RESPONSE BY BRITISH SKY BROADCASTING LIMITED TO OFCOM'S FIXED NARROWBAND RETAIL SERVICES MARKETS CONSULTATION DOCUMENT OF 19 MARCH 2009

1. INTRODUCTION AND EXECUTIVE SUMMARY

1.1 This submission is British Sky Broadcasting Limited ("**Sky**") response (the "**Response**") to Ofcom's Fixed Narrowband Retail Services Markets consultation document of 19 March 2009 (the "**Consultation Document**"). The Response focuses on the provision of residential fixed narrowband analogue access and residential fixed narrowband calls.

1.2 Our key points are that:

(a) In light of the current state of competition for calls and access, Ofcom's conclusions that the provision of access and calls is now competitive, and that BT no longer has significant market power, are irrational; the analysis in the Consultation document is too cursory to enable a sound judgment to be reached on these matters;

(b) Significant barriers to entry and expansion remain, particularly as a result of inadequacies in wholesale products available to communications providers; as a result, the latter's ability to compete with BT Retail across the UK is significantly hindered;

(c) Ofcom's concerns about *"friction in the switching process"* already exist through the contractual barriers that BT has been allowed to erect through the introduction of its rolling contracts and high termination charges;

(d) Consequently, it would be wrong for Ofcom to remove the SMP designation from BT at this stage, as conditions of competition can in no way be considered to amount to effective competition. Instead, retention of the existing SMP conditions, in order to address BT's continued SMP, is justified.

2. A DECISION TO WITHDRAW EX ANTE REGULATION SHOULD BE BASED ON CLEAR AND COMPELLING EVIDENCE THAT THE MARKET IS EFFECTIVELY COMPETITIVE

2.1 Ofcom has expressed an intention to withdraw SMP conditions from BT in relation to the retail supply of residential fixed narrowband telephone lines and residential fixed narrowband calls.[1]

2.2 *Ex ante* regulation imposed pursuant to Part II of the Communications Act 2003 (CA03) should only be withdrawn where Ofcom *"concludes that a market is effectively competitive.*[2] To that end, the regulatory framework as implemented in the UK by the CA03 requires Ofcom to conduct periodic reviews of markets subject to market power determinations to decide whether to make proposals for the modification of SMP conditions.[3] Only where it is concluded, based on a thorough review

1 Paragraph 1.10 of the Consultation Document.
2 Article 16(2) of the Framework Directive.
3 Section 84(2) CA03.

of relevant evidence, that an undertaking "*is no longer a person with significant market power in that market*" can SMP obligations be withdrawn.[4]

2.3 All the available evidence points to a view that BT continues to have SMP in the markets that Ofcom has defined. Ofcom's relatively brief analysis shows that:

(i) BT maintains very large market shares in relation to access and calls which, according to established case law, raise a presumption of dominance;[5]

(ii) inadequacies in wholesale products hinder operators' abilities to innovate and differentiate their products from those of BT Retail, thus stifling the switching process that could be expected to increase as retail products become less homogenous;

(iii) Ofcom's own evidence shows that switching activity has slowed in recent years. Even absent deregulation, it is clear that contractual barriers remain which allow BT to inhibit the ability of its customers to switch; and

(iv) despite the entrance of new operators, BT has been able to maintain its prices at a relatively stable level, indicating an ability to act without regard to its competitors.[6]

2.4 Further, certain features of the market can be expected to help support BT's market shares, and thus perpetuate its significant market power. For example, there is the asymmetry of BT being the 'default supplier', which continues to favour BT Retail: when a calls-only customer of another supplier cancels their contract without positively switching to another CP, their service will default to BT Retail (which remains the only provider able to offer stand-alone line rental).

2.5 Given this evidence, Ofcom's conclusion that these markets "*are now competitive*"[7] is perverse. In these circumstances, it would be irrational to conclude that BT "*is no longer a person with significant market power*" in those markets, and, accordingly, Ofcom should not withdraw the SMP regulation that currently applies to BT.

The danger of relying on prospective trends as a basis for removing ex ante regulation

2.6 Much of Ofcom's analysis concerns the extent to which BT's existing SMP in the relevant markets will be eroded in the future. Premature removal of *ex ante* conditions has the clear potential to result in significant harm to consumers – notably in the form of higher prices, and risks to emerging competition to BT. Accordingly, if the removal of *ex ante* regulation is to be based to a significant extent on arguments that trends considered to undermine BT's existing SMP will continue into the future, and be sufficient to eliminate that SMP, a high standard should be set for evidence in support of such conclusions.

2.7 This is particularly the case given that there is relatively little downside to maintaining *ex ante* controls in place in view of the fact that Ofcom is able to review the relevant markets at any point in the future. Accordingly, there is little to be lost from waiting to see whether the trends

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4 Section 84(4) CA03.

5 Market shares are more reliable as an indicator of market power in markets characterised by a high degree of product homogeneity and where market boundaries are reasonably clear. In the present case, access and calls are relatively uncontroversial as 'meaningful' spheres in which to assess the degree of competition among firms. Accordingly, such a presumption is appropriate in this case.

6 See, for example, paragraph 5.74 and 6.33 of the Consultation Document.

7 Paragraph 1.9 of the Consultation Document.

examined by Ofcom do in fact eliminate BT's SMP in these markets, and much to be gained in terms of avoiding the potentially significant costs of removing regulation prematurely.[8]

2.8 In Sky's view, this argument is all the more compelling because Ofcom fails to recognise the significant uncertainties associated with the prospective competitive trends that it identifies. Much of Ofcom's arguments comprises speculation rather than evidence-based analysis.

2.9 In practice, in order to rebut the presumption of dominance, Ofcom should be able to explain the extent to which it expects BT's market shares to decline (i.e. that they will decline to a level where BT no longer enjoys SMP). Such a decline should also not simply be by the end of the forthcoming review period. It is not sufficient for Ofcom merely to highlight a general decline in BT's market shares, based on a number of unsubstantiated prospective competitive trends: as the Commission has indicated, *"the fact that an undertaking with a significant position on the market is gradually losing market share may well indicate that the market is becoming more competitive, but it does not preclude a finding of significant market power"*.[9]

2.10 In the present case, it is far from clear, even under the current regulatory framework that the downward trend in BT's market shares will continue. Absent SMP regulation, there is a risk that this trend will cease or even reverse.[10] Without sufficient supporting evidence to show that BT's market share will inevitably decline, an approach based on 'anticipation' runs counter to Ofcom's duties: rather than justify a removal of *ex ante* regulation, anticipated market share movements simply indicate a continuing need for Ofcom to keep the relevant markets under review.

Ofcom's analysis is too cursory to enable a sound judgment to be reached on these matters

2.11 It is important that any decision to remove *ex ante* regulation applying to BT's activities in these markets is based on clear and compelling evidence that BT no longer has SMP in these markets, in view of the potentially significant consequences for consumers and competition. Ofcom's analysis of this matter, however, falls well short of such a standard. Ofcom's analysis of evidence relevant to this issue is extremely cursory.

2.12 We do not propose to address in detail in this Response the inadequate nature of Ofcom's analysis. The main areas in which we offer detailed comments are in relation to (a) barriers to entry to, and expansion within, the relevant markets, and (b) impediments to consumers switching suppliers.

2.13 We note, however, the glaring disparity in, and approach to, numerous areas of Ofcom's analysis between the Ofcom's pay TV investigation, which is in practice wholly focused on Sky, and the narrowband calls and access markets examined by Ofcom in the current consultation document. For example:

(a) in relation to profitability, in the pay TV review Ofcom has employed consultants to undertake detailed examinations of Sky's profitability. Ofcom's examination of BT's profitability in the supply of the relevant products is meagre in comparison; and

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8 For example, in its 2006/07 review of wholesale broadband access, which involved a two-stage process to consultation, Ofcom was able to assess whether competitive conditions of the proposed Market 3 would change as it had predicted before making a final decision (see, for example, paragraph 1.21 of its consultation document of 21 November 2006). Ofcom also acknowledged in that consultation that it is "*difficult to accurately predict future market shares*" (paragraph 5.85).

9 Paragraph 75 of the EC SMP Guidelines.

10 For example, extrapolating over the next 3 years the recent rate of decline of BT's market share for access of around 3-4% per annum, BT can be expected still to have a market share of over 50%. This is also consistent with the forecasts in Table A7.1 of Ofcom's May 2009 Statement on A New Pricing Framework for Openreach, which suggests a similar market share for access for BT in 2011/12.

(b) Ofcom cites survey evidence relating to consumers' propensity to switch away from BT, and concludes that this evidence "*suggests that customers are relatively price sensitive and would be willing to switch*". This can be contrasted with Ofcom's approach to the pay TV review, where little or no weight has been placed on similar evidence, ostensibly because of concerns that it would be affected by the Cellophane fallacy, and 'stated preference bias' (normally known as "*hypothetical bias*").

3. BARRIERS TO ENTRY AND EXPANSION

3.1 Notwithstanding the introduction of (regulated) wholesale products, and contrary to Ofcom's view about their successful development and deployment, Sky continues to have concerns over their adequacy in terms of allowing communications providers (CPs) to differentiate the quality and/or scope of their own retail services from those offered by BT Retail. Barriers to entry and expansion therefore remain in relation to residential fixed narrowband services, limiting the extent to which CPs can develop innovative retail products (in relation to all aspects of the overall 'product wrap') to differentiate their offering from that of BT Retail. The key consequence of such limitations is an inability of other CPs to provide a comprehensive service, of universal standard, across the whole of the UK - in contrast to BT Retail, CPs are limited to differentiating their services in their 'on-net' areas only.

BT's wholesale voice products do not allow CPs to fully leverage their NGN investments.

3.2 The suite of wholesale products that are available to CPs remains inadequate. As a result of BT's decision not to develop wholesale NGN voice products under its 21CN programme, BT can be expected to retain a competitive advantage, given the consequence that the ability of other CPs to compete effectively with BT Retail (in terms of the range of features that can be offered to consumers) will be hindered.

WLR + CPS asymmetry

3.3 Ofcom places great store in the Consultation Document on the availability and take up of WLR and CPS as enabling effective retail competition. However, WLR and CPS are 'asymmetrical' at best, in that they only facilitate the replication of line access and call origination services. Critically, they do not allow CPs to take full control of call termination, numbering, features, tones and voicemail, thus restricting them from innovating and differentiating their voice products by offering their own, unique set of line features.[11]

3.4 Sky acknowledges that the PSTN technology of BT's current network does not readily facilitate competing network operators taking full control of a narrowband line; however, such control is perfectly feasible on IP-based NGNs. Whilst many alternative networks in the UK have now deployed their NGNs, BT's failure to move to NGN-based voice will have consequences through restricting other network operators from realising the full potential of their investments, in terms of innovation and economic efficiency. In practice, this means that competing CPs are hindered from fully leveraging their investment in their own voice networks, for example by ingressing calls to all their customers themselves. Instead, BT Wholesale will continue to receive wholesale geographic termination revenues for WLR and CPS end users.

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11 In this regard, comparisons can be drawn to the evolution of retail competition in broadband, which was enhanced by the greater ability of ISPs to innovate in areas where they had unbundled local exchanges, rather than simply reselling a BT Wholesale product such as IPStream.

Availability of LLU Voice is constrained

3.5 Furthermore, this 'asymmetry' is not entirely resolved when LLU operators adopt MPF-based (full LLU) voice services. Although an LLU operator can offer full two-way (duplex) voice services to its dual product (broadband and voice) holder customers who are served from its unbundled exchanges, it will still be wholly reliant on WLR and CPS (or BT Wholesale Calls) in order to supply services to its voice-only customers and dual product holders outside of its unbundled network. The voice service that can be offered to such single product or 'off-net' customers will differ compared to those served via MPF: for example, numbering, features, tones, voicemail and, potentially, prices would all differ.

3.6 As a consequence, LLU operators are placed at a disadvantage relative to BT Retail which is able to offer the same voice services ubiquitously to all its customers irrespective of their location or whether they take broadband from BT Retail as well. As Ofcom itself recognises, "*switching is more likely to occur when there is a range of price points and offers in the market and consumers can choose between differentiated products*".[12]

3.7 A further consequence is the fact that LLU operators are unable to fully exploit their NGN investments both in terms of all their voice customers being entirely hosted on their voice platforms and through being able to optimise the convergence capabilities of their NGNs (the scope and scale economies and innovation potential from data and voice sharing the same infrastructure), a concern recognised by Ofcom in paragraph 5.34 of the Consultation Document.

3.8 The materiality of this issue should not be underestimated. LLU coverage in the UK stands at about c.80% of the population and is not expected to grow significantly in the future. Broadband growth rates are already in decline. Similarly, the number of fixed line voice-only customers in the UK is dependent upon the level of broadband penetration and uptake of bundles i.e. customers who take broadband and fixed line voice from a single supplier. Even if bundling of broadband and telephony reached full saturation of dual product holders, theoretical LLU voice coverage would still only cover around two-thirds of the UK population.

3.9 The geographic limitation to the deployment of LLU voice also opens up important questions with regard to the appropriateness of national market definitions for both retail and wholesale calls and access services. It is clear that there are differences in competitive conditions within and without LLU areas. However, given the inability for LLU operators to use xMPF to serve on-net voice-only customers at this time, there is a further limitation within LLU areas that is dependent on whether customers take both broadband and voice or voice-only.[13]

3.10 Two potential wholesale products could have addressed some of these issues of asymmetry but are currently not planned for launch by BT:

(i) **Wholesale Voice Connect (WVC)** was originally to be made available by BT as part of its 21CN programme and would have enabled CPs to take full control (via their own call servers) of a narrowband BT line;

(ii) **xMPF** would have allowed LLU operators to unbundle just the baseband voice frequencies of a BT copper line and, therefore, would have enabled the LLU operator to offer the same voice service to its on-net voice-only customers as it does to its MPF-based customers.

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12 Paragraph 5.47 of the Consultation Document.

13 This is different to LLU broadband in that the LLU operator can use either full or partial LLU to serve dual product holders and broadband-only customers respectively.

The fact that wholesale products that afford CPs more control over their services haven't yet been introduced to the market helps perpetuate retail product homogeneity, hindering the development of effective competition.[14]

Porting Charges favour BT

3.11 In certain respects, such as with number porting, providing voice services over full LLU introduces more inequality in wholesale and retail markets, not less. An LLU operator's MPF-based customers will generally have ported their telephone numbers over from BT's network. The LLU operator effectively returns a proportion of its wholesale geographic termination revenues for calls to these customers back to BT in order to compensate it for the routing of ported calls over BT's network. For an operator such as Sky, this reduction in wholesale geographic termination revenue could be as much as up to 40-50%. As BT is a net exporter of numbers to other operators, it is in a materially better position than its competitors because its net termination revenues will be proportionately higher than for other operators.

3.12 When an LLU operator adopts MPF-based voice it will typically migrate the relevant part of its existing WLR customer base, and connect suitable new customers (i.e. on-net dual product holders), to full LLU. In the vast majority of cases, this will require the porting of the customer's telephone number from BT's network to the LLU operator network.

3.13 The whole principle that underpins the obligation for network operators to provide number portability is that, without it, there would be significant barriers to customer switching. In the UK, calls to ported numbers are typically routed by the originating CP first to the range holding network (the "donor" network) who will then route the call onward to the network to which the relevant number was ported (the "recipient" network). The donor network is entitled to charge the recipient network for the cost of this onward routing (known at the Average Porting Conveyance Charge or "APCC").

3.14 BT has recently introduced disaggregated APCCs whereby each network operator has been assigned its own specific APCC. In the case of Sky, should it adopt MPF-based voice, 43% of its call termination revenue would be effectively returned to BT via the APCC charge for calls to ported numbers. It is worth noting that Sky would charge BT an APCC that is about five-times less when it is the donor network due to relative differences in the size and (component) composition of different operators' respective networks involved in such onward routing. The end result of lower net termination revenues is therefore lower call margins for non-BT terminating networks, which can feed through to have adverse consequences for retail competition.

BT Retail's incentives and countervailing power

3.15 As noted above, a product such as Wholesale Voice Connect (WVC) could help overcome some of the asymmetry issues we have identified, by allowing CPs to take control of call termination, features, numbering and tones for its customers. However, since the publication of this Consultation Document, BT has announced that it no longer plans to launch this product.[15] Similarly, xMPF could have enabled LLU operators to serve their on-net fixed line voice-only customers more efficiently, an outcome seemingly anticipated by Ofcom in paragraph 5.39 of the Consultation Document.

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14 It does not necessarily follow that, just because different wholesale products could address asymmetry, Ofcom should oblige BT to offer NGN-based voice products: any such wholesale regulation would need to be justified. NGN investment incentives are perhaps more appropriately considered through regulatory charge setting.

15 BT has also shelved plans to launch Wholesale Broadband Connect Converged (WBCC), its MPF based broadband and voice product

3.16 These are examples of where the incentives on BT to invest in new wholesale products could have sub-optimal consequences for the market as a whole: in essence if BT Retail doesn't want to consume such a wholesale product itself, then that is likely to have significant consequences on the decisions by BT Wholesale (or BT Openreach) to launch a fit for purpose wholesale product. For example, WVC could have been beneficial to other CPs but would not have offered material benefits to BT Retail.[16] If BT Wholesale had launched WVC, it may have effectively ceded a proportion of its call termination revenues to other CPs (who would have ingressed the calls onto their own networks and retained the termination revenues themselves). Consequently, BT Retail should be considered to have some form of countervailing power on BT Wholesale, which can (indirectly) have adverse consequences for retail competition generally.

Failure by BT to launch a true IP interconnection product leads to additional costs for NGN operators

3.17 BT's originally planned IP interconnection product (NGN Call Conveyance – NGN CC) would also have entitled CPs to take advantage of converged interconnection through Multi Service Interconnect Links (MSILs), thus, enabling them to interconnect with BT for both voice and wholesale broadband (WBC), at 20 locations around the UK. A further nine locations were also identified for voice interconnection only.

3.18 As a result of these products not being introduced, Cps have been deprived of the opportunity of realising further efficiencies, through benefitting from further scale and scope economies. Interconnecting CPs have lost an opportunity to manage their network footprint more efficiently and, to a large extent, will continue to meet BT in different locations to hand-off voice and broadband via differing interconnection technologies.

3.19 For voice interconnection with BT, this means that an NGN operator must either convert IP to TDM, at its own expense, prior to handing calls over BT's regulated interconnection products (ISIs or CSIs) or it uses BT's IP Exchange service which offers unregulated IP-IP interconnection circuits at a limited number of locations around the UK. There is a cost to NGN operators for conducting IP-TDM conversion.

3.20 In the European Commission's *Recommendation on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU*, NRAs are advised that, in order to promote effective competition, the appropriate cost model when setting charge controls for call termination should be one that is based on efficient technological choices. Specifically, the Commission considers that a cost model "*could in principle assume that the core network for fixed networks is Next-Generation-Network (NGN)-based*".[17] In Ofcom's Network Charge Control (NCC) cost model, however, the Recommendation is ignored as costs continue to be based on a hypothetical PSTN-based network model.

3.21 Furthermore, the technology required for IP to TDM conversion (Media Gateways) would not typically be the technology choice for an NGN operator. The preferred choice of cheaper Session Border Controllers (SBCs) offers scope for the development of features (such as "presence" services). However, it is worth noting that, for these services to be extended outside of the NGN operator's network into BT's, BT would have to deploy NGN-based voice as well.

3.22 We consider Ofcom's cost model more fully in our response to the NCC consultation, but it is apparent that BT's failure to invest fully in an NGN can be expected to result in consequential disadvantages for those CPs who have adopted new technology more quickly, with consequent impacts on retail competition.

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16 The attraction of WVC is limited to non-BT communications providers who have their own NGN.

17 Paragraph 12 of the Recommendation.

Developments since last Review

3.23 In relation to access, Ofcom notes that 12 significant new providers have started to offer WLR, providing 2.7 million lines, representing 12% of total exchange lines; and by September 2008 there were 1.4 million LLU residential lines, i.e. around 6% of total exchange lines (paragraphs 5.38-5.39 of the Consultation Document). Whilst Ofcom is correct that this does represent growth over the last 2-3 years in non-BT controlled lines, it still represents less than c.20% of total exchange lines. Ofcom itself notes that the rate at which exchanges are being unbundled slowed during 2007, and indicates that LLU does require sunk investment, implicitly acknowledging that represents some form of barrier to entry or expansion.

3.24 Ofcom's evidence does therefore show that there has been an increase in WLR and LLU, which has contributed to the decline in BT's market share for access over the last review period. It does not, however, provide support for the contention that BT's market share will continue to decline at a sufficient rate such that, during the forthcoming review period, the presumption of dominance can be rebutted (notably that BT's market share can be expected to decline to well below 40-50%). In light of the slowing rate of unbundling, and compounded by the concerns raised above about the inadequacies in BT's wholesale products, it is <u>not</u> clear that BT's market shares will continue to fall, rather than stabilise at a level where it continues to have SMP.

Entry strategies

3.25 Ofcom is correct that competition is likely to be enhanced by the entry of more stand-alone LLU operators.[18] In paragraph 5.42 of the Consultation Document, Ofcom rightly notes that new LLU entrants can provide attractive products/bundles which should help increase the competitive pressure on BT (in relation to both access and calls). But, as Ofcom acknowledges, LLU requires substantial investment in infrastructure.

3.26 Ofcom states that *"this competitive pressure appears to be set to continue, with, for example, Sky announcing plans to invest in LLU"*.[19] However, no attempt is made to articulate the likely effect on BT. As it stands, it does not represent sufficient (or compelling) 'evidence' to rebut presumption of dominance.

3.27 The only data referenced by Ofcom is the fact that 40% of consumers now purchase multiple communications services from a single supplier.[20] No clarity is provided as the product mix within such bundles, and the extent to which this involves access and calls, as well as other services such as broadband; nor has Ofcom provided any analysis of the impact that such bundling has had, and can continue to be expected to have, on BT's market shares for access and calls.

3.28 Overall, Ofcom's analysis of barriers to entry and expansion is inchoate. In particular, in light of Sky's concerns with the adequacy of existing wholesale products referenced above, the factors mentioned by Ofcom in the relevant parts of Sections 5 and 6 of the Consultation Document, are, in of themselves, insufficient to support the contention that BT no longer has SMP for access and calls. As a result of these asymmetry issues, effective competition in retail narrowband markets is less likely to materialise, and in fact current barriers, as discussed above, are likely to hinder the development of such competition. As such, it remains inappropriate to deregulate BT in retail fixed narrowband markets.

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18 Paragraph 5.41 of the Consultation Document.

19 Paragraph 5.95 of the Consultation Document.

20 Figure 60: Ofcom - The Consumer Experience 2008 Research Report

4. CONSUMER SWITCHING

4.1 In paragraph 5.65 of the Consultation Document, Ofcom recognises that "*an incumbent with a large market share might benefit from increasing friction in the switching process because this might aid customer retention ... e.g. tying the customer into a contract*". Ofcom specifically refers to BT's 12 month renewable contract, though appears to consider this justified on the basis that customers under such contracts "*get extra benefits ... and may end up with a lower bill*".

4.2 It is only as a result of BT's continuing SMP that it has been able to introduce rolling contracts of this nature (for example, BT has not introduced corresponding restrictions in its customer broadband contracts; nor have other fixed line operators in their customer contracts). Despite the inducement of a reduction in call package costs, such contractual terms are hardly representative of what would be expected in a market that is effectively competitive: allowing customers only a short window (as short as 6 days from receipt of a notification letter) within which to switch without contractual penalty, even if they have been a BT customer for a significant period of time, could only be introduced by a provider that had the ability to act independently of its customers and competitors. The effect of this is, as Ofcom itself recognises, designed to aid customer retention, by severely limiting a customer's opportunity to switch.[21]

4.3 In markets that already feature product and pricing homogeneity (as recognised by Ofcom in paragraph 5.47 and Table 5.5 of the Consultation Document), BT's contractual arrangements further contribute to a dampening of consumer switching generally, and therefore further supports BT's continued SMP. Such contracts make it even harder for BT customers to, and so less likely that they will, switch provider, given the very limited and infrequent opportunities for them to do so.

4.4 The nature of such a rolling contract also fuels the need for contact with BT, as losing provider: the BT renewal letter states that the contract will be automatically renewed unless a customer wishing to cancel calls BT, providing it with a win-back opportunity.

4.5 Further, if any customer on a rolling contract did wish to switch mid-rolling contract, they would face very high early termination charges (which appear to contravene Ofcom's guidance in that they remain in excess of any ongoing costs that BT would continue to face for the remainder of the rolling contract term), which can only act as a significant disincentive to switching. Again, the fact that BT is able to impose such high charges provides an indication of its market power.

5. IT IS NECESSARY TO RETAIN THE TWO SMP CONDITIONS TO WHICH BT IS SUBJECT IN THESE MARKETS

5.1 The two SMP Conditions that BT Retail is currently subject to are (i) an obligation not to unduly discriminate, and (ii) a requirement to publish charges. The retention of both remains justified.

No undue discrimination condition

5.2 Were BT able to discriminate, in particular by targeting leavers, that would further entrench BT's SMP, by making it less likely that its customers would switch and so that its market shares would be eroded. BT can easily identify those customers attempting to switch - for example, in the absence of the no undue discrimination condition, BT's ability (and likely wish) to bundle voice services with broadband would mean that dual product holders would need to contact BT when

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21 Ofcom outlines its concerns in paragraph A1.92 of its Guidance on unfair terms in contracts for communications services (Annex 1 to Ofcom's Statement on its review of Additional Charges, December 2008): "*Our concern about such [automatic renewal] terms is that they may be used to bind a consumer to a series of fixed-term contracts, without the consumer intending and agreeing to be so bound and without receiving any commensurate benefit for being so. The consumer may experience only an unintended extension to his payment obligations*".

they wished to leave BT (particularly where this process required a broadband MAC). In order to deter such a customer from leaving, BT would be able to offer product or bundle discounts, with the effect of protecting its customer base, and so preserve its SMP. Ofcom itself recognises this concern in paragraph 5.62 , where it states that it "*may need to be careful about any proposals that would allow BT to target discounts to customers indicating an intention to leave*".

5.3 As currently proposed, BT would also be able to discriminate against its "*more inert (non market active/aware customers*" by offering discounts only to more active customers. This discrimination would be directly linked to BT's ability to target active customers at the point where they attempt to churn. As such targeting of discounts would be independent of factors such as age and socio-economic group which may characterise a social grouping, we dispute that BT might have difficulty in targeting inactive customers.[22]

5.4 Ofcom should therefore be concerned that removal of this SMP condition would enable BT to offer discounts selectively to its voice customers, particularly those seeking to leave, thereby helping BT to prevent its market shares being eroded further. Given the large size of BT's market shares for access and calls, and the concerns around switching that have been identified above, the effect of affording BT the ability to offer discounts in this manner may well in fact be to further reinforce to its SMP.

Publication of charges condition

5.5 This condition remains important as it provides transparency to BT's retail charges and terms and conditions, to facilitate detection and enforcement of breaches.

Ofcom Consultation on Mis-selling of Fixed Line Telecommunications Services

5.6 In its parallel consultation on mis-selling of fixed line telecommunications services, Ofcom is consulting on a range of issues around switching processes, as a means of addressing its concerns around slamming and mis-selling. We have noted in our response to this parallel consultation that the consumer welfare-enhancing benefits of a gaining provider-led process risk being diminished through undue losing-provider contact during the switching process.

5.7 Ofcom should recognise that the consumer protection measures it is considering under that parallel consultation therefore risk being undermined by Ofcom's proposal for de-regulation under the present consultation. It is important to recognise that these two consultations are mutually reinforcing: the benefits that Ofcom accepts would be realised from a gaining provider-led process will be reinforced by the retention of the existing SMP controls on BT. Conversely, the removal of the no undue discrimination condition on BT can be expected to counteract the benefits of the gaining provider-led approach, particularly in relation to BT customers that need to contact BT as a losing provider to churn (for example, in order to obtain a MAC, or under any process relating to the simultaneous switching of broadband and voice).

5.8 It is therefore important, given the current state of competition in fixed line telecommunications, and the high market shares that BT continues to have, that the existing SMP conditions are retained. Rather than act to deregulate BT at this point in time, Ofcom should instead continue to monitor competitive developments (including those that will result from initiatives that are currently being considered, for example in the parallel mis-selling consultation) and whether BT's market shares are being eroded, such that a finding of effective competition in relation to access and calls can be justified.

Sky **June 2009**

[22] Paragraph 5.60 of the Consultation Document.