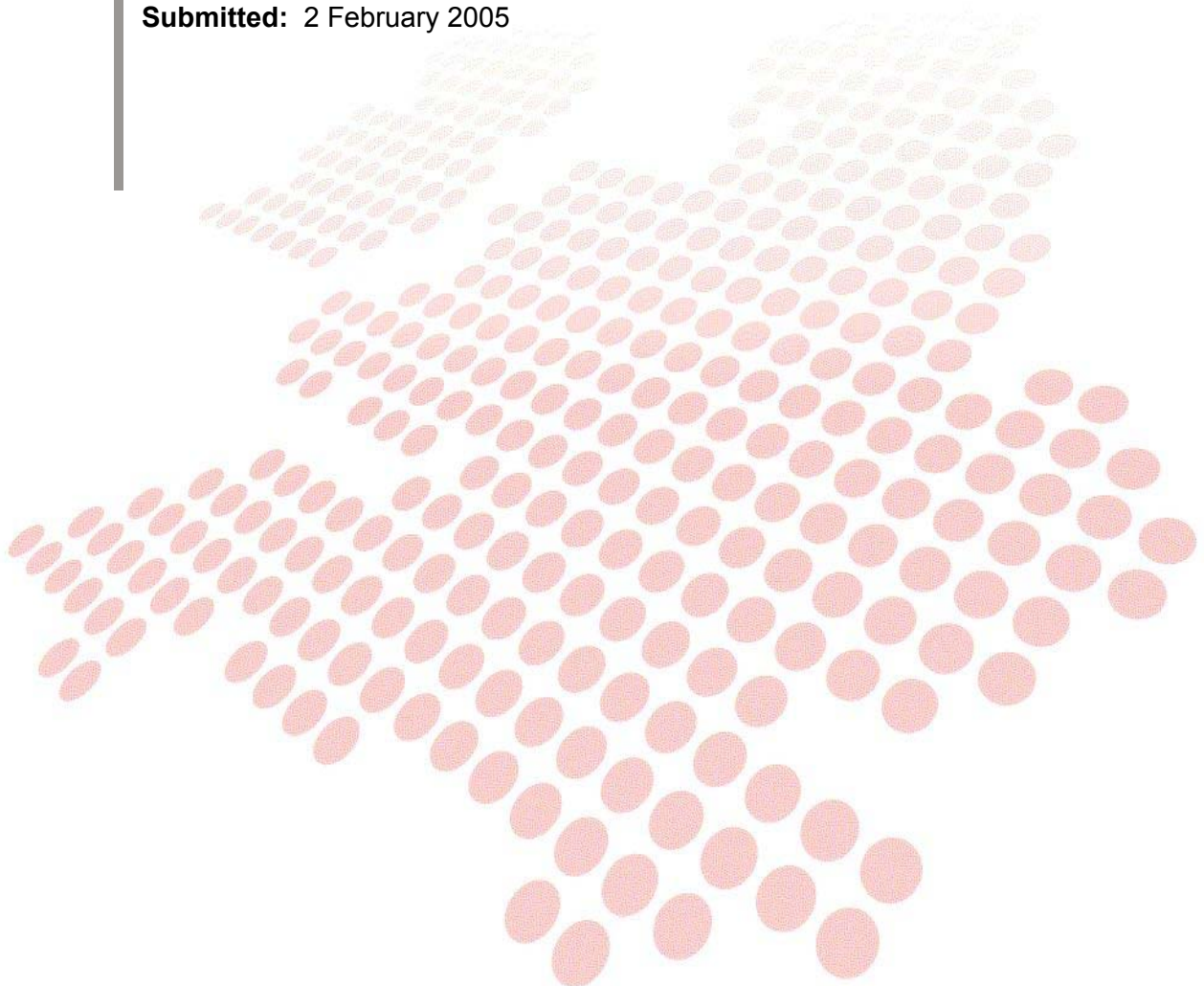


# Strategic Review of Telecommunications Phase 2 consultation document

UKCTA response to Ofcom consultation paper

**Submitted:** 2 February 2005

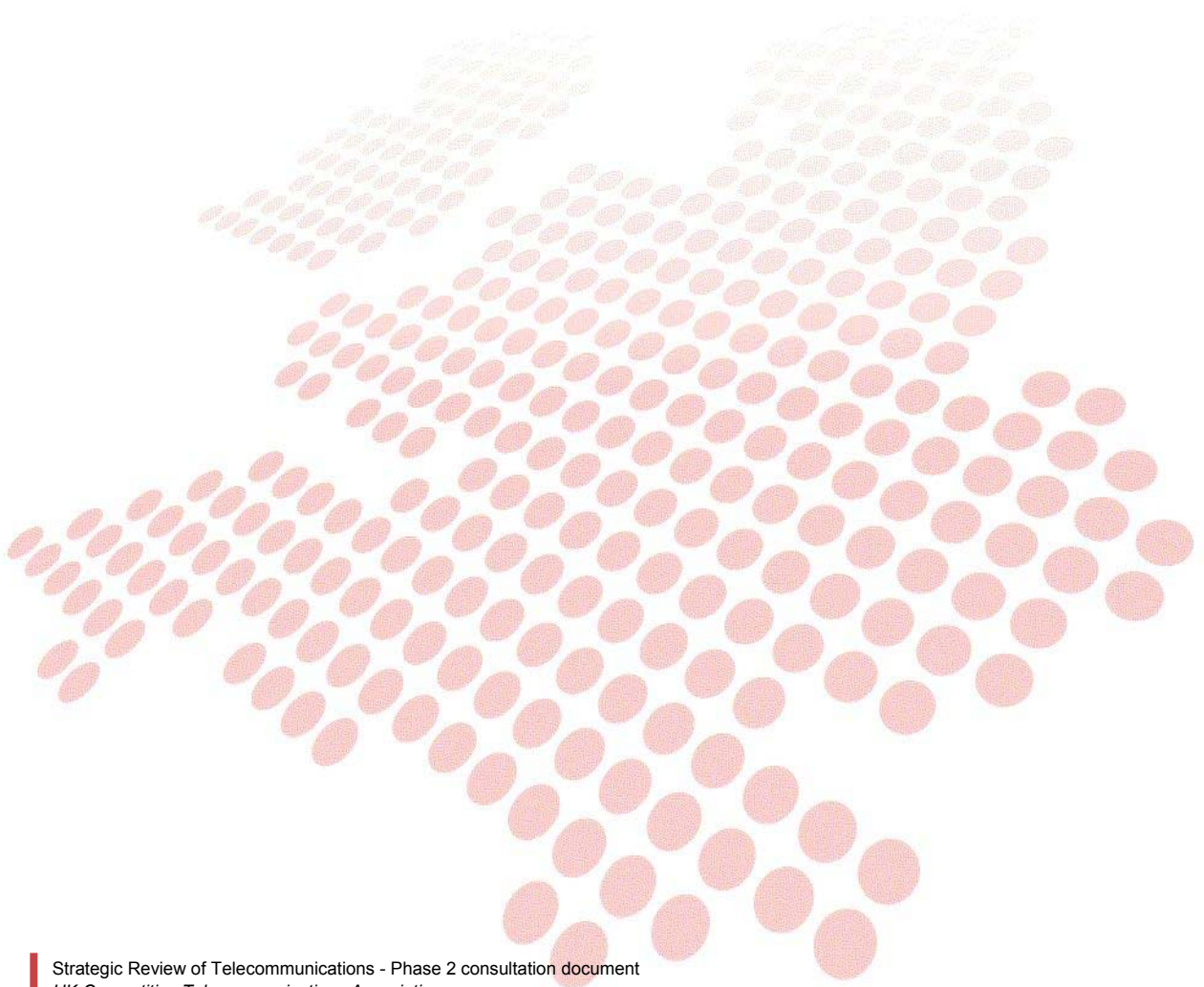


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## The Need to Focus on Delivery

UKCTA commends Ofcom on its good work on the Telecoms Strategic Review. UKCTA believes that at the high strategic level Ofcom has successfully captured the issues facing our industry today. The real challenge now is to turn the principles into detailed, effective, practical and enforceable measures which will make a difference to the competitive environment in the market.

Value is best delivered to customers through competition, which encourages service and product innovation and the delivery of value for money offerings which meet the needs of customers. If a model for sustainable, innovation-rich, deep network competition can be developed, implemented and maintained, as an industry we will be able to deliver new and better ways for consumers to purchase communications services, for businesses to engage in commerce and improve internal processes, and for citizens to communicate with each other, with businesses and with government. All-in-all, a genuinely competitive environment will promote the consumption of new services, economic growth and social transformation. But we are not at present on a road that will get us there. To achieve these gains, telecommunications companies must be able to succeed according to the quality of their strategy, management and business processes, rather than be dependent on the extent to which an operator can unfairly extend market power from one market into another, as is the case as present.

Ofcom has rightly recognised that change requires a fundamental shift in regulation and, in particular, an increased focus on promoting competition at the deepest levels of infrastructure where it will be effective and sustainable, and on designing regulation to achieve real equality of access.

UKCTA supports all of Ofcom's proposed seven principles for telecoms regulation, and also acknowledges (provided that there will be teeth behind it) that its Option 3 – real equality of access – offers the best hope of delivering an enduring platform for sustainable competition. The emphasis is indeed on "real". Theoretical equality of access will not address the current imbalance and make the new regulatory settlement a success.

The main area of concern is the current lack of developed thinking about implementation and delivery of a new "regulatory settlement". The potential for BT to make small movements towards a new settlement, while at the same time continuing to prevaricate and delay in the negotiation and implementation must be removed at the outset to make a new settlement work. Industry as a whole cannot afford to sit through months of talks while competition continues to be harmed through the marked lack of equality of access on BT's key bottleneck wholesale products. For this reason, we fully support Ofcom's line that if BT does not make timely or sufficient progress Ofcom will be obliged to make a reference under the Enterprise Act. While such a route may prove inconvenient in the short term for all parties we agree that it would be the only option. Without serious engagement from BT, there is quite simply no alternative but to

pursue the Enterprise Act route. So, Ofcom must move quickly to see if a new regulatory settlement can be delivered. This new “regulatory contract” must be worth signing: it must ensure that BT actually delivers on the contract, both upon signing it and throughout implementation. If at any stage during the implementation of real equality of access BT’s incentive is to maximise shareholder value by reneging on the new regulatory contract, then it will do so. Unless all players have confidence that the new settlement will be implemented and that strong incentives are in place to make it happen, there is no benefit to proceeding down the Option 3 route.

To ensure that real equality of access is achieved the new “regulatory contract” must include, as a minimum, all of the following four fundamental requirements:

1. Enforceable sanctions and incentives to ensure BT does not later renege on or undermine the new “regulatory contract”:
  - Without this, BT will renege, and we will return to “business-as-usual”.
2. BT organisational change:
  - BT needs to have, at least, a separate monopoly division which transacts with its own competitive businesses and with competitors on the same basis.
3. Deregulation to be based on clear deliverables being first met by BT:
  - In particular, BT needs to have implemented full product equivalence and this needs to have been validated through measurable changes in market behaviour.
4. Detailed implementation of product, price and process equivalence for agreed key BT wholesale services:
  - We need to have determined and agreed, supported by Ofcom and based on tightly specified timetables, the improvements which BT will deliver to such key wholesale products.

Without BT, Ofcom and the rest of the industry pre-committing to each of these four strands of delivery at the outset, real equality of access will not be achieved. If commitment is not sought and given by BT at the outset UKCTA believes that a referral under the Enterprise Act would be preferable.

We are committed to working with BT, Ofcom and other stakeholders to establish and implement a new regulatory settlement. However the same commitment is required from BT and Ofcom to make it succeed.

## Answers to 20 Questions Raised by Ofcom in its Phase 2 Consultation Document

### 1. Do you agree with Ofcom's proposed principles for regulation of telecoms markets?

In its TSR Phase 2 consultation document, Ofcom lists its proposed seven principles of telecoms regulation. These are to:

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

#### Attacking entrenched dominance and its effects

UKCTA fully supports Ofcom's seven principles. UKCTA members seek to deliver value to their customers by providing innovative and fairly priced alternative services to those of BT. For too long customers have suffered as BT's near-total monopoly in a narrow part of the telecommunications network has led to a frustration of competition elsewhere in the value chain. It is the job of the regulator to ensure:

- that the effects of entrenched dominance are reduced to those areas where sustainable competitive provision is not possible; and
- that the effects of entrenched dominance, where unavoidable, are identified, minimised and isolated such that any effect will be limited to those specific markets in which the dominance exists, and not in

adjacent markets in which the full benefits of competition ought to be evident.

If implemented and enforced, Ofcom's seven principles form a rigorous basis for ensuring that the telecommunications industry will be able to maximise its potential to deliver competitive and innovative services to residential and business users and enhance communications opportunities. This will enrich UK society and help to stimulate economic growth.

### **The task ahead**

UKCTA believes that the size of the task ahead should not be underestimated, not just for the regulator, but for all telecommunications stakeholders. Implementation will require constant analysis, re-analysis and tracking through KPIs. We also believe that the regulator will need to adopt a judicious mix of courage and caution. Ofcom must be publicly willing to take up this challenge.

### **BT internal reference offers**

To emphasise the scale of the task, it is currently not even clear what services BT provides to its own downstream businesses. The internal reference offers published by BT on its website provide absolutely minimal information.

As a first step, we therefore would recommend that BT be required to publish a definitive list of the products it provides to its downstream businesses in SMP markets.

### **The competitive environment - market analysis**

Undoubtedly, it is correct for the regulator to promote competition wherever it is efficient and sustainable, and this should ultimately be at the deepest level of infrastructure that will support it. However, an empirical exercise needs to be undertaken to determine exactly where competition is viable, and where monopoly provision cannot economically be broken. Although we recognise that this will be a serious challenge we agree that it is absolutely necessary if we are to succeed in fostering a culture of innovation through competition.

As UKCTA members are key stakeholders in this market we do not think that this exercise can be done by BT and Ofcom alone. UKCTA is committed to working with BT and Ofcom to understand the competitive conditions that exist today, and that might result from prospective technological and regulatory change.

## Next steps

Over the last eighteen months, UKCTA has been a prime advocate of the principle of real equality of access at network levels where competition will not be effective. We are keen to reinforce this message in our response.

Nevertheless, great care now needs to be taken as we are now in a vital stage where key decisions need to be made as to:

- whether and where equivalence of inputs ought to be required; and
- where equivalence of outcomes may be more appropriate.

We agree that ongoing delivery of real equality of access will require radical organisational and behavioural change. This is because BT's existing structure is predicated on delivering maximum value to shareholders of BT Group in its entirety and not on the need for BT to provide regulated services to all customers (both internal and external) on an equal basis. It is vital that regulation is put in place which works both now and in the future to incentivise BT to deliver true and full equality of access.

## De-regulation

Ofcom is quite right to suggest that, as competitive conditions allow, it should withdraw from regulation at other levels. However the importance and complexity of this task should also not be underestimated – analysis and caution are required here.

Regulation in downstream markets roughly divides into two types:

- Consumer protection regulation: those rules designed to protect customers to make up for the lack of competition (e.g. retail price controls);
- Identification regulation: rules designed to protect competition against distortion by monopoly or near-monopoly markets/providers. These are regulations, such as price publication and accounting information, which exist in downstream markets to allow the regulator to enforce the non-discrimination obligation that typically exists in the upstream markets.

The regulator needs to treat these two types of downstream regulations differently. Although premature removal of regulation could cause adverse consequences in both cases, the nature of the damage caused will differ.

In the first case, premature removal of consumer protection measures before competition has developed sufficiently could lead to consumer exploitation in the short term. However, in this case, the further development of competition would not be adversely affected.

By contrast, removal of the second type of regulation could cause competition to suffer by resulting in monopoly power growing in markets that should otherwise be competitive. For example, if we do not have transparency of and access to the downstream information that confirms that BT is selling its monopoly services to itself and competitors on the same terms (KPIs, price publication, accounting information), then it is likely that BT would indeed give its own downstream businesses preferential treatment.

Therefore Ofcom needs to proceed with extreme caution before embarking on de-regulation, not least because if consumer protection regulations and identification regulations are both removed prematurely, the effect will be both to encourage immediate consumer exploitation and to hamper the possibility of market entry to correct it.

Additionally and most importantly we would request that Ofcom fully consults before any such deregulation is implemented.

*We believe that only total input equivalence, backed up by radical behavioural and organisational change within BT, could ever justify widespread removal of downstream “identification” regulations.*

## **Equivalence**

The high level Strategic Review debate has focused on where equivalence of inputs (versus equivalence of outcomes) might be appropriate. Where we have equivalence of outcomes, there has been a parallel debate about what this might mean in practice.

UKCTA would argue that equivalence of outcomes must mean a lot more than non-discrimination as it has been understood to date. To assess equivalence of outcomes, we need to measure the outcomes in a very detailed way to make sure that they are, in practice, exactly equal. Where we continue to have sub-standard inputs for Altnets (e.g. where BT’s competitors have to purchase wholesale products from BT through an inefficient “service provider gateway” or “SPG”), then we will need some kind of financial compensation to re-equalise outcomes. This is the model that has been pioneered through the interim-local calls product (or the “same and adjacent DLE” or “SAD” product). This would ensure that competition is achieved on merit (rather than quality of regulated inputs) in downstream markets. It would also give BT some incentive to move towards true equality of inputs more rapidly (again, as is the case with SAD). A

major downside of equivalence of outcomes (relative to inputs) is that it does require quite intrusive downstream regulation to ensure we get the data that allows us to measure outcomes to make sure they are equal.

### **Next Generation Networks**

UKCTA strongly supports Ofcom's desire to promote a favourable climate for efficient and timely investment and to stimulate innovation. The next generation of all-IP core networks provide a discontinuity which, if the right signals are given by the regulator, could lead to a re-invigoration of innovation-rich competition.

However, competitive investment in NGNs does require a consistent and transparent regulatory approach. Investors should assume commercial risk when making any particular investment, and the cost of capital will reflect that commercial risk. It would be detrimental to investment, and therefore to both BT and to industry, to require investors to further absorb additional investment risk which is derived from regulatory uncertainty. BT may argue that regulatory risk will raise its cost of capital and the threshold for new investment. Altnets can argue with equal merit that risky investment will be difficult to justify unless investors feel confident that the investment will not later be expropriated as a result of the regulator's failure to adequately prevent BT discriminatory practices. We therefore agree with Ofcom that a favourable climate for investment requires a consistent and transparent regulatory approach.

### **Product/Geographic regulation**

UKCTA recognises that there will be a growing case going forward for accommodating varying regulatory solutions for different products and, where appropriate, different geographies. However, we are somewhat nervous that without thorough analysis of the outcome of particular approaches, we may find ourselves with unintended consequences that lead to a foreclosure of competition. For example:

- policing of cost-based charging for bottleneck services and minimum margins for BT, currently carried out on a national basis for a national market with national pricing, would need to reflect disaggregated cost data resulting from any regional approach to regulation – this would be a serious practical challenge;
- a premature move to regional markets, with lesser obligations in certain geographies, if incorrectly designed, could lead to “black holes” in which BT's competitors are not able to supply a service equivalent to that of BT's. The need for national ubiquity for many customer types are such that these “black holes” could limit the ability of BT's competitors to

compete throughout the market. For example, in servicing a corporate customer with a geographically dispersed head office and branch network, any successful telecoms supplier would need to guarantee service throughout the whole of the customer's networked premises. These will extend certainly to branch offices but also, increasingly, to IPVPN access for home workers. Any gaps would prevent provision of service.

Where the definition of sub-national geographic markets involves deregulation, the points we make above about the importance of retaining identification regulation is key.

We would therefore advise extreme caution in this area.

### **Enduring bottlenecks**

Ofcom is right to recognise that BT's access network constitutes a key economic bottleneck at present. Although technological and commercial conditions may operate in the very long term to change this situation there is little or no evidence that such a development is on the immediate horizon. Ofcom clearly needs to take care that it does not unintentionally suffocate such a development were it to emerge.

Finally, Ofcom proposes a principle of light-touch regulation in the wider value chain where there are no enduring economic bottlenecks. Again, this is a principle which we support. However, we need to proceed with care. As indicated above there are currently certain obligations in non-bottleneck markets which are there to prevent discriminatory behaviour which may otherwise flow over from upstream bottleneck markets. For example, without a price publication and non-discrimination obligation in certain downstream retail and wholesale markets, it will not be possible for the regulator or competitors to have confidence that BT is charging itself and competitors the same price for key monopoly inputs.

UKCTA believe that the introduction of certain conditions as part of the new "regulatory settlement" may diminish the need for this sort of downstream regulation. We recommend that this new settlement therefore includes:

- a complete implementation of input equivalence for key BT bottleneck products, thereby eliminating the need to measure outcomes to assess that equivalence exists;
- radical organisational and cultural reform within BT, such that BT's bottleneck business acts as a separate entity, which treats BT's competitive businesses and competitors on an equal basis,

accompanied by structural changes which will create the correct incentives in the way in which BT's SMP services are provided; and

- a system of enforceable incentives (“carrots” and “sticks”) such that BT is properly incentivised at all times to deliver on real equality of access.

If Ofcom removes downstream obligations before these three conditions have as a minimum, been satisfied, or indeed before their impact has been validated through measurable changes in market behaviour, the competitive landscape would be irreparably damaged, and opportunity lost in terms of delivery of value to citizens, consumers, and UK businesses.

**1 a) What regulatory role should Ofcom play in the wider telecoms value chain?**

As discussed above, only once a satisfactory regulatory settlement has been secured and implemented (including verification that the market is responding in the way anticipated), it may then (and only then) be appropriate for Ofcom to play a smaller role in the wider telecoms value chain.

This said, even where real equality of access is established, as long as BT has a high market share, BT will continue to have an incentive to raise the cost to the customer of switching supplier. Ofcom will therefore have a continued role in helping to lower customer switching costs. In particular, Ofcom must seek to implement migration processes which allow customers to switch from BT to competitors without having to face unreasonable cost or disruption. For example, as BT seeks to migrate its legacy customers (e.g. FeatureNet) to new world services (such as IP-VPNs), competitors must be able to benefit from the same migration products.

The importance of assuring an ability to migrate cheaply and in a simple manner and, where appropriate, free of penalty for breach of retail contract, should not be underestimated. We would point to past experience when this issue was successfully tackled in the context of PPCs by Oftel. See also our answers to question 5 d) and question 17).

We would also point to the importance of Ofcom's wider role and duty in relation to regulatory developments taking place outside the Industry but which have a bearing on the Industry. We believe that Ofcom will still be required to play a role in this arena.

For instance, there is much that can be done by Ofcom in areas such as Street Works and Non-Domestic Property Rating where telecoms operators face major business-affecting risks, the implications of which may not be fully understood within other Government circles. It is UKCTA's view that Ofcom

should be directly involved in developing a true 'joined up Government' approach to such initiatives and should actively advocate outcomes that will be of benefit to the sector.

**1 b) How should Ofcom reflect differences in competitive characteristics in different geographic areas?**

As we discuss in the main body of our answer to question 1, UKCTA believes there may be a case, at least in theory, to move to more geographically-focused regulation in some instances. However, UKCTA does not currently support such a move. There are severe potential risks if implementation of such an approach is in any way flawed. Before any action is taken, we recommend a thorough, detailed investigation and analysis of the possible effects on the competitive landscape of a more geographically-specific approach before we proceed in this direction. Such an analysis must not be limited to an examination of the theoretical case for regionally-based markets or remedies, but must also centre on the key questions of practicality of implementation. It should also focus on the need to retain identification regulation in downstream markets in any geographic markets where deregulation is under consideration.

As Ofcom will be aware competition law gives little guidance on the important issue of how to define geographic markets in network industries. Accordingly, UKCTA requests that Ofcom undertake a separate consultation exercise on issues – both practical and theoretical – relating to geographic market definition.

**1 c) What factors need to be taken into account when considering the scope of demand and supply-side substitution in telecoms markets on a geographical basis?**

Ofcom's discussion of the challenges which may be faced in looking at demand and supply-side substitution in telecoms markets on a geographic basis is interesting. The fixed location of purchasing affects the operation of competitive substitution in a way that differs from many other markets. Certainly, it is not reasonable to have markets and remedies varying by postcode, not least because of the fact that the administrative burden for Ofcom and operators alike would be untenable and customer confusion/detriment would result.

Discussion on the demand-side would need to focus on the locations of customers (rather than customer sites) and the need for a national presence. The existence of geographically-specific markets might hinder competition for business customers who need all their geographically dispersed premises serviced by a single operator. Such customers can only be serviced by operators with a national presence, such that geographic market definition may

not be of relevance. For example, if Acme bank has branches throughout the country, the existence of five suppliers in London will be of no relevance to Acme if only one of these suppliers can offer its service outside London.

Even for residential service, where customers only ever purchase service for a single site at one time, there may be a case to say that an advantage exists for those operators that are able to offer service throughout the United Kingdom as opposed to those that are limited to regional coverage.

UKCTA therefore urges Ofcom to take care in reflecting any perceived need for national presence if it considers a move toward geographically-focused markets appropriate.

- 1 d) To what extent would it be appropriate in the future to take into account differences in competitive conditions in different areas through**
- (i) the aggregation of similar geographic areas or**
  - (ii) through different remedies?**

Clearly it would not be appropriate to have a geographic market covering, for example, every single house or every single postcode in the United Kingdom. Were there to be a case for moving towards more geographically-focused regulation, some aggregation of similar geographic areas may well be appropriate. Also, it may then become appropriate to have different remedies to reflect different competitive conditions.

Again, we would advise caution to ensure that we are not faced with unintended consequences which could lead to a substantial lessening of competition, for example through the emergence of black holes which prevent BT's competitors from competing fairly on a nationwide basis. We also need to make sure that sufficiently disaggregated data can be collected and analysis carried out to have confidence that the regulator is able to fulfil its duty to ensure compliance with its duties to conduct market analyses in accordance with the Framework Directive.

- 1 e) Would you support a requirement to provide Ofcom with data on particular products on a geographic basis as part of the regular reporting requirements? What is the correct level of disaggregation?**

We would always support any requirement to provide Ofcom with data that enables it to better regulate the United Kingdom marketplace. However, any additional data collection burden imposed on operators must be proportionate to the benefit gained by moving to a regime that induces this additional burden.

Ofcom should not underestimate the burden that would be faced by all operators in seeking to supply, for example, geographically disaggregated cost data.

In the case of BT, there would be a particular burden in seeking to understand BT's cost base in each geographic area, and to ensure that the disaggregation was auditable (and audited) to a suitable standard. UKCTA is particularly concerned that this exercise may fail to yield any meaningful geographic cost data, particularly bearing in mind that BT's national access network asset base is estimated not by adding up the asset register throughout the country, but rather by a series of local access costing surveys designed to be statistically significant on a national basis.

Further consideration and consultation needs to be undertaken regarding the cost, and comfort, of carrying out the necessary samples to produce a statistically significant asset register at the local level.

Additionally, the practical issues involved in moving to geographically-based regulation should not be underestimated. These will require the design and use of consistent and relevant measurement metrics.

In the case of alternative players, Ofcom needs to be aware that not all players have the same back-office systems and different systems will generate different data. Manual data collection, meanwhile, is massively labour-intensive and costly.

While we will always support the principle that Ofcom should have access to the right data, Ofcom also needs to be sufficiently flexible to ensure that information requirements do not unduly disadvantage particular players.

## **2. Where and to what extent should Ofcom rely on ex post competition law rather than ex ante regulatory conditions?**

UKCTA supports the Ofcom view that, given the prevalence of enduring economic bottlenecks in a key part of the telecommunications value chain, it is not advisable for Ofcom to rely on ex post competition law rather than ex ante regulatory conditions. The success of competition in those parts of the value chain that will support it, is itself dependent on the implementation of real equality of access and all the supporting conditions that will make implementation successful. Competitive success also requires suitable migration products to be created that allow seamless low cost switching for customers wishing to move to a competitor of BT's. UKCTA believes that these features of a competitive market would only be possible by imposition of ex ante regulation.

Competition law can not be used to create an environment which guarantees equality of access or migration products. This is because, as Ofcom has itself stated, competition law in this sector will not give competitors the confidence to plan their businesses and make significant investments.

### **3. In what circumstances would it be appropriate for Ofcom to make a reference under Section 131 of the Enterprise Act?**

UKCTA agrees with Ofcom that achieving real equality of access is vital to the future of competition in the United Kingdom and that the likely best way of achieving this is Option 3.

We must not forget, however, that there may be some within BT who through desire or history, may not be so keen to embark on this journey. Changing the culture of an organisation is never an easy task. Ofcom must guard against getting carried away by the momentum of the Strategic Review, only to find that in six months' time promised transformation has proved no more than an illusion, such that we then return to the old world of discrimination and missed opportunities.

The only way in which this Review can achieve its goal is to ensure that all stakeholders will sign up to the new "regulatory contract" with confidence in its success. This commitment applies doublefold to BT whose behaviour is absolutely crucial to the success of delivering and maintaining an equality of access regime. The contract needs to deliver on real equality of access and we need to have confidence that it will endure.

If at any stage throughout the implementation of real equality of access BT will maximise shareholder value by renegeing on the "regulatory contract", then it will surely do so. Indeed, BT management would have an obligation to its shareholders to do so. A contract which cannot be enforced is of no value – this applies equally to the "regulatory contract" at discussion here.

If Option 3 is to deliver us the competitive level playing field we all desire then, as a minimum, it must include:

- enforceable sanctions and incentives to ensure BT does not (now or in the future) renege on or undermine the new "regulatory contract";
- significant, effective and transparent BT organisational and cultural changes;
- implementation of equivalence in key product areas;

- deregulation only when delivery of real equality of access has been evidentially proven;
- clear objective metrics against which the success of the scheme can be measured.

Without these five conditions forming part of the “regulatory contract” UKCTA believes that the new regime will fail to differ in any sizeable way from the sector which Ofcom inherited. Under such circumstances, UKCTA is firmly of the view that Ofcom would have no choice but to make a reference under Section 131 of the Enterprise Act. Nevertheless, we trust that Option 3 – Real Equality of Access – if properly implemented, can be a win-win for BT, competitors and customers. BT would gain by having an organisation structured to deliver value to customers on a coherent basis, uninhibited by the dual-personality that, in our opinion, impairs its businesses today, and the intrusive, but necessary regulation that constrains its competitive activities. The telecoms industry and economy as a whole will benefit by finally being able to compete on merits. Those competitors that succeed in understanding their customers needs and innovating accordingly, will deliver margin and growth to shareholders. Ultimately, customers will gain the most, as competition on merits ensures that only those that organise themselves efficiently and deliver value to customers will thrive.

#### **4. Should Ofcom adopt a broad approach of focusing regulation on enduring economic bottlenecks while tackling the problem of inequality of access head-on?**

UKCTA fully supports Ofcom’s broad approach of focusing regulation on enduring economic bottlenecks while tackling the problem of inequality of access head-on in the manner set out in Option 3.

#### **5. How can real equality of access be achieved at the product level?**

Real equality of access can only be achieved by detailed negotiations between BT and industry, facilitated by Ofcom, where it can be shown that all players will benefit through successful implementation. This is the missing part of the conundrum so far.

While it can be argued that BT currently has incentive to engage in a debate due, in particular, to the fear of an Enterprise Act referral by Ofcom, this threat will wane as time goes on and as the equality of access negotiations progress. *It is therefore vital that Ofcom ensures that BT is sufficiently incited to negotiate in good faith on an ongoing basis.* Without this there will merely be

more of the same discussions that resemble all the product negotiations in which UKCTA members have participated – for example, CPS, WLR, PPCs, LLU, etc. This can only be prevented by introducing measurable radical organisational and behavioural reform along with incentives to BT Group (both “prizes and penalties”) to ensure that continued obfuscation and delay is no longer value enhancing for BT.

Our recent experience with BT’s ‘internal reference offers’ have increased our concern that BT is not yet fully committed to the concept of equivalence. We would observe that there remains a long way to go before we can become confident that BT is committed to equal treatment of Altnets and BT’s own downstream businesses in relation to product development.

**5 a) Do you agree with Ofcom’s definitions of the various forms of equivalence?**

UKCTA agrees with Ofcom’s definitions of the various forms of equivalence.

**5 b) Do you agree that equivalence of inputs can deliver more effective equality than application of equivalence of outcomes?**

Most certainly, UKCTA agrees that equivalence of inputs can deliver more effective equality than application of equivalence of outcomes.

Under equivalence of inputs, Ofcom is required to do little more than verify that the product being supplied to competitors is exactly identical to the product that BT supplies to itself (although this is not true for migration products, where a poor but equivalent implementation would asymmetrically benefit BT, which has more customers to lose than it has to gain).

By contrast, with equivalence of outcomes, BT is able to sell competitors a different product to the one it sells to itself, but the result must be that BT’s competitors are not disadvantaged, in terms of outcome, relative to BT’s own downstream businesses. To give effect to this principle, the regulator has no alternative but to measure outcomes in great detail and to evaluate these to make certain that no disadvantage is conferred on Altnets’ ability to compete as a result of receiving a different product to the one that BT sells to itself. So, the informational burden on Ofcom, BT and competitors is non-trivial, while the regulation that would be required to ensure the supply of data required to measure outcomes in this way would not be unobtrusive. In addition, with equality of outcomes, if for legacy reasons the way in which wholesale products are provided gives BT a sizable advantage in its ability to compete for downstream customers, then an adjustment to charges will be required to “re-equalise” outcomes. Such an approach, as followed for the interim-local calls product, is an inevitable result of the equivalence of outcomes approach. Yet

its implementation is likely to be contentious and intrusive, hardly consistent with Ofcom's aim to withdraw from regulation in downstream markets. In short, input equivalence is inherently better than outcome equivalence.

This discussion should, we hope, help to persuade BT of the desirability of equivalence of inputs. Equivalence of outcomes may appear to be the easier of the two when significant product engineering would be required to achieve equivalence of inputs, but the regulatory challenge, especially when one considers the usual difficulties of asymmetric information between the regulator and the incumbent, ought not to be underestimated.

*UKCTA strongly prefers the implementation of equivalence of inputs, wherever this is in any way possible.*

Nevertheless, UKCTA recognises that BT's existing network and operational support systems were designed with BT Group's vertically integrated needs in mind, with competition grafted on, often in an inefficient and expensive way, at a later stage. This means that there may be instances when the product or process re-engineering requirement needed to achieve full equivalence of inputs would be genuinely prohibitive. In such circumstances, we concede that equivalence of outcomes must be considered as an alternative. However, we urge Ofcom not to treat equivalence of outcomes in these circumstances as simply "more of the same" i.e., a loose application of the non-discrimination principle to a myriad of products with little analysis of the competitive consequences of these substandard offerings. Where we have to fall back on equivalence of outcomes, Ofcom ought not to shy away from the need to measure outcomes and, in turn, to have in place the regulations required to support the need to measure outcomes. Where outcomes differ, Ofcom must ruthlessly pursue, with industry, improvements in the quality and pricing of those products relied upon by Altnets to deliver service to their customers. Industry wholeheartedly supports and would work closely with Ofcom in such a process.

While improvements are being realised, and prior to a re-measurement of outcomes, it is vital that charges be adjusted to ensure that BT's competitors are not, having taken account of adjusted charges, disadvantaged relative to BT in their ability to deliver service to customers.

This approach, as developed through the highly innovative local calls product (or "SAD"), ensures:

- that all players compete on a level playing field, such that customers can benefit from competition on merits; and

- that BT has the incentive to pursue product and process improvements, as the size of the adjustment will necessarily reduce as these improvements take place. Indeed, it gives the incentive to BT to find a way to move towards full equivalence of inputs, as this will guarantee that no adjustments need to be made and, if combined with suitable organisational reform and a suitable incentives regime, may eventually justify significant downstream deregulation.

**5 c) Do you agree with the principles proposed on where equivalence should be applied and the specific suggestions for individual products?**

We believe that Ofcom's suggestions regarding the application of equivalence to particular products needs further development.

We have some refinements and areas of disagreement which we have been feeding through, both to Ofcom and BT, over recent weeks. For example:

- **CPS:** UKCTA does not agree that carrier pre-selection is a product that “now provides [a] reasonable level of equivalence”. Both in terms of pricing and processes, UKCTA members face a significant disadvantage when seeking to compete with BT in the calls market. We have been discussing these issues with Ofcom and will continue to refine and develop our proposals in this area.
- **PPCs:** There may be limits in the extent to which PPCs can provide Altnets a truly equivalent means of accessing business customers' large premises. This is because PPCs give BT control over the access transmission technology, a control that BT has used to its advantage over the years. The delays in introducing a wholesale Ethernet offer, and the subsequent substandard non-equivalent product which has been proposed following the introduction of a heavily contested regulatory obligation, together with the continuing non-replicability of certain diversity products, serve as evidence of BT's ability to use this control to exclude competitors.

UKCTA considers, therefore, that in the context of the equivalence debate, the time is now right for Ofcom to give consideration to making dark fibre access available to competitors. Such an obligation could be more consistent with equivalence of inputs, would hand over the transmission technology choice to the company offering the service over the relevant access lines, and would thus act as a spur to risk-taking and innovation. A dark fibre obligation would also be consistent with Ofcom's stated obligation of focusing regulation on bottlenecks, as a dark fibre obligation would oblige BT to offer a more narrow product in response to the access transmission bottleneck. While we would emphasise that the technical, operational and economic implications of fibre

unbundling are not yet fully understood, we would welcome moves by Ofcom to start work on this.

**5 d) How do you suggest the principle of equality is achieved for ‘associated products’ that BT does not depend on (such as migration products)?**

UKCTA supports Ofcom’s analysis of some of the ways in which the principle of real equality of access could be achieved for ‘associated products’ that BT does not depend on (such as migration products). Equivalence alone in this area will prove insufficient to create fair competition. This is because BT, as the highest share operator, would uniquely benefit from perfectly equivalent migration products of a poor standard. For example if switching between suppliers was made impossible because of the inefficiency of the switching process and disruption caused through transfer, all operators would simply retain their existing customers. Clearly the supplier with over 70% of the market (i.e. BT) would stand to gain the most in this environment. Competitors and customers would suffer.

**Migration products**

Ofcom therefore has an important role to play in ensuring the availability of ‘associated products’ on which BT does not depend, particularly of migration products that allow customers to switch from BT to competitors’ offerings. This will involve detailed analysis and implementation, combined with incentives on BT to deliver. As a benchmark, where BT is enabling a new service for an existing customer, the process for enabling the same service for the same customer but for delivery by an alternative player should be equivalent. In a case, however, where an existing BT service is to be migrated to another provider, detailed attention needs to be given to engineering a proper migration process.

UKCTA believes that the obligation on BT to successfully create a key set of migration products (which are agreed with industry rather than offered by BT) must form a pivotal part of the “regulatory contract”. Without it, it is unlikely that competition will thrive or that end-users will benefit from an innovative, customer-facing industry. If this is the case, then UKCTA believes that Ofcom and other telecoms stakeholders will be unable to sign up to any new “regulatory contract”.

**Commercial terms for bottleneck products**

UKCTA believes there is a second important area of disadvantage which, like migration, is not simply solved by requiring equivalence of input. This area comprises the commercial terms associated with bottleneck products, notably the payment and credit vetting terms, but also contractual liabilities, forecasting

penalties etc. The commercial terms that BT is able to impose on its customers by virtue of its market power are far more draconian than would be acceptable in a normal business relationship. The resultant squeeze on working capital and cashflow, and constraints on financial flexibility contribute significantly to the cumulative competitive disadvantage suffered by Altnets. Even if the same commercial terms were to be imposed on BT's downstream businesses, they would not bite in the same way as they do on Altnets because treasury and risk management are conducted at group level in BT.

Ofcom should acknowledge that fair commercial terms (i.e. comparable with those that would prevail under normal market conditions) are a key determinant of whether a product is fit for purpose. We would also recommend that Ofcom develop more detailed guidelines on what it would deem necessary to address this imbalance on commercial terms. This in turn will enable contractual negotiations between BT and industry to be conducted against a background of greater regulatory certainty.

## **6. What behavioural changes by BT do you believe would be necessary to achieve real equality of access?**

We support Ofcom's view that behavioural change will not be achievable by BT without radical organisational change. BT is not currently structured nor incentivised to deliver high quality bottleneck services to BT's downstream competitors. Even with a genuine commitment from BT's senior management to achieve real equality of access, without the necessary internal restructuring this will fail.

*BT therefore needs to reform so as to secure a genuine separation between its regulated upstream bottleneck business and its downstream businesses offering services on commercial terms in competition with others.*

As a minimum, UKCTA believes that BT must create a bottleneck services business which:

- is a separate company within BT Group with separate UK GAAP P&L;
- has independent board members;
- has a duty to treat all customers equally written into its memorandum/articles of association;
- receives actual payments from BT's downstream businesses, rather than being covered merely by fig-leaf regulatory accounts.

Nevertheless, we note that Ofcom has invited BT to suggest a set of behavioural and cultural changes that will allow it to deliver product equivalence on an ongoing basis. We look forward to hearing BT's proposals in this area. We would note that we will need to measure BT's proposal to see if it offers the promise of a new culture and *raison d'être* for BT's new constituent organisations. In particular, we will need to gauge whether it appears that the organisation formed to provide bottleneck inputs to BT's remaining (competitive) organisations and BT's competitors on an equal basis is actually organised and incented to do so.

*UKCTA strongly believes that industry must be given a formal opportunity to feed back comments on BT's proposals before any specific regulatory decisions are taken.*

The following issues may be of relevance when looking at the appropriateness of any solution proposed by BT:

- What is the estimated cost and timescale of implementation of the proposed changes?
- How does the difficulty of shifting assets between entities vary with each solution? This is relevant if we think the equivalence line might move.
- How adept is the proposed design at dealing with any common costs - assets that are shared between the monopoly and the competitive activity?
- How does BT's proposed organisational reform address the jagged edge: assets that might be monopoly in one geographic area, but competitive in others?
- How does BT's proposal affect the behaviour of BT people in achieving equivalence?
- More generally, how are institutional incentives to achieve true equivalence altered by the new design?
- How does the information available to monitor whether we are achieving equivalence vary?
- How does the new structure guarantee that the [same] information will flow to all downstream competitors, for example concerning the installed access network base at customer sites?

Although not relevant to the regulatory assessment of whether BT's proposals on organisational change are sufficient to give confidence that we will achieve real equality of access, UKCTA believes that organisational change may also actually enhance BT's value, independent of the benefit of greater regulatory certainty and coherence. In particular if BT asked itself the following questions it may view such organisation change more positively:

- How does the new structure affect the ability of BT entities and staff to deliver value to its own shareholders? (through greater clarity of roles - e.g. provider of safe investment regulated monopoly commodity v. provider of more risky, innovative, competitive service)?
- How do the new structures affect the ability of BT to raise investment funds? (through greater clarity of roles - e.g. provider of safe investment regulated monopoly commodity v. provider of more risky, innovative, competitive service)?

Finally, UKCTA believes that BT's proposals must also be assessed by Ofcom on the basis of the following question:

- *How does the new BT structure affect the ability of Altnets to fund investment and to reduce costs and innovate, through having the confidence that BT will deliver on equivalence?*

Delivery of a coherent internal structure, and visibility of the incentives on staff to deliver equal services to competitors and BT's downstream businesses, are essential first steps to convince industry that BT intends to deliver real equality of access and that it is actually equipping its organisation to do so.

Nevertheless, there will always be the fear that BT's history and culture will in some way cause it to revert to type despite attempts at institutional reform. Given this fear, it is vital that Ofcom ensures that BT Group's interests are aligned with full delivery of equality of access. This will require a comprehensive set of rewards and sanctions which can be shown to be sufficient to make it in BT's interest to see through the entire journey that will take us to a full implementation of real equality of access.

## **7. How should Ofcom reflect the competing considerations of efficient investment and consumer protection in determining the regulated returns that BT may earn from its network?**

We note that Ofcom is consulting separately on the allowable returns that BT should earn on its regulated services, and we will be responding in detail on this issue in due course.

For the purposes of this response, UKCTA members simply wish to make the following points:

1. For forward-looking investment decisions, no new funds will be forthcoming in any market where expected returns are not sufficient to persuade investors to assume the risk that any venture might actually fail to make a return. Where a potentially risky investment is seen to earn a low return investors will seek out alternative less risky or higher return opportunities. This applies equally to risky investment carried out by BT (either in the monopoly or competitive parts of its business) and risky investment carried out by competitors. Ofcom needs to be aware that, if competitors are to make risky investments to upgrade their networks to the new world of NGNs, and if they are to exploit new and deeper access network products, then there must be confidence that any future returns will not be expropriated by non-equivalent practices by BT (such as margin squeeze).

Ofcom is right, therefore, to follow a framework that provides the right incentives to invest on all players, minimises regulatory risk, and balances the need to promote efficient investment while protecting customers from overcharging for services in areas where there is dominance.

2. Ofcom will need, as it cements its work in this area through its Cost of Capital workstream, to take extreme care in assessing the actual level of risk in each segment of BT's regulated business. Dark fibre and copper access to customer premises is a sunk, extremely low risk, anti-cyclical activity carried out by BT which therefore suggests a very low cost of capital. By contrast, the provision of downstream, competitive retail and wholesale services is a higher risk, pro-cyclical activity which should command a higher cost of capital.
3. Finally, there must be a debate between Ofcom, BT and industry about the appropriate level of risk to be recognised in charging for any non-contestable investments that may take place in next generation access, such as fibre-to-the-home or fibre-to-the-kerb.

#### **8. Do you agree with Ofcom's proposed approach to current generation broadband?**

UKCTA agrees with Ofcom's proposed approach to current generation broadband i.e. of promoting competition within DSL at the deepest level of infrastructure where it is effective and sustainable.

**8 a) What should Ofcom's approach be to naked DSL?**

As voice increasingly becomes available over DSL, Ofcom should give serious consideration to requiring BT to make naked DSL available. This could be crucial to ensuring that consumers in rural areas have a choice of VoIP-based service providers to choose from.

**8 b) Should there be different regulated wholesale products for current generation broadband in different locations?**

UKCTA understands the theoretical discussion surrounding the attraction for having different regulated wholesale products in different locations. However, as discussed in our answer to Question 1 above, Ofcom must proceed with care, and needs to guard against (i) unintended consequences of regionally-focused regulations; and (ii) proceeding without having sufficiently disaggregated cost data to ensure enforcement of cost-based charges and margin squeeze obligations.

UKCTA and its members would like to further engage Ofcom on the desirability and practicality of different regulated wholesale products for current generation broadband in different locations.

**8 c) How should the potential lack of equivalence faced by LLU operators in a 21st Century network environment be addressed?**

UKCTA has submitted a detailed response to Ofcom's Next Generation Networks (NGN) Consultation, and equivalence regarding 21CN is addressed in detail in that document.

Our overriding message, as UKCTA, is that the difficulties outlined in our NGN response must be overcome. It is not an option for BT to attempt a 21<sup>st</sup> Century network implementation which achieves anything less than perfect equivalence between BT's own competitive businesses and those of competitors choosing to compete on the basis of LLU. Such an implementation would not be consistent with a new regulatory contract based on perfect input equivalence and innovation-rich competition at the deepest level possible. We are committed to working together to secure an implementation that does deliver on this promise. However it is essential that BT also shows its commitment. At this time this could be done by a public commitment from BT to full input equivalence in the 21CN world supported by BT committing, up front, to using exactly the same LLU product, with the same prices, systems and processes, as that which it offers to competitors.

Additionally we are also very concerned that there are significant business risks to the LLU model arising from the taxation regime in terms of rating and we

would strongly encourage Ofcom to take a leading role in working with the Office of Deputy Prime Minister to resolve the problems that ODPM have recently acknowledged.

**9. Do you agree with Ofcom's proposed approach to deregulation of voice services?**

UKCTA agrees in principle with Ofcom's proposed approach to the deregulation of voice services. However, as discussed above in our answer to question 1, we would advise caution. In particular, premature deregulation of those rules that protect downstream competition from possible leverage of dominance could lead to a diminution of competition and a strengthening of BT's retail market power. Deregulation should only occur once BT has implemented, and demonstrated the durability of, fully equivalent offerings for the upstream bottleneck services on which competitors depend and once these are reflected in actual market developments. This would require full equivalence of inputs, organisational reform and incentives for BT to deliver that are sufficient to give confidence to the entire industry.

**9 a) Do you agree that Ofcom should review regulation of retail voice markets in 2005?**

We agree that Ofcom should review regulation of retail voice markets. This should ideally happen during 2005 but Ofcom should retain the flexibility to delay the review should insufficient progress have been made on equivalence.

We would hope that by the time of the review, a fully equivalent fit-for-purpose WLR product will be in operation, with an appropriate margin between the wholesale and retail price charged by BT.

We also hope that equivalence in product, process and pricing will have been introduced for CPS. For example, it is vital that the CPS transaction charge – the price paid by competitors to BT for, amongst other things, signing up a customer – be reduced to the minimum level required to discourage inefficient churn. It is also essential that BT Retail, or BT's downstream wholesale businesses, face an identical charge when it signs up a customer.

Once these conditions are satisfied, then it would be appropriate for Ofcom to conduct a review which could lead to a further relaxation in BT's RPI-X retail price controls. It may still not be appropriate, however, to relax those regulations – identification regulations – designed to identify discriminatory practices by BT (such as accounting separation, price publication and non-discrimination).

**9 b) Do you agree with Ofcom's proposals for deregulating call conveyance markets and wholesale IDD?**

UKCTA supports Ofcom's intention to review call conveyance markets and wholesale IDD markets. Whether it is then appropriate to remove BT's obligations will naturally depend on the detail of the reviews. UKCTA will of course participate actively in such reviews.

**9 c) When would it be appropriate to remove the requirement on BT to provide indirect access?**

We support the principle espoused by Ofcom that, in general, regulated wholesale products should be withdrawn once they have been superseded by other wholesale products. However, we do not agree with Ofcom that wholesale indirect access (IA) may soon reach this point.

Indeed, before the introduction of CPS, IA was the only method available to competitors to provide an "all calls" offering to wholesale and retail customers. Although CPS is now available (recognising that it is undeniably the method of choice for offering these services) there is an important legacy base of customers that are serviced via IA. This service is a necessity because of BT's endless delays in providing a fit for purpose CPS product. In addition, there are a number of particular competitive calls applications, such as PBX least cost routing, which add value to end users but can only be supported with the IA service.

Removing the obligation on BT to provide IA will currently leave significant customer types stranded. UKCTA would therefore recommend that for the foreseeable, future availability of an IA service must remain a mandated requirement.

**9 d) How should PSTN-specific regulation evolve under NGNs? What should next generation CPS and WLR products look like?**

Since issuing its TSR phase 2 consultation, Ofcom has conducted a consultation on Next Generation Networks, which is now complete. UKCTA participated in this consultation and submitted a detailed response which specifically addresses this question. We would refer Ofcom to this response.

- 9 e) What are the prospects for increased competition for voice services provided using broadband access products (such as LLU and the evolution of DataStream)? What conditions and transitional arrangements would need to be in place to allow service providers to secure access on the basis of commercial terms rather than PSTN-specific regulated products?**

This issue is discussed, in part, in UKCTA's response to Ofcom's NGN consultation.

UKCTA believes it is vital that fit-for-purpose equivalent migration products are available for moving customers from legacy voice products to broadband voice products. For example, it is necessary that service providers are able, where desirable, to migrate customers from CPS/WLR-based voice to LLU-based voice in a seamless low-cost manner.

- 9 f) How should Ofcom ensure competition in areas where alternative platforms were not in place?**

UKCTA has not been able to understand fully what Ofcom is trying to ascertain through this question.

We would re-iterate, nevertheless, that the regulator needs to ensure that fit-for-purpose equivalent wholesale products are available where a bottleneck exists. The nature of this bottleneck may vary according to geographic area.

- 9 g) When do you expect fixed-mobile substitution to result in a single economic market for voice call origination?**

Given key differences in functionality, and in cost structures and levels, UKCTA does not believe that sufficient fixed-mobile substitution could result in a single economic market for voice call origination in any relevant future timeframe.

- 10. Do you agree with Ofcom's proposals for deregulation of business voice services?**

Until full equivalence of inputs has been achieved for the key products, along with organisational change and BT Group incentives that align to the continued delivery of equivalence of inputs, it will not be appropriate to consider deregulation of business voice services. To do so would risk scuppering the limited competitive gains that have been made in these segments over recent years. In the absence of full equivalence, it would not be appropriate to withdraw the existing set of downstream regulations.

**10 a) Has the voice market for large business become more competitive since Ofcom issued its large business pricing statement, necessitating the conduct of a new market review?**

UKCTA does not believe that the segments of the voice markets covering large businesses has become more competitive since Ofcom issued its large business pricing statement in May 2004. It would be wholly wasteful to conduct a new market review on this issue at this stage.

**10 b) What wholesale inputs should be provided on an equivalent basis before BT should be granted greater freedom in relation to the pricing of voice services to large businesses?**

BT should provide input equivalence on all bottleneck access products which competitors need (or may need) in order to establish connectivity with their business customers for the provision of voice services.

Ofcom must bear in mind that large business customers are not necessarily comprised of a small number of large head-office type corporate sites. Many large businesses are composed of a mixture of large city centre or business park corporate sites and smaller regional offices, branch networks and home workers. To service these customers competitors need to be able to offer a full integrated network service covering all sites. Partial solutions, based on particular geographies or particular types of sites are not saleable.

In short, before BT is granted greater freedom in relation to the pricing of voice services to large businesses, there must be no business premise type, large or small, which competitors cannot access on exactly the same terms as BT. In the case of voice services, this will require input equivalence on all types of bottleneck access services over which voice can be carried, including:

- Carrier pre-selection, including analogue, digital and Featurenet;
- Wholesale line rental, both ISDN2 and analogue, and including a fit-for-purpose transfer process where an existing BT VPN customer needs to be transferred (through seamless stripping of features) to a competitor's VPN offering;
- PPC, WES, or unbundled access fibre: whichever is the appropriate technology for accessing larger business sites (where competitor own-build is not viable) for the provision of voice services;
- LLU and, particularly where LLU is not commercially viable, the appropriate bitstream product for providing "direct" voice services to smaller customer sites of large business customers;

- Interconnection circuits, so that competitors' cost base for providing voice call services are not raised through artificially inefficient routing or non-equivalent charging for the provision of interconnection circuits.

Given that large business customers are typically serviced through complex communications offerings, deregulation should not be considered until the following conditions have been satisfied:

- A fit-for-purpose process for migrating customers from BT to competitive suppliers, particularly where this involves moving BT legacy VPN customers to competitors' IP-VPN product offerings. Absent this, a switch of suppliers may lead to disruption of service which would deter customers from switching from BT even where competitors' offerings (absent transfer disruption) were of a superior quality and a lower price.
- The BT Access network database detailing the exact installation in each customer site should be made available to competitors on an exactly equal basis. At present, BT competitors seeking to plan for and price up for complex bids must do so from a position of near total ignorance of the access network capability available at each site. BT competitors cannot therefore know for certain what service capability can be provided to the customer at what timeframes. Indeed, they cannot even know what liability they may face for outpayments to BT.

By contrast BT knows the exact access network availability at each site and the exact access network provision cost implication. This gives BT an enormous advantage in a tender process.

Note that this issue applies to all key access network bottleneck products (e.g. CPS, LLU, PPCs) and is a key barrier in achieving real equivalence. It must therefore be addressed as a matter of urgency by Ofcom.

Here, again, we return to the distinction between consumer protection regulation and identification regulation. Identification regulation will continue to be essential for as long as there is market power in downstream markets or the opportunity to leverage upstream dominance into those markets.

**11. How should regulation of narrowband internet evolve as networks migrate to NGNs, and how will functional, low bandwidth internet access be provided in future?**

UKCTA believes that Ofcom is faced with two options with regards to narrowband internet as networks migrate to NGNs:

- Ofcom could ensure the continued provision of low bandwidth internet access through regulation; or
- Ofcom could promote the switch to broadband access by announcing, at some future stage, a firm date for withdrawing narrowband regulations.

Whichever option Ofcom takes it is essential that it provides clarity and certainty for all interested parties and engages further with stakeholders on the issue.

**12. How can the arrangements for access and interconnection to next generation networks best address our proposed regulatory principles?**

Arrangements for access and interconnection to NGNs are core to the entire NGN debate. These issues are discussed at great length in UKCTA's response to Ofcom's NGN consultation and we refer Ofcom to this response accordingly.

**13. What should Ofcom's regulatory approach be to next generation access networks?**

UKCTA believes that, if next generation access networks do emerge, it is likely that they will continue to display natural monopoly characteristics, in at least some geographic areas. Given this, it is essential that Ofcom commit to mandating real equality of access for these networks (where and so long as they remain a bottleneck asset). However, UKCTA recognises that, where new investment is risky, returns must recognise the extent of that risk. UKCTA therefore supports Ofcom's Option B – equality of access from the outset with risk-adjusted rate of return. However, as we discuss in our answer to question 13 a) it is vital that Ofcom makes the correct risk-adjustment if it is to minimise undesirable consequences.

We would also encourage Ofcom to consider the issues raised by public sector subsidy for next generation access networks. A number of initiatives have been proposed by RDAs and local authorities which seek to address a perceived 'market failure' by investing in subsidised 'civil infrastructure' (or in some cases

service provision). These have the potential to undermine existing private sector investment, inhibit future investment and displace private sector activity with less efficient publicly subsidised (and often publicly managed) activity. Although some of the wider policy issues fall outside Ofcom's remit, Ofcom has a clear remit to promote efficient operation of the market. We therefore believe Ofcom should:

- provide a more rigorous analytical framework for assessing the extent of market failure and the degree of unsatisfied demand;
- provide clarity on what ex-ante regulation would apply to such public sector entities (assuming that there is indeed market failure);
- contribute to the development of government policy on the application of state aid rules to such interventions.

### **13 a) In what circumstances should Ofcom forbear from regulating next generation access?**

Ofcom should only ever forbear from regulation of an asset or service if it is provided competitively or, at the very least, if it is fully contestable (i.e. where there are low barriers to entry and exit). This will not be the case in the foreseeable future for next generation access. Indeed, should there be a commercial imperative to invest in next generation access, it is likely that only BT would be able to exploit this opportunity given its existing dominance in access network ducting. Forbearance would then mean that only BT would be able to offer service to downstream wholesale and retail customers, who would not benefit from competitive supply and the inducement to quality, innovation and value for money that comes with it.

Nevertheless, if it becomes appropriate for investment to take place in next generation access, it is vital that any likely investor is not deterred from committing funds as a result of inadequate or uncertain regulations. For any investment to take place, it is necessary that investors foresee the possibility of a return sufficient to cover their commercial risk. If it is judged that next generation access will be a bottleneck in the same way as existing access, then it is appropriate for the regulator to commit to real equality of access for resulting new products. However, to ensure that efficient investment takes place, the regulator must commit to a regulated price that gives a return sufficient to cover the risk of the investment.

Ofcom must, of course, proceed with care to make sure that it can set a regulated charge based on as accurate an assessment of risk as is possible. If it sets the risk-adjusted rate of return too low, Ofcom could deter socially efficient investment. However, if Ofcom sets the rate too high, this could

encourage inefficient investment, and give the resulting monopolist an excess rate of return which would then give it the ability and incentive to margin squeeze competitors in downstream wholesale and retail markets. Ofcom must guard against this danger. To do so will involve it ensuring that it implements a robust ex-ante margin squeeze test for key downstream competitive markets as early as possible.

**13 b) How important is it that the investment be made contestable; is this achievable?**

UKCTA believe that regulatory forbearance would be a very damaging policy direction at this time. Forbearance from regulation could only ever be justified if the resulting market (and not just the investment) were fully contestable. Only in this case will the resulting monopolist be prevented from exercising market power to the detriment of downstream customers. In practice, UKCTA believes that next generation access will give rise to neither contestable investment nor contestable markets.

**13 c) How should Ofcom regulate next generation access if market power were to emerge in this market?**

It is highly likely that market power would emerge in the market for next generation access. This is because BT has already installed all the old-network access ducting and would be the only player able to cost-effectively install next generation access. While a duct sharing obligation might in theory break BT's stranglehold over the ability to lay new access network to existing sites, in practice the operational difficulties around duct sharing make this extremely unlikely.

As a result, and as we have stated in our answer to Question 13), we believe that Ofcom should select its Option B – equality of access from the outset with risk-adjusted rate of return.

**13 d) How might structural options help to eliminate the problems of monopoly access assets being owned by vertically integrated operators?**

UKCTA believes that structural options considered will not eliminate the problem of the likely natural monopoly that will develop should next generation access networks be built. However, structural options might help to reduce the risk of a vertically integrated operator with a key bottleneck asset distorting competition in otherwise competitive downstream markets. In effect, structural options may therefore allow a more robust form of equality of access to be built into the roll-out of any new next generation access networks.

UKCTA urges Ofcom to give further consideration to the use of such options in these circumstances, so that competition in next generation services can thrive without the constant threat of leverage of dominance from upstream wholesale markets. UKCTA would welcome further dialogue with Ofcom on developing its thinking around creation and implementation of any structural options.

**14. What set of wholesale access services should BT be required to provide in order to promote competition in the business market?**

Please refer to our answer to Question 10 b) where we have set out at length the list of wholesale access services which are required to be provided equivalently to ensure that Altnets can compete effectively in business markets.

By way of summary, these are:

- Carrier pre-selection;
- Wholesale line rental;
- PPC, WES, or unbundled access fibre;
- LLU and bitstream (currently Datastream);
- Interconnection circuits.

In addition, effective competition for business customers requires that:

- BT introduce a fit-for-purpose and economically efficient process for migrating customers from BT to competitive suppliers, particularly where this involves moving BT legacy VPN customers to competitors' IP-VPN product offerings;
- The BT Access network database detailing the exact installation in each customer site be made available to competitors on an exactly equal basis.

**15. What can be done to facilitate the migration of complex corporate services (e.g. VPNs) between suppliers?**

UKCTA cannot emphasise enough the importance of a fit for purpose well specified process to allow the migration of complex corporate services (such as VPNs) between BT and its competitors. If introduction of equivalence for BT

bottleneck services was successful, efficient and innovative competitors to BT could develop a complex corporate service offering, which was both of a higher quality and at a lower price than that of BT's. In such circumstances, one would expect the customer to churn from BT and take the service offered by the competitor. This would constitute a healthy competitive environment in which companies are rewarded for creating service packages which are attractive to customers.

However, without a pre-specified migration process, it is possible that the customer would face significant disruption of service during slow transfer between suppliers. With unequal market shares, it will always be in the interests of the dominant retail operator to make switching costs as high as possible. Faced with a perceived risk of significant disruption (temporary loss of service, loss of dialling plans, etc.) then it is quite possible that customers will chose to remain with BT despite the existence of a superior, cheaper product offering from a competitor. This is not a healthy competitive dynamic.

We therefore urge Ofcom to move urgently and decisively towards the introduction of a suite of migration products that allow low cost, minimal disruption transfer of customers from BT to competitors, where the customer has elected to do so. It is crucial that such migration processes form an integral part of any new regulatory settlement being developed as part of the new "Equality of Access" framework.

**16. Are any alternative structures for call termination appropriate? Could evolution to IP interconnection introduce market mechanisms that make intrusive regulation unnecessary?**

UKCTA has suffered for quite some time under the burden of asymmetric regulation of call termination, with fixed rates regulated at cost while mobile operators have been allowed to earn excessive returns on their overpriced services. The result has been huge cross-subsidies between fixed and mobile networks, and therefore vastly wasteful over-investment in mobile networks and under-investment in fixed networks. In addition, in particular markets, such as in the provision of "private wire" fixed-to-mobile on-net calls, mobile operators have been allowed to exclude fixed line competitors through margin squeeze. This debate has been well documented over the years.

UKCTA would be extremely keen, therefore, to find structural solutions that will bring an end to the call termination bottleneck. However, despite years of analysis, we have struggled to find any such solutions that are likely to succeed. We would be keen to continue to work with the regulator in search of long term solutions to address this imbalance.

In the medium term, however, we see little alternative to the imposition of cost-based charge controls for mobile call termination. At present, we cannot see how the evolution to IP interconnection could introduce market mechanisms that would make such intrusive regulation unnecessary. However, it may be appropriate to consider moving to a capacity-based charging model. This would reduce inefficiencies by encouraging greater fill of interconnect links.

UKCTA undertakes to keep these issues under review as the IP world continues to develop, in the hope that some commercial or technological solution may emerge that would provide a competitive constraint to mobile operator excessive pricing and retail discrimination resulting from monopoly provision of call termination. For the present, we think it would be extremely damaging to move away from the existing structure of charge controls, and would urge the regulator to establish symmetry between fixed and mobile network operators by ensuring both types of players have cost based charges estimated using equivalent methodologies.

**17. What approaches should Ofcom adopt to reducing search and switching costs in telecoms?**

UKCTA supports the emphasis that Ofcom has placed on the need to reduce search and switching costs in telecoms. Competition will only succeed in delivering value to customers if customers can understand and assess the offerings that are available and can switch suppliers should they find products more suited to their needs. UKCTA members therefore recognise the challenge faced by industry to reduce search and switching costs. We will continue to work with Ofcom and consumer groups to facilitate easier search and switching by customers.

**18. What should be the arrangements for funding the USO in future?**

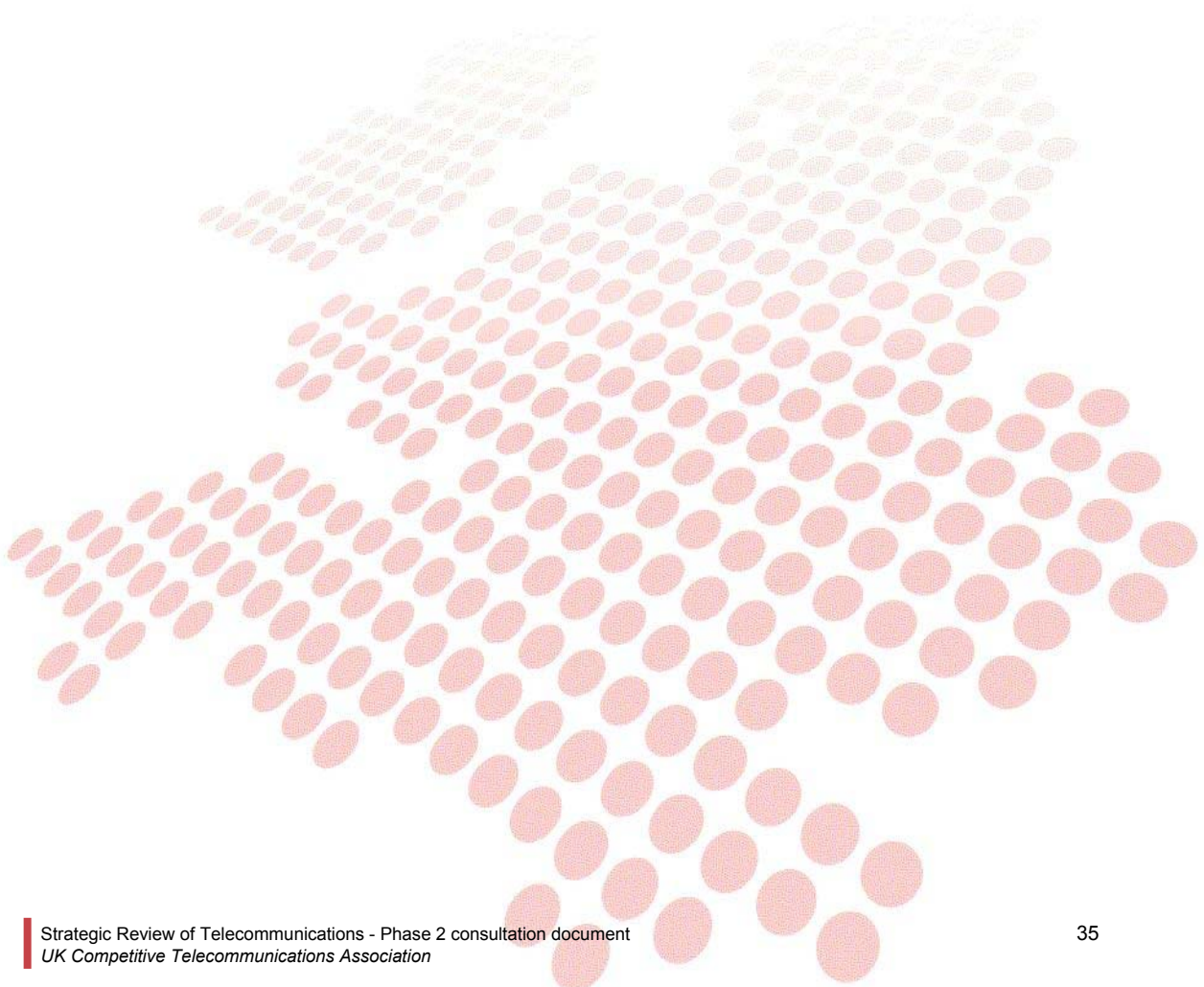
Ofcom has recently issued a consultation on universal service provision and UKCTA will be responding to this document in detail in due course. At some point in the future, UKCTA recognises that it may be appropriate to fund any USO in a competitively neutral way. However, given the pervasive lack of real equality of access and, therefore, the tilting of the competitive playing field in favour of BT, we believe that the imposition of such a funding mechanism for the USO is still a long way off.

**19. How could competition for the delivery of the USO be organised in future?**

Again, UKCTA will be responding to Ofcom's USO consultation in due course. Nevertheless, UKCTA does believe that, to ensure service innovation and incentives to reduce cost, some consideration should be given to the possibility of opening up to competition the provision of USO products at some stage in the future.

**20. Should mobile technologies be used to help address the existing USO?**

Where mobile technologies can provide a lower cost equal functionality method of addressing the existing USO, then UKCTA believes that consideration to such an approach would be justified.



## Annex A – UKCTA Members

UKCTA is a trade association committed to establishing a genuinely competitive telecommunications market in the UK, one that is free from discrimination that favours monopoly incumbents and which maximises investment and innovation. It pursues this objective through advocating pro-competitive regulatory and policy solutions to the communications industry regulator Ofcom, the Government and other interested organisations.

UKCTA comprises the following member companies:

- |                             |                         |
|-----------------------------|-------------------------|
| 1. AT&T                     | 13. ntl:                |
| 2. Cable & Wireless         | 14. Opal Telecom        |
| 3. Centrica                 | 15. Opera Telecom       |
| 4. Caudwell Communication   | 16. Redstone            |
| 5. Colt Telecom Group       | 17. Telco Global Ltd    |
| 6. Easynet                  | 18. Telefonica          |
| 7. Energis                  | 19. THUS                |
| 8. Fibernet Group           | 20. Tiscali             |
| 9. Gamma Telecoms           | 21. Viatel              |
| 10. Global Crossing         | 22. Wanadoo             |
| 11. Kingston Communications | 23. Your Communications |
| 12. MCI                     |                         |