



Review of retail and wholesale ISDN30 markets

Consultation on the proposed markets, market power determinations and remedies

This is a non-confidential version.
Redactions are indicated by ✕

Consultation

Publication date: 4 May 2010

Closing Date for Responses: 15 June 2010

Contents

Section	Page
1 Summary	2
2 Introduction	6
3 Approach to market definition, SMP assessment and imposition of remedies	9
4 Retail market definition	19
5 Retail market power assessment	32
6 Wholesale market definition	42
7 Wholesale market power assessment	52
8 Retail remedies for KCOM	59
9 Wholesale remedies for Openreach and KCOM	62
10 Price regulation of wholesale ISDN30 services	91
Annex	Page
1 Responding to this consultation	98
2 Ofcom's consultation principles	100
3 Consultation response cover sheet	101
4 Consultation questions	103
5 Legal Instrument	105
6 Legal Instrument (Directions)	127
7 Market review process	137

Section 1

Summary

Introduction

- 1.1 This consultation document considers competition in the provision of retail and wholesale ISDN30 services, proposing the appropriate relevant markets, analysing those markets and, where appropriate, proposing the regulatory remedies which we consider are needed to address the competition issues we have identified. The proposals set out herein are intended to further the interests of consumers in relevant markets.
- 1.2 ISDN30 is a digital telephone line service that provides up to 30 lines over a common digital bearer circuit. These lines support a wide range of services including basic telephony with additional features to those available on analogue exchange lines. Retail ISDN30 exchange line services are used by businesses which need multiple access lines (typically 8 lines or more) at a particular site. Wholesale ISDN30 exchange line services are purchased by resellers to provide retail services.
- 1.3 The retail product is almost always used by businesses to provide exchange line connectivity to the on-site private branch exchange ('PBX').

Background

- 1.4 This review builds on and is further to the analyses carried out in two consultation documents published on 19 March 2009 (*Fixed Narrowband Retail Services Markets*¹ and *Review of the fixed narrowband services wholesale markets*²) ('the retail consultation' and 'the wholesale consultation' or 'the March consultations'). The March consultations considered competition in the provision of retail and wholesale ISDN30 services. Both documents concluded provisionally that BT had significant market power ('SMP') in the relevant retail and wholesale services markets in the UK excluding the Hull area. KCOM was provisionally found to have SMP in the equivalent retail and wholesale services markets in the Hull area.
- 1.5 On 15 September 2009, we published two further documents (*Fixed Narrowband Retail Services Markets*³ and *Review of the fixed narrowband services wholesale markets*⁴) ('the retail statement' and 'the wholesale statement' or 'the September statements') in which we stated that we intended to assess further the markets for retail and wholesale ISDN30 services in light of responses to the March consultations while reaching a conclusion on the other markets covered in the March consultations. This consultation document explains our further provisional conclusions on the retail and wholesale services markets for ISDN30 services.

¹ http://www.ofcom.org.uk/consult/condocs/retail_markets/fnrsm_condoc.pdf

² http://www.ofcom.org.uk/consult/condocs/review_wholesale/fnwm.pdf

³ http://www.ofcom.org.uk/consult/condocs/retail_markets/statement/statement.pdf

⁴ http://www.ofcom.org.uk/consult/condocs/wnmr_statement_consultation/main.pdf

Summary of proposals

Forward look

- 1.6 We have assessed that a period of four years is an appropriate forward look for this review. We have taken into account expected and foreseeable developments in coming to this view, including specifically the impact of Internet Protocol (IP) technologies.

Market definition

- 1.7 We have considered whether the product market should be widened to include alternatives to ISDN30. We are proposing that it should not. In particular, we have considered the impact of IP based services. Based on evidence gathered from industry and user surveys, we have provisionally concluded that these services are not yet well established in the market and there is no strong user impetus to switch away from ISDN30. We are therefore proposing to identify retail and wholesale services markets for the supply of ISDN30 in the UK excluding the Hull area. We are proposing equivalent definitions for the Hull area.

SMP

- 1.8 At the wholesale level, we are proposing that Openreach has SMP in the market for the supply of ISDN30 services in the UK excluding the Hull area⁵. We are proposing that KCOM has SMP in the equivalent market in the Hull area.
- 1.9 At the retail level, we are proposing that BT no longer has SMP in the retail market for the supply of ISDN30 services as a result of market developments since the retail consultation. In particular, we have seen further evidence of BT's market share declining. We have not seen any evidence of competition in the provision of ISDN30 retail services in the Hull area and have therefore concluded provisionally that KCOM has SMP in the retail supply of ISDN30 in the Hull area.

Remedies

- 1.10 At the wholesale level, we are proposing that the following requirements which presently apply to Openreach and KCOM should continue to apply:
- A requirement to provide Network Access on reasonable terms and conditions;
 - A requirement not to unduly discriminate in the provision of ISDN30;
 - A requirement to publish a Reference Offer;
 - A requirement to notify charges, terms and conditions; and
 - A requirement to notify technical information.

⁵ Openreach is the access division of BT established by Undertakings in 2005. Whilst the proposed SMP services conditions in this document apply to British Telecommunications plc, Openreach is the division of BT which provides the wholesale ISDN30 services which we are proposing to regulate. Therefore, throughout this document, we refer to Openreach as the supplier of wholesale ISDN30 services. For retail markets, we refer to BT.

- 1.11 For Openreach only, we are also proposing that the following remedies should continue to apply:
- A requirement to publish quality of service information;
 - A requirement to provide New Network Access on reasonable request;
 - A requirement to provide wholesale line rental ('WLR') ISDN30;
 - A requirement to account separately;
- 1.12 In addition we are proposing the following new remedies for Openreach:
- Charge controls; and
 - A requirement to provide cost accounting information.
- 1.13 In relation to charge controls, we consider that we need to address the level of profitability of Openreach's wholesale ISDN30 services. Openreach's reported returns in the provision of wholesale ISDN30 services are significantly above its cost of capital and have been increasing. As noted above, we do not expect sufficient competitive constraints on charging (including from IP based services) to emerge during the forward look period. We therefore propose to impose a charge control on wholesale ISDN30 services supplied by Openreach. To ensure sufficient transparency of costs in support of a charge control, we also propose to impose cost accounting requirements on Openreach.
- 1.14 We propose to synchronise modelling work on the charge control with work on other regulated services provided by Openreach. Specifically, the charge controls for local loop unbundling ('LLU') and WLR are set to expire on 31 March 2011 and will be reviewed ahead of this. Synchronising the charge controls will ensure that they are set on a consistent basis and using the same data. We therefore intend to consult on our proposals for ISDN30 charge controls and detailed cost modelling in a separate consultation document. In the interim, we propose to set a safeguard control for wholesale ISDN30 services, provided by Openreach, to ensure charges do not increase in nominal terms.
- 1.15 At the retail level, in the Hull area, we propose to require KCOM to publish prices for retail ISDN30 services and not discriminate unduly in the provision of them. This is a continuation of remedies that currently apply.

Market Research

- 1.16 We have also published today market research in relation to the use of ISDN30 services and IP-based services. This research has helped to inform the provisional conclusions set out in this consultation.

Consultation

- 1.17 Responses on the issues set out in this document are required by **15 June 2010**. This will allow a 6 week consultation period which is in accordance with our guidelines as we consider that this is a category 2 consultation. Although this is an important policy proposal, it relates to a specialist product that will be of interest to a limited number of stakeholders. Additionally, as we have previously consulted on the

ISDN30 markets in the March consultations, we consider that all stakeholders will be aware of the general issues that are discussed within this document.

Section 2

Introduction

Scope of this consultation

- 2.1 This consultation document considers the markets for the provision of retail and wholesale ISDN30 exchange line services in the UK excluding the Hull area and, separately, in the Hull area.
- 2.2 ISDN30 is a digital telephone line service that provides up to 30 lines over a common digital bearer circuit. These lines support a wide range of services including basic telephony with additional features to those available on analogue exchange lines, and data services.
- 2.3 Retail ISDN30 exchange line services are used by businesses with a need for 8 or more access lines at a particular site. Wholesale ISDN30 exchange line services are used by resellers to provide retail services.

Background

- 2.4 This review builds on and is further to the analyses carried out in two consultation documents published on 19 March 2009 (*Fixed Narrowband Retail Services Markets*⁶ and *Review of the fixed narrowband services wholesale markets*⁷) ('the retail consultation' and 'the wholesale consultation' or 'the March consultations'). The March consultations considered competition in the provision of retail and wholesale ISDN30 services. Both documents concluded provisionally that BT had significant market power ('SMP') in the relevant retail and wholesale services markets in the UK excluding the Hull area. KCOM was provisionally found to have SMP in the equivalent retail and wholesale services markets in the Hull area.
- 2.5 On 15 September 2009, we published two further documents (*Fixed Narrowband Retail Services Markets*⁸ and *Review of the fixed narrowband services wholesale markets*⁹) ('the retail statement' and 'the wholesale statement' or 'the September statements') in which we stated that we intended to assess further the markets for supply of retail and wholesale ISDN30 services in light of responses to the March consultations. This consultation document explains our further provisional conclusions on the retail and wholesale services markets for ISDN30 services.
- 2.6 To assist us in this review, we sent formal information requests to a number of communications providers ('CPs') seeking information about the provision of services to businesses including asking them whether they use ISDN30 and/or IP-based alternatives to provide services to their customers.

⁶ http://www.ofcom.org.uk/consult/condocs/retail_markets/fnrsm_condoc.pdf

⁷ http://www.ofcom.org.uk/consult/condocs/review_wholesale/fnwm.pdf

⁸ http://www.ofcom.org.uk/consult/condocs/retail_markets/statement/statement.pdf

⁹ http://www.ofcom.org.uk/consult/condocs/wnmr_statement_consultation/main.pdf

- 2.7 We also conducted consumer research user surveys to understand businesses' views on the services that they purchase.
- 2.8 The information that we have gathered has enabled us to come to the provisional conclusions set out in this document.

Impact Assessment

- 2.9 Impact assessments provide a valuable way of assessing different options for regulation and showing why the preferred option was chosen. They form part of best practice policy-making. This is reflected in section 7 of the Communications Act 2003 ('the Act'), which requires that generally we have to carry out impact assessments where our proposals would be likely to have a significant effect on businesses or the general public, or where there is a major change in our activities. However, as a matter of policy, we are committed to carrying out and publishing impact assessments in relation to the great majority of our policy decisions. For further information about our approach to impact assessments, see the guidelines *Better policy-making: Ofcom's approach to impact assessment*¹⁰.
- 2.10 The analysis presented in this document represents an impact assessment, as defined in section 7 of the Act. In particular, in Sections 4 and 6 we consider potential approaches to market definition. In Sections 5 and 7 we consider whether or not any operator holds SMP in a particular market and in Sections 8 to 10 we consider what the appropriate remedies are for each market where we have proposed SMP. In each of those sections we discuss all of the relevant considerations and options that we have considered, including their impact, before making our proposal.

Equality Impact Assessment

- 2.11 We are separately required to assess the functions, policies, projects and practices on race, disability and gender equality. Equality impact assessments (EIAs) also assist us in making sure that we are meeting our principal duty of furthering the interests of citizens and consumers regardless of their background or identity.
- 2.12 We have therefore also considered what (if any) impact the issues under consideration may have on equality. We do not consider the impact of the decisions made in this statement to be to the detriment of any group within society. In particular, we do not consider that they will have a differential impact on consumers in different parts of the UK or on consumers with low incomes.
- 2.13 We have not carried out separate EIAs in relation to race or gender equality, or equality schemes under the Northern Ireland and Disability Equality Schemes. This is because we do not believe that the policies presented here, which primarily affect wholesale markets, would have a different impact in relation to people of different gender or ethnicity, or consumers in Northern Ireland or on disabled consumers compared to consumers in general.

Outline of the rest of this document

- 2.14 The rest of the main part of this document is structured as follows:
 - Section 3 – Approach to market definition, SMP assessment and imposition of remedies;

¹⁰ http://www.ofcom.org.uk/consult/policy_making/guidelines.pdf

- Section 4 – Retail market definition;
- Section 5 – Retail market power assessment;
- Section 6 – Wholesale market definition;
- Section 7 – Wholesale market power assessment;
- Section 8 – Retail remedies for KCOM;
- Section 9 – Wholesale remedies for Openreach and KCOM; and
- Section 10 – Price regulation of wholesale ISDN30.

Section 3

Approach to market definition, SMP assessment and imposition of remedies

Introduction

- 3.1 In this section we set out the processes that we have followed in Sections 4, 5, 6 and 7 in defining the markets within this review, how and on what basis we assess whether anyone has SMP in a given market and whether SMP conditions should be imposed in a relevant market. The remedies we consider are appropriate are set out in Sections 8, 9 and 10.
- 3.2 We set out further detail on the legal framework pertaining to the market review process is set out in Annex 7.

Forward Look

- 3.3 Rather than just looking at the current position, market reviews look ahead to how competitive conditions may change in future. Our evaluation of the current market takes into account past developments and evidence. Then we consider the expected or foreseeable market developments over a reasonable period in the future.
- 3.4 The actual period used for this forward look should reflect the specific characteristics of the market and the expected timing for the next review. In this market review, we have looked at potential developments over the next four years.
- 3.5 In these markets, the key anticipated change over the next four years is the increased use of IP-based alternatives to ISDN30. However, there is uncertainty about the speed of take up of IP services (as discussed in Section 4). This makes it harder to foresee how the existing competitive conditions will change in the next four years.
- 3.6 However, based on past data and the information before us, we are of the view that competitive and technological developments are not expected to materially affect our proposed market definitions within a four year period. Our user surveys indicate that a large majority of ISDN30 users are not currently considering switching to alternative services in the short term. Switching to IP services appears likely to arise as companies upgrade or replace their systems, but, as this happens relatively infrequently (it can represent a large overhead), substitution to IP services is likely to happen only gradually over time.
- 3.7 We consider a four year forward look to be reasonable in this case as this period provides a reasonable degree of regulatory certainty to stakeholders in the UK. It also seems a reasonable point at which to take stock of developments in relation to IP-based solutions. The four year forward look covers a potential charge control and the interim period until any such control is set.
- 3.8 The four year forward look that we have used allows for the possibility of our next market review taking place in that timeframe. However, given the potential impact of the take up of IP-based alternatives in this market over the next few years we will continue to monitor the market, and we will consider the timing of the next review

accordingly. In doing this, we will consider the new procedures and timeframes for conducting market reviews introduced by the amendments to the EU regulatory framework. Those requirements will apply in the UK from 26 May 2011.

Approach to market definition

- 3.9 There are two dimensions to the definition of the relevant market: the relevant products to be included within the market and the geographic extent of the market. As such it is often practical to define the relevant product market before exploring the geographic dimension of the market.
- 3.10 The market definition exercise of the market analysis is not an end in itself, but a means to an end. Market definition aids the assessment of whether end-users of a product are protected by effective competition and thus whether there is a requirement for the imposition of *ex-ante* regulation. It is in this light that we have conducted our market definition in this review.

Demand-side and supply-side substitution

- 3.11 Market boundaries are determined by identifying constraints on the price setting behaviour of firms. There are two main constraints to consider: first, to what extent is it possible for a customer to substitute other services for those in question (demand-side substitution); and second, to what extent can suppliers switch, or increase, production to supply the relevant products or services (supply-side substitution) in response to a relative price increase.
- 3.12 The ‘hypothetical monopolist test’ (HMT) is a useful tool often used to identify close demand-side and supply side substitutes. A product is considered to constitute a separate market if the hypothetical monopolist supplier could impose a small but significant non-transitory increase in price (SSNIP) above the competitive level without losing sales to such a degree as to make this price rise unprofitable. If such a price rise would be unprofitable, because consumers would switch to other products, or because suppliers of other products would begin to compete with the hypothetical monopolist, then the market definition should be expanded to include the substitute products.
- 3.13 We define markets first on the demand-side. The analysis of demand-side substitution (set out in Sections 4 and 6) has been undertaken considering if other services could be considered as substitutes by consumers, in the event of the hypothetical monopolist supplier introducing a SSNIP above the competitive level.
- 3.14 Then we assess supply-side substitution possibilities to consider whether they provide any additional constraints on the pricing behaviour of the hypothetical monopolist which have not been captured by the demand-side analysis. In this assessment, supply-side substitution is considered to be a low cost form of entry which can take place within a reasonable timeframe (e.g. up to 12 months). The key point is that, for supply-side substitution to be relevant, not only must suppliers be able, in theory, to enter the market quickly and at low cost by virtue of their existing position in the supply of other products or areas, but there must also be an additional competitive constraint arising from such entry into the supply of the service in question.
- 3.15 Therefore, in identifying potential supply-side substitutes it is important that providers of these services have not already been taken into consideration. There might be suppliers who provide other services but who might also be materially present in the

provision of demand-side substitutes to the service for which the hypothetical monopolist has raised its price. Such suppliers are not relevant to supply-side substitution since they supply services already identified as demand-side substitutes. As such, their entry has already been taken into account and so supply-side substitution from these suppliers cannot provide an additional competitive constraint on the hypothetical monopolist. However, the impact of expansion by such suppliers can be taken into account in the assessment of market power.

Common pricing constraints

- 3.16 Another factor that is sometimes an additional consideration in setting market boundaries is whether there exist common pricing constraints across customers, services or geographic areas (i.e. areas in which a firm voluntarily offers its services at a geographically uniform price). Where common pricing constraints exist the geographic areas in which they apply could be included within the same relevant market even if demand-side and supply-side substitutes are not present. Failure to consider the existence of a common pricing constraint could lead to unduly narrow markets being defined.

Homogeneous competitive conditions

- 3.17 Our approach also takes into account the SMP Guidelines¹¹. In particular, paragraph 56 of the SMP Guidelines states that:

“According to established case-law, the relevant geographic market comprises an area in which the undertakings concerned are involved in the supply and demand of the relevant products or services, in which area the conditions of competition are similar or sufficiently homogeneous and which can be distinguished from neighbouring areas in which the prevailing conditions of competition are appreciably different...”

- 3.18 Hence, subject to the relevant caveats above, where there are geographic areas where competitive conditions are sufficiently homogeneous the definition of the relevant geographic market will include all of those areas within one market

Relationship between wholesale and retail markets

- 3.19 Analysis of retail market definitions logically takes place prior to the definition of wholesale markets. This is because the demand for the upstream service is a derived demand i.e. the level of demand for the upstream input depends on the demand for the retail services which it supports. If the upstream input accounts for a sufficiently large proportion of the downstream price, the range of available substitutes at the downstream (retail) level will inform the likely range of substitutes for the upstream (wholesale) service. This is because a rise in the price of a wholesale service which is passed through to the retail service might cause retail customers to switch products to services which may adequately substitute for the service in question, thus reducing demand for the wholesale input.

¹¹ Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services (2002/C 165/03).

Relevance of existing regulation

- 3.20 When we conduct our analysis to define the relevant retail and wholesale markets we assume that there is no SMP regulation in place in the market under consideration.
- 3.21 In addition, the wholesale market is defined assuming the absence of regulation at the retail level. We have therefore considered demand-side and supply-side substitution possibilities at the retail level only if they are economically viable in the absence of SMP regulation in the market being considered. This approach is consistent with the Explanatory Memorandum¹².
- 3.22 On the other hand, it is appropriate to take into account any regulation that is upstream of the market being considered, as upstream regulation (e.g. wholesale remedies) has the potential to affect the competitive state of downstream (i.e. retail) markets. Indeed, this is generally one of the main intentions of upstream regulation.

Geographic market

- 3.23 In addition to the products to be included within a market, market definition also requires the geographic extent of the market to be specified. The geographic market is the area within which demand side and/or supply side substitution can take place and is defined using a similar approach to that used to define the product market. We have considered the geographic extent of each relevant market covered in this market review.
- 3.24 There are a number of possible approaches to geographic market definition. One approach would be to begin with a narrowly-defined area and then consider whether a price increase by a hypothetical monopolist in that narrowly defined area would encourage customers to switch to suppliers located outside the area (demand-side substitution) or CPs outside the area to begin to offer services in the area (supply-side substitution). If supply and/or demand side substitution is sufficient to constrain prices then it is appropriate to expand the geographic market boundary.
- 3.25 We recognise that in certain communications (product) markets in the UK, there could be different competitive pressures in different geographic areas. For example, BT competes in the provision of local access with Virgin Media where it has cable access network infrastructure. We have to consider whether, in this case, it would be appropriate to identify separate geographic markets for some services. We have, for example, defined separate geographic markets in our *Review of the wholesale broadband access markets*¹³. Defining such geographic markets may be problematic because, due to the dynamic nature of communications markets, the boundary between areas where there are different competitive pressures may be unstable and change over time, rendering the market definition obsolete.
- 3.26 Therefore, defining separate geographic markets is only likely to be a worthwhile exercise where the market conditions are considered to be sufficiently different on an ongoing basis.

¹² Explanatory Memorandum to the Commission Recommendation of 17 December 2007 on relevant Product and Service Markets

http://ec.europa.eu/information_society/policy/ecommerce/doc/library/proposals/sec2007_1483_final.pdf

¹³ *Review of the wholesale broadband access markets*, 23 March 2010

<http://www.ofcom.org.uk/consult/condocs/wba/wbacondoc.pdf>

- 3.27 An alternative approach is to define geographic markets in a broader sense. This involves defining a single geographic market but recognising that this single market has local geographical characteristics. That is to say, recognising that within the single market there are areas where competition is more developed than in other areas. This avoids the difficulties of proliferation and instability.
- 3.28 In carrying out this particular market review, we have taken into account the guidance on geographic markets produced by the European Regulators Group (ERG), *ERG Common position on Geographic Aspects of Market Analysis*, published in October 2008.

Market power assessment

- 3.29 As mentioned above, market definition is not an end in itself. The definition of the scope of the relevant economic market is carried out in order to identify the products and the geographic area over which an assessment can be made of CPs' ability to act to an appreciable extent independently of competitors, customers and consumers, i.e., whether there are any CPs that hold a position of SMP within a particular market.

Definition of SMP

- 3.30 Sections 45, 46 and 78 of the Act grant us the power under certain circumstances to set conditions which require CPs to do certain things. Specifically, Section 46(7) states that SMP services conditions may be imposed on a particular person who is either a CP or a person who makes associated facilities available, and who has been determined to have SMP in a services market (i.e. a specific market for electronic communications networks, electronic communications services or associated facilities).
- 3.31 Accordingly, having identified the relevant product and geographic markets, we are required to analyse each market in order to assess whether any person or persons have SMP as defined in Section 78 of the Act (Article 14 of the Framework Directive¹⁴).
- 3.32 Section 78 of the Act provides that SMP is defined as being equivalent to the competition law concept of dominance in accordance with Article 14(2) of the Framework Directive which provides:

"An undertaking shall be deemed to have significant market power if, either individually or jointly with others, it enjoys a position equivalent to dominance, that is to say a position of economic strength affording it the power to behave to an appreciable extent independently of competitors, customers and ultimately consumers."

- 3.33 Further, Article 14(3) of the Framework Directive states that:

"Where an undertaking has significant market power on a specific market, it may also be deemed to have significant market power on a closely related market, where the links between the two markets are such as to allow the

¹⁴ Directive 2002/21/EC on a common regulatory framework for electronic communications networks and services (the "Framework Directive")

http://ec.europa.eu/information_society/policy/ecommerce/current/index_en.htm

market power held in one market to be leveraged into the other market, thereby strengthening the market power of the undertaking".

- 3.34 Therefore, in the relevant market, one or more undertakings may be designated as having SMP where that undertaking or undertakings enjoy a position of dominance. Also, an undertaking may be designated as having SMP where it could lever its market power from a closely related market into the relevant market, thereby strengthening its market power in the relevant market.

The Criteria for assessing SMP

- 3.35 In assessing whether an undertaking has SMP, we have taken due account of the SMP Guidelines as we are required to do under Section 79 of the Act. We have also considered the application of the equivalent guidelines published by Oftel¹⁵.
- 3.36 The SMP Guidelines require national regulatory authorities ('NRAs') to assess whether the competition in a market is effective (i.e. no CP is found individually or jointly dominant). This is undertaken through a forward looking evaluation of the market, determining whether the market is prospectively competitive, taking account of foreseeable developments.
- 3.37 Market share is an indicator of market power but the SMP Guidelines state that high market share alone is not sufficient to establish the possession of SMP. The SMP Guidelines further state that, in the Commission's practice, single dominance normally arises where market shares are over 40%, and very large market shares of over 50% are evidence of the existence of a dominant position. This presumption is rebuttable and a thorough and overall analysis is required before coming to a conclusion on the existence of SMP. Non-exhaustive criteria are suggested to measure the power of a market undertaking. This is considered in Annex 7.
- 3.38 Where a market is found to be competitive then no SMP conditions can be imposed. Section 84(4) requires that any SMP condition in that market, applying to a person by reference to a market power determination made of the basis of an earlier analysis, must be revoked.

The need for *ex ante* regulation

- 3.39 Before turning to the last market review stage concerning *ex ante* remedies, it is necessary to consider whether competition law (*ex post*) remedies are sufficient. This consideration is necessary to establish, in line with the 27th recital to the Framework Directive, whether or not a market is effectively competitive. (In this context it is to be noted that the importance of identifying the problem reappears under Article 8(4) of the Access and Interconnection Directive. This is because obligations imposed in accordance with Article 8 shall be based on the nature of the problem identified, proportionate and justified in light of the objectives laid down in Article 8 of the Framework Directive.) In assessing the sufficiency of Competition Law, a number of considerations are taken into account.

¹⁵ www.ofcom.org.uk/static/archive/oftel/publications/about_oftel/2002/smpg0802.htm

Appropriate to promote the development of competition

- 3.40 As a competitive market will produce a more efficient outcome than a regulated market, the promotion of competition is central to securing the best deal for the consumer in terms of quality, choice and value for money.
- 3.41 Where markets are effectively competitive, *ex post* competition law is sufficient to deal with any competition abuses that may arise. However, without the imposition of *ex ante* regulations to promote actively the development of competition in a market which is not effectively competitive, it is unlikely that *ex post* general competition law powers will be sufficient to ensure that effective competition becomes established. For example, this is because *ex post* powers prohibit abuse of dominance rather than the holding of a dominant position. *Ex ante* powers can be utilised to reduce the level of market power in a market and thereby encourage effective competition to become established.
- 3.42 The risk is not all one way as use of some *ex ante* measures can themselves limit or add nothing to the development of competition. We have recognised this in removing some regulation in some markets where markets are not effectively competitive.
- 3.43 We are proposing that *ex ante* regulation is necessary in all of the markets covered in this consultation in which we found someone to have SMP. The proposed remedies considered in Sections 9 and 10 are appropriate to promote the development of competition in downstream ISDN30 markets. A failure to regulate the legacy CP (Openreach or KCOM) in these markets is likely to affect the development of competition in that competing providers would be unlikely to provide intermediate or retail services without wholesale services provided by the legacy CP. In the absence of regulation, the legacy CP would have little incentive to provide wholesale services.
- 3.44 It is preferable to apply regulation at the wholesale level as this both addresses SMP issues in the wholesale markets and promotes competition in downstream markets that rely on wholesale inputs¹⁶. This fits with the requirement that NRAs take measures which meet the objective of encouraging efficient investment in infrastructure and promoting innovation (see Article 8(2) of the Framework Directive and section 4 of the 2003 Act). The regulation of wholesale markets encourages competing providers to purchase wholesale products and combine them with their own networks to create products in competition with the legacy CP.

Imposition of *ex ante* regulation

- 3.45 We set out in Annex 7 the factors relevant when assessing the need for *ex ante* regulation and whether competition law might be appropriate to address the competition concerns identified.
- 3.46 Section 87(1) of the Act provides that, where we have made a determination that a person is dominant in a particular market, we must set such SMP services conditions as it considers appropriate and as are authorised under the Act. Section 87(1) implements Article 8 of the Access Directive.
- 3.47 Paragraphs 21 and 114 of the SMP Guidelines state that NRAs must impose one or more SMP services conditions on a dominant provider, and that it would be inconsistent with the objectives of the Framework Directive not to impose any SMP services conditions on an undertaking which has SMP.

¹⁶ For the Hull area, however, we consider retail regulation is also necessary

- 3.48 The Act (Sections 45-50 and 87-92) sets out the obligations that we can impose if we find that any undertaking has SMP. Sections 87 to 92 implement Articles 9 to 13 of the Access Directive and Articles 17 to 19 of the Universal Service Directive.
- 3.49 Recital 27 of the Framework Directive provides that *ex-ante* regulation should be imposed only where there is not effective competition and where competition law remedies are not sufficient to address the perceived problem. In order to provide a full analysis, we have considered whether we could rely on competition law alone, while noting the obligations referred to above.
- 3.50 Section 3 of the Act sets out our general duties. Section 3(1) states that our principal duty is to further the interests of citizens in relation to communications matters and consumers in relevant markets, where appropriate, by promoting competition. Specifically, Section 3(2)(b) states that we are required to secure the availability of a wide range of electronic communications services throughout the UK. Section 3(4)(b) explains that, in meeting these requirements, we must have regard to the desirability of promoting competition in relevant markets. Also, in furthering the interests of consumers, we must have regard to choice, price, quality of service and value for money. Additionally, Section 4 of the Act sets out the Community duties which flow from Article 8 of the Framework Directive.
- 3.51 We, in considering whether to propose any SMP services conditions, have considered all of these requirements. In particular, we have considered the requirement to promote competition in relation to the provision of electronic communications networks and electronic communications services.
- 3.52 Also, SMP services conditions must be appropriate (Section 87(1) of the Act) and satisfy the tests set out in Section 47(2) of the Act. These are that each condition must be:
- objectively justifiable in relation to the networks, services or facilities to which it relates;
 - not discriminate unduly against particular persons or a particular description of persons;
 - proportionate to what the condition is intended to achieve; and
 - in relation to what it is intended to achieve, transparent.
- 3.53 In Section 7, we have explained why we consider that BT and KCOM have SMP in their respective markets for wholesale ISDN30. Article 16 of the Framework Directive provides that
- “where an NRA determines that the relevant market is not effectively competitive, it shall identify undertakings with SMP on that market... and... shall on such undertakings impose appropriate specific regulatory obligations...”
- 3.54 In assessing the appropriate level of regulation to be applied, we have also taken into account the SMP Guidelines which state at paragraph 15 that regulation should aim to promote an open and competitive market, and at paragraph 16 that *ex-ante* regulations should be imposed to ensure that an SMP provider cannot use its market power to restrict or distort competition on the relevant market or leverage market power in to adjacent markets.

- 3.55 We have also taken full account of Oftel's guidelines, which were published on 13 September 2002 ('the Access Guidelines'), on the imposition of access obligations under the new Directives¹⁷. These describe the circumstances in which we would consider the imposition of wholesale access obligations to be appropriate, give guidance on the nature of the wholesale products we would expect to be supplied as a result of an obligation to provide access, and describe the conditions under which products should be made available.
- 3.56 In addition, we have considered the Revised ERG Common Position on the approach to appropriate remedies in the electronic communication networks and services (ECNS) regulatory framework¹⁸ ('the ERG Remedies Position') and, in particular, the statement that
- "...there is a presumption that *ex ante* regulation is appropriate on the 18 markets in the Recommendation if a position of SMP is found."¹⁹
- 3.57 The ERG Remedies Position sets out that in the case of markets where there is a single firm having SMP, remedies should be considered to address the following concerns:
- entry-deterrance;
 - exploitative behaviour; and
 - productive inefficiencies.
- 3.58 The ERG Remedies Position sets out that, in the case of a single firm having SMP in a wholesale market such as that for wholesale ISDN30 access, the following remedies should be considered to address the concerns set out above:
- a requirement to publish a reference offer;
 - an obligation to meet reasonable requests for access to, and use of, specific network elements and associated facilities;
 - an obligation for access charges to be cost-orientated;
 - a requirement to pre-notify changes in tariffs;
 - the setting of price controls; and
 - an obligation not to discriminate.

European Commission's Recommendation on Markets

- 3.59 In 2003, the European Commission issued its *Recommendation on relevant product and services markets*²⁰ identifying product and service markets within the electronic communications sector in which *ex ante* regulation may be warranted. The

¹⁷ http://www.ofcom.org.uk/static/archive/oftel/publications/ind_guidelines/acce0902.htm

¹⁸ See http://erg.eu.int/doc/meeting/erg_06_33_remedies_common_position_june_06.pdf

¹⁹ See page 9. Note: the number of markets has been reduced to 7 in the Recommendation (second edition)

²⁰ Commission Recommendation of 11 February 2003 2003/311/EC, OJ L114, 8.5.2003, p.45.

Commission revised the Recommendation in December 2007, reducing the number of markets on the list²¹.

- 3.60 In formulating our proposals, we have taken utmost account of the Recommendation on Markets, the Explanatory Memorandum and the SMP Guidelines. We explain this in the specific context of this market review in paragraphs 4.72 to 4.80.

²¹ Commission Recommendation of 17 December 2007 2007/879/EC, OJ L344, 28.12.2007, p.65: http://eur-lex.europa.eu/LexUriServ/site/en/oi/2007/l_344/l_34420071228en00650069.pdf and also the accompanying Explanatory Note, *Commission Staff Working Document, Explanatory Note to the Commission Recommendation on Relevant Product and Service Markets within the electronic communications sector susceptible to ex ante regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communication networks and services (Second edition)* http://ec.europa.eu/information_society/policy/ecommerce/doc/library/proposals/sec2007_1483_final.pdf

Section 4

Retail market definition

Introduction and Summary

- 4.1 The purpose of this section is to propose a retail market definition which we will then use to assess market power. It is important to note that market definition is not an end in itself. We believe that there are risks in putting too much emphasis on an assessment of where the boundaries of the relevant economic market might lie as what matters for an assessment of SMP is not so much whether a service lies just “inside” or just “outside” a market but rather the constraint it imposes on the delivery of services within that market (for example the impact of IP-based services on the ISDN30 access market).
- 4.2 Where the evidence of substitutability is ambiguous we have adopted a cautious approach and retained our previous market definitions while recognising any increased competitive constraint from greater substitutability in our SMP assessment.
- 4.3 The retail consultation provisionally found that there was a distinct market for the supply of retail ISDN30 exchange line services. BT's response to the retail consultation (and representations that it has made subsequently) stated that the market definition proposed was too narrow and that alternative technologies could be used to provide multiple channel exchange line services. BT suggested that ISDN30 is increasingly competing with new technologies such as IP-based products²² and that our analysis did not sufficiently take these into account.
- 4.4 We have given considerable thought to this matter as explained in more detail later in this section. However, our provisional conclusion remains the same (i.e. ISDN30 is in a separate retail market from other services).
- 4.5 The structure of this section is as follows: first, we provide descriptions of the various products relevant for this assessment. Then we discuss demand and supply side substitution, and finally the relevant geographic market.

Product descriptions

- 4.6 Analogue, ISDN2 and ISDN30 are standard exchange line services associated with the current Public Switched Telephone Network ('PSTN') which is based on Time Division Multiplexing ('TDM') technology.

Analogue exchange lines

- 4.7 An analogue exchange line provides a single 64kbit/s channel that can support traditional telephony, facsimile and modem data traffic. Analogue exchange lines are delivered as follows:
 - In the UK outside of Hull, BT provides analogue exchange lines via its copper access network.

²² For instance, BT suggested that IP Centrex, Hosted VoIP and SIP Trunking services all offer similar functionality to ISDN30.

- Within the Hull Area, KCOM provides analogue exchange lines via its copper access network. This network is also used to deliver broadband services.
- Virgin Media delivers analogue exchange lines using its cable network. This service is delivered using a copper access network but shares the same duct as the hybrid fibre/coaxial network used to deliver Virgin Media's cable TV and broadband. Virgin Media's cable network is available to approximately 50% of the population.
- Local loop unbundling (LLU) provides access to the BT copper access network (KCOM is also required to provide LLU although no demand has yet arisen from other CPs looking to enter the market in the Hull Area). The majority of LLU providers have used this type of access to provide broadband services only, but some providers have used LLU to provide combined narrowband and broadband offers.

ISDN2

- 4.8 ISDN2 (Basic Rate ISDN) is a digital telephone line service which provides 2 digital channels with a bandwidth of 64 kbit/s each and a control channel of 16kbit/s on a single exchange line. These channels support a wide range of services including basic telephony with additional features to those available on analogue exchange lines and data services with bandwidths up to 128 kbit/s. ISDN2 can support two telephone calls simultaneously.
- 4.9 ISDN2 lines are provided using the copper access network infrastructure. It is unlikely to be economic for providers that do not have a copper access network to deploy their own infrastructure to support ISDN2 services. The main providers of ISDN2 lines are BT, KCOM in the Hull area and Virgin Media (using its ntl:telewest business brand) where it has a cable network footprint.
- 4.10 ISDN2 services are designed to cater for smaller business sites. The ISDN2 service is generally appropriate for sites requiring less than 8 voice channels.

ISDN30

- 4.11 ISDN30 (Primary Rate ISDN) is a digital telephone line service that uses a 2 Mbit/s bearer circuit to provide up to 30 digital channels with a bandwidth of 64 kbit/s per channel plus a control channel of 64 kbit/s. These channels support a wide range of services including basic telephony with additional features to those available on analogue exchange lines and data services. ISDN30 can support up to 30 telephone calls simultaneously.
- 4.12 ISDN30 is used exclusively by businesses. It is used most commonly to provide exchange line connectivity to on-site PBXs.
- 4.13 ISDN30 is generally used to provide multiple channel applications to businesses in need of 8 or more lines (it is generally accepted that for businesses that require less than 8 lines other services such as ISDN2 will provide a better solution).
- 4.14 A number of CPs (such as C&W and Colt) provide ISDN30 using their own infrastructure. The larger bandwidth required to provide these services and the higher concentration of premises likely to use ISDN30 services in city centres makes the deployment of alternative infrastructure economic in some cases.

4.15 It is also technically possible to provide ISDN30 via LLU. To date we are not aware of any CPs who have done this ~~>~~.

Leased lines

4.16 Leased lines provide dedicated transmission capacity between customer sites and can be used to carry voice and data traffic.

IP-based services

4.17 In the last few years there has been a marked shift to the use of IP-based technologies for communications networks. This trend is evident in:

- public networks where TDM based telephony networks are beginning to be replaced with IP-based multiservice Next Generation Networks;
- business voice networks where IP-based PBXs are superseding TDM based PBXs; and
- IP and ethernet transmission technologies are increasingly being used in access and backhaul networks as well as for leased lines in preference to older technologies such as asynchronous transfer mode ('ATM').

4.18 New telephony services based on IP-based technologies that could potentially be substitutes for ISDN30 are now becoming available. There are three main types of IP based technologies:

- *SIP Trunking*²³ – an exchange line service that uses IP for voice and data transmission and Session Initiation Protocol ('SIP') for the telephony control signalling. SIP Trunking services are generally multi-line services that are used to provide exchange line services to modern IP PBXs that support this type of interface.
- *IP Centrex* – an exchange line service that includes the functionality of a PBX within a CP's network. This enables businesses to have the call management features of a PBX such as extension numbering and inter-extension calling without the need to purchase or operate a PBX. Centrex services have been available in various forms for many years and more recently IP-based variants have been introduced and these are commonly known as IP Centrex²⁴.
- *Hosted VoIP*²⁵ - this is another term used to describe IP Centrex services. It is generally used to describe services provided to small sites that are accessed via an ordinary broadband internet connection.

4.19 It is important to note that IP based services and the terminology used to describe them are still evolving. This is particularly true of IP Centrex and Hosted VoIP which are somewhat interchangeable.

²³ This is sometimes referred to as IP Business Trunks or IP Trunks.

²⁴ Typically, special IP telephones are used which communicate with a call server located in the CP's network via an IP access connection and a data local area network ('LAN') within the business premises. As with SIP Trunking, IP is used for voice and data transmission and SIP for telephony signalling.

²⁵ This is sometimes referred to as Hosted Telephony.

Demand-side substitution

Analogue exchange lines, ISDN2 and ISDN30

- 4.20 ISDN30 is a narrowband access service designed to cater for larger business sites. ISDN30 supports up to 30 channels and, as discussed above, is used most commonly to provide multiple telephone lines to PBXs. It is generally accepted that the entry level for ISDN30 is 8 channels, and charges are set generally on a per channel basis above this level. ISDN2 and ISDN30 also support a wider range of supplementary services²⁶ than analogue lines.
- 4.21 Given the different uses to which analogue and ISDN30 exchange line services are put it is very unlikely that ISDN30 access customers would regard analogue services as suitable demand side substitutes.
- 4.22 The functional differences identified between analogue and ISDN30 exchange line services suggest that a hypothetical monopolist providing ISDN30 access who attempted a SSNIP above the competitive level would not find the profitability of this constrained by demand side substitution to analogue lines. This is because ISDN30 access customers are unlikely to be willing to give up the extra functionalities of their ISDN30 access given a SSNIP.
- 4.23 Business ISDN2 services are designed to cater for smaller business sites with single line ISDN2 services providing 2 channels. As explained above, ISDN2 is appropriate for sites requiring less than 8 voice channels. ISDN2 is not generally used for much larger sites, since the PBXs on these sites will normally be designed to support an ISDN30 connection, not a large number of ISDN2 connections. Therefore, it is not cost-effective at current prices for a customer requiring over 8 channels to substitute an ISDN30 service for an ISDN2 service. Whereas ISDN2 is provided over narrowband copper loops, the majority of ISDN30 access is provided over fibre or HDSL enabled copper. The cost of providing ISDN30 over either fibre or HDSL enabled copper will be considerably cheaper than providing the same service over multiple ISDN2 copper lines.
- 4.24 Therefore, at competitive prices, an ISDN30 (30 channel) customer will not find 15 ISDN2 lines a good demand side substitute. However, there are likely to be some ISDN customers who desire an intermediate number of channels such that they would find provision via either ISDN2 or ISDN30 demand side substitutes.
- 4.25 More generally, we consider that the number of customers able to substitute between ISDN30 and ISDN2 is not large enough to act as a competitive constraint on ISDN30 so we provisionally conclude that ISDN30 is in a separate market from analogue lines and ISDN2. Moreover, we believe that an ISDN30 supplier's ability to price discriminate is somewhat limited as this is a mass product sold to many businesses.

ISDN30 and Leased Lines

- 4.26 An ISDN30 service can be considered to consist of two components, a bearer service that connects the customer premise to the exchange and the call control/switching functions provided by the exchange. A leased line can be used to provide the bearer service and thus leased lines can be considered an upstream input.

²⁶ For example, Digital Select Services and direct dial in (DDI).

- 4.27 A fundamental difference between ISDN30 and leased lines is, however, that the former provides switched voice and data access services whereas the latter provides transmission capacity only therefore a retail customer cannot purchase leased lines alone as a demand side substitute for ISDN30 exchange lines. This means ISDN30 and leased lines are not substitute products.

IP services and ISDN30

- 4.28 In this section we consider demand side substitution between hosted services (such as IP Centrex and Hosted VoIP), SIP Trunking and ISDN30.
- 4.29 In response to the retail consultation BT commented that we had not taken IP-based products sufficiently into account in our market definition analysis. BT thought that a proper analysis would show that broadband and IP based solutions are growing and are increasingly substitutable for ISDN30. We have undertaken significant further analysis in this area since the retail consultation. We have gathered further evidence via a market research survey of ISDN and IP users, and also gathered further information from CPs through formal requests under Section 135 of the Act (the 'S135 requests').
- 4.30 In considering the impact of IP services, first we discuss functional differences between ISDN30 and IP services and then we look at user preferences.

Functional aspects

Hosted VoIP and IP Centrex

- 4.31 The key functional differences between Hosted VoIP services/IP Centrex and ISDN30 is that, in addition to exchange line functionality, IP Centrex and Hosted VoIP incorporate the functionality of a PBX. IP Centex and Hosted VoIP would therefore only be a substitute for ISDN30 for businesses that are prepared to use a managed network based service for PBX functionality as an alternative to an onsite PBX. Historically, some businesses have preferred the security and control of having PBXs on their premises.
- 4.32 As part of the S135 requests, we asked 7 large CPs whether they considered that Hosted VoIP, Centrex and SIP Trunking provided an alternative service for users of ISDN30. We considered that the views of these CPs would provide us with a relatively accurate barometer of the extent to which alternative technologies are used as substitutes for ISDN30 at present and the extent to which they will do so in the future.
- 4.33 Those CPs who provided an answer regarding Hosted VoIP and Centrex had mixed views. In the main, the CPs asked thought that these products could be an alternative to ISDN30 in certain instances. However, Hosted VoIP and Centrex would not necessarily constitute a direct like for like comparison to ISDN30, and would probably not be suitable as a substitute for all customers. The S135 information received from CPs suggests that the number of Centrex and Hosted VoIP channels currently supplied is small relative to the number of ISDN30 channels (based on data from the 7 CPs we requested information from, Centrex and Hosted VoIP combined

represent less than 450,000 channels²⁷. We estimate that there are around 3.2 million ISDN30 channels in total).

SIP Trunking

- 4.34 SIP Trunking is in essence an IP-based exchange line service and is therefore a closer functional substitute for ISDN30 than IP Centrex and Hosted VoIP which incorporate PBX functionality. The CPs who responded to the S135 requests were of the view that SIP Trunking could be a functional replacement for ISDN30. However, the responses also revealed the relative immaturity of the SIP Trunking product offering. A number of CPs have only recently started to offer SIP Trunking or plan to start offering services in 2010. As such, there are currently relatively few SIP trunks in the UK.
- 4.35 Some CPs predict a fast growth in SIP Trunking, but the absolute number of channels is expected to remain relatively small. One CP thought growth would be more muted due to the economic climate. This was because IP solutions require enhanced customer premise equipment, which was seen as an additional cost without any immediate material benefits to the customer.
- 4.36 Our research and market analyst reports that we have seen indicate that SIP Trunking services are generally promoted as a cheaper alternative to ISDN30, both in terms of circuit rentals and call charges (which sometimes includes free 'on-net' calls between sites). However, CPs also promote other benefits such as additional flexibility in terms of scalability and numbering configuration compared with ISDN30. BT has also informed us that in multi-site applications SIP Trunking services offer efficiency savings associated with trunk aggregation which would reduce the overall number of channels required for a given traffic level.
- 4.37 SIP Trunking services are relatively new and immature and there are therefore a number of obstacles which need to be overcome for them to appeal to a wide market. The biggest obstacle to widespread acceptance of SIP Trunking has generally been businesses' reservations concerning its ability to provide a reliable and consistently high quality of service. In part, these reservations may have arisen because some SIP Trunking services use bearer circuits without Quality of Service ('QoS') support making them less reliable than ISDN30 connections.
- 4.38 CPs are addressing these problems by the use of QoS enabled bearer circuits or by the provision of dedicated bandwidth. However, until market confidence builds, take up of SIP Trunking services may be limited.
- 4.39 A further consideration is that deployment of SIP Trunking will require an IP enabled PBX (generally a recent model IP PBX that is capable of supporting SIP Trunking) or a gateway device to provide an ISDN30 interface for PBXs that are not capable of supporting SIP Trunking. Our user survey (discussed below) indicated that 90% of ISDN30 users have a PBX, and 62% (of all ISDN-based companies who have a PBX) are IP-enabled. This leaves a significant minority whose PBX is not IP enabled. When asked how often they replace their PBX around two thirds of the ISDN30 users surveyed indicated that it was less than every 5 years. This is likely to indicate that PBX replacement creates an additional barrier to IP service take up in the short term.

²⁷ Not all CPs who responded to the S135 request provided Centrex/Hosted VoIP. One CP was unable to estimate the number of Centrex/Hosted VoIP channels they provide.

4.40 Further, we understand that there are concerns that IP PBX interoperability can be an issue because the SIP signalling used to communicate between the network and the PBX is not standardised. If so, it is not always the case that any SIP enabled PBX can connect to any SIP Trunking service provider. In practice, it is likely that in the medium term, CPs are likely to offer services that are compatible with recent model PBXs manufactured by major vendors. In the short term, however, compatibility issues may further hamper take-up.

User preferences

- 4.41 We commissioned Prodata, an independent research company, to carry out primary research with businesses on our behalf. Given the low take-up of IP based alternatives to ISDN30, we commissioned two business surveys (one for companies that predominantly use ISDN30 ('ISDN30 users') and the other for companies that predominately use IP based services ('IP service users'))²⁸. We used the surveys to gain an understanding of:
- the reasons why businesses are using ISDN30 services;
 - the length of time for which they are likely to continue to use ISDN30 services;
 - whether IP technologies are regarded as a valid substitute for ISDN30 services or a migration path; and
 - the experience of businesses who have already migrated from ISDN30 to IP based services.
- 4.42 We have published this research today alongside this consultation.
- 4.43 A key finding of the research was that ISDN30 remains an important communications service for many companies. 93% of ISDN30 users considered this to be their primary service and 84% were not currently considering switching away from ISDN30.
- 4.44 Another key theme was that ISDN30 is valued for its reliability. 59% of ISDN30 users included reliability among its functional values, with 36% saying that this was the most important functional value. Reliability appears to be less important for IP users where 41% included it among the functional values.
- 4.45 Companies were less likely to rely solely on IP services. Our survey showed that 71% of IP service users considered this to be their primary service (versus 93% for ISDN30 users). 41% of IP service users who had migrated from ISDN30 had retained at least some of their ISDN30 services (either as a supplementary or a back up service). This compares with 13% of ISDN30 users who also use IP services. Again, this might reflect the perceived quality/reliability differential between IP services and ISDN30.

²⁸ As we discuss later, many companies use both ISDN30 and IP services. We have split the companies as follows. Those who carry out more than 66% of their business functionality on ISDN30 are defined as "ISDN30 users", while those that carry out more than 66% of their business functionality on IP services are defined as "IP service users". Although it is recognised that these companies may also use the additional service, unless noted otherwise, any reference to ISDN30 or IP services relates to the dominant service only. Prodata interviewed 475 predominantly ISDN30 companies and 156 predominately IP service companies.

- 4.46 The degree of ‘dual use’ of IP services and ISDN30 might suggest that the services are not good substitutes because, if they were fully substitutable, then users would not seek to retain both services. In reality the situation is probably more nuanced because IP services and ISDN30 may be used for different purposes (e.g. IP for inter-site calls and ISDN30 for external calls). It is likely that some companies, who ultimately plan to switch to IP services, will migrate to IP services slowly and may well have a period of dual running (e.g. they may ‘try out’ IP services prior to full implementation). Also it appears that IP users may retain some ISDN30 services for contingency reasons.

Strength of substitution to IP

- 4.47 In order to ascertain the strength of substitution from ISDN30 to IP services we asked ISDN30 users whether they were considering switching away from ISDN30. The majority of users (84%) were not currently considering switching away from ISDN30. 65% plan to keep using ISDN30 for two years or more, and 17% plan to use it for more than 10 years. When asked why they planned to continue using ISDN30, 46% of these companies mentioned its reliability and 40% that it met their needs.
- 4.48 For those who were considering moving away from ISDN30 the perceived benefits of doing so were to obtain cheaper alternatives and better value for money. Better service features were also a key reason for moving.
- 4.49 We asked ISDN30 users what they were planning to do when they stopped using ISDN30. 39% of respondents had not thought about replacing their ISDN30 service (clearly this indicates that switching away from ISDN30 is a very low priority for these companies). 24% mentioned that they would move to Hosted VoIP and 16% to SIP Trunking.
- 4.50 We also asked ISDN30 users which service they believed to be the best replacement for ISDN30. 54% of companies did not feel able to answer this question, again indicating a lack of awareness/consideration in this area. Of those able to respond, 25% said that they would not replace ISDN30, 67% that they would replace it with an IP-based service and 7% gave another response. Of the 148 companies who mentioned an IP-based service as the best replacement for ISDN30, 58% mentioned VoIP services, of which about a fifth specifically mentioned Hosted VoIP. SIP Trunking was the second most mentioned IP-based service and was mentioned by 28% of companies. IP Centrex was only mentioned by 2 companies and 18 companies mentioned a non-specific form of IP.
- 4.51 A further consideration in relation to substitution from ISDN30 at the retail level is whether ISDN30 is currently priced at the competitive level. Later in this consultation we state that we believe that Openreach’s wholesale access charges for ISDN30 are currently too high and propose that they are reduced via a charge control. This will have a knock on impact in the retail market and, even if the retail market is competitive, suggests that retail prices are currently too high. If retail prices are set above the competitive level (i.e. the level which would prevail if both the wholesale and retail markets were competitive) it is more likely that consumers will view alternative products as substitutes. Thus, even the relatively low level of substitution identified in our survey, is likely to be overstated.

Awareness of IP

- 4.52 Most ISDN30 users (86%) were aware of IP services. 30% of the ISDN30 users surveyed who are aware of IP services have either trialled, or are planning to trial IP

services. Of those who have trialled IP services and made decisions (91 companies), 44% decided to proceed with implementing the service. When asked about their concerns about IP services, 38% of the 113 companies with experience of trialling it²⁹ mentioned quality of service issues and 37% reliability. Finance was also an issue with 19% mentioning price and 12% the additional investment required.

Significance of price in a decision to switch

- 4.53 To gauge the significance of price in any decision to switch from ISDN30 we asked all ISDN30 users (regardless of whether they had expressed an intention to switch) whether a 10% fall in the price of ISDN30 (from all suppliers) would influence their decision to switch. It is more standard practice to ask users about their reaction to a 10% increase in prices. However, in the wholesale consultation we identified that Openreach was making high returns on ISDN30 services and therefore considered that, in this case, it made more sense to ask ISDN30 users about their reaction to a price decrease.
- 4.54 17% of respondents could not answer this question and a few said that they were not considering replacing ISDN30 at all. Of those able to answer, 33% of respondents did not believe the price decrease would affect a decision to switch away. Of the companies who were actively considering switching from ISDN30, 14% felt it would not affect their decision to switch, and 41% that it would be a consideration but have limited impact. 21% of companies would be more likely to stay with ISDN30 as a result of a price decrease, but only 12% of those were considering switching.
- 4.55 It is possible that a fall in the price of ISDN30 would lead some of these companies to reconsider switching. But 54% of potential switchers and 56% of all ISDN30 users³⁰ feel that a price decrease in itself would have little impact, these results confirm our view that there are also wider factors that trigger switching away from ISDN30.

Experience of those who have switched to IP services

- 4.56 A significant number of IP services users had implemented these services relatively recently, with 40% using them for less than 2 years. Of all IP-based companies, 69% were using Hosted VoIP, 35% SIP Trunking and 17% IP Centrex (some companies used more than one type of service).
- 4.57 The main reason (mentioned by 43% of IP users) for implementing IP services related to lower costs, and 70% of IP users believe that they saved money on their regular bills by implementing IP services. Quality of service and reliability were also important reasons for implementing IP services, mentioned by 39% and 35% of IP users respectively. This contrasts with the evidence from users who have not yet adopted IP services which showed that one of the obstacles to widespread acceptance of SIP Trunking was reservations about service quality. This contrast may simply reflect the naturally different perceptions of companies who have not yet experienced a new and unfamiliar technology and those who have. A system upgrade and need for increased flexibility were also both mentioned as a reason for implementing IP services by over a quarter of IP users.
- 4.58 In general, the main triggers for switching from ISDN30 to IP services are event-driven with 51% of companies saying that a general upgrade and 23% that a PBX

²⁹ This includes those currently trialling IP services and those who have previously trialled it.

³⁰ This excludes ISDN30 users who were unable to answer the question.

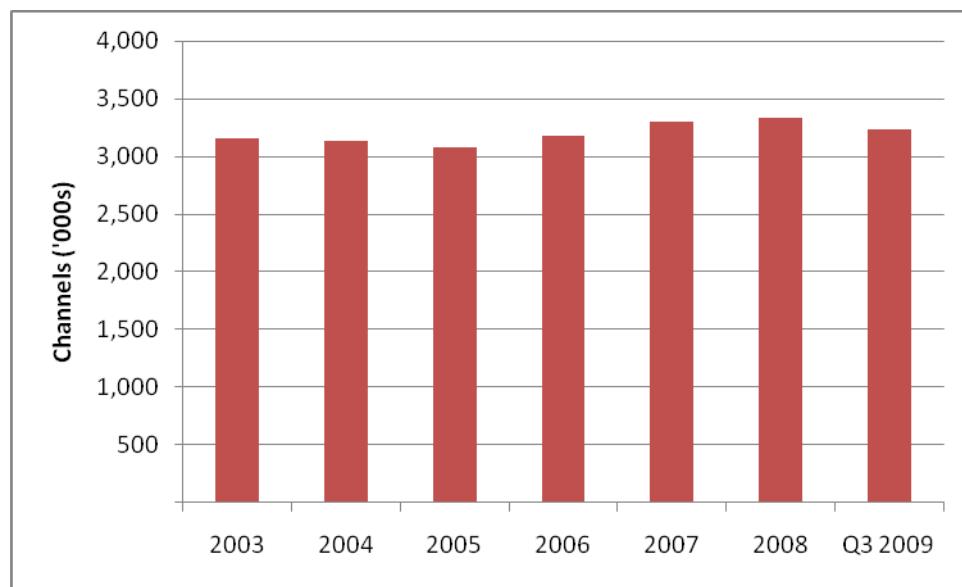
replacement triggered the change. The key non-event trigger was the need to reduce costs.

- 4.59 The majority of companies (75%) required investment in new equipment when they moved to IP services. We asked IP users who required investment the approximate cost of moving to IP services. Almost a third (32%) did not know what they spent or did not answer. 28% of companies spent less than £20k, 24% £20-100k and 15% over £100k.

Other evidence

- 4.60 Evidence has been submitted to us based on market analyst reports. This evidence includes suggestions that IP Voice is becoming a more established and credible mainstream technology, and that service convergence may drive a move to IP. It also includes evidence consistent with the findings of our survey and our discussions with ISDN30 users that an obstacle to widespread acceptance of SIP Trunking and VoIP generally has related to users' reservations about its quality and reliability. Analysts make differing forecasts on the growth of IP-based services.
- 4.61 We agree that IP based services are likely to gain momentum in the future. However, we would question whether this is likely to happen to any significant extent in the next 3-4 years. The number of ISDN30 channels has remained broadly constant over a number of years as shown in the Figure 4.1. Between Q4 2008 and Q3 2009 the total number of ISDN30 channels fell by 3%, consistent with a gradual substitution from ISDN30 to alternatives. Furthermore, even if there were significant growth to say 500,000 IP channels in the next couple of years, this still only represents around 16% of the current ISDN30 market.

Figure 4.1: ISDN30 channels³¹



Source: Ofcom/CPs

³¹ The ISDN30 channels are our estimates based on CP data provided as part of our regular market data collection processes. We have also collected information on ISDN30 channels as part of the S135 requests for this market review (used in sections 6 and 7). The estimate based on S135 information produces a slightly lower estimate of the market size (2.9 million channels at Q3 2009).

Summary

- 4.62 In light of this we believe that, for the period of our forward look, a narrow market definition based on ISDN30 only is still appropriate i.e. none of Hosted VoIP, IP Centrex or SIP Trunking are demand-side substitutes for ISDN30. However, we recognise the competitive constraints from IP services in the SMP assessment.

Supply-side substitution

Analogue exchange lines, ISDN2, LLU and ISDN30

- 4.63 It would be possible for CPs providing analogue exchange lines, ISDN2 or providing services over LLU to upgrade their networks to offer ISDN30 services. However, this would require significant sunk investment to provide the necessary functionality and to undertake the necessary operational support systems updates.
- 4.64 Given that the ISDN30 market is forecast to decline, such investments are unlikely to be economic given the limited time period over which sunk costs could be recovered, and the fact that adding to capacity in a market forecast to decline is likely to lead to a fall in the retail prices over the period of the investment.
- 4.65 In practice we have observed very limited supply-side substitution over time, with the number of self-supplied ISDN30 exchange lines (excluding Openreach to BT Retail) remaining relatively constant at approximately 800,000 channels.

Leased lines and ISDN 30

- 4.66 For the same reasons, supply-side substitution from leased lines into retail ISDN30 access, although feasible, is highly unlikely. Although leased lines may be used to provide the bearer circuits for ISDN30 services, significant investments would be required in switching equipment and operational support systems updates to provide telephony services.

IP services and ISDN30

- 4.67 As discussed above, IP-based services such as SIP Trunking are being offered by CPs as alternatives to ISDN30. Although it would be possible for providers to offer ISDN30 services instead, sunk investment would be required to develop ISDN30 services. Given this, it seems likely that CPs would concentrate their efforts on promoting their IP-based services as alternatives to ISDN30 rather than to provide ISDN30 services (particularly as IP-based alternatives are seen as the successor product to ISDN30).

Geographic market

- 4.68 In the March consultations we proposed a single UK market excluding Hull, and a separate Hull market³². We had had two stakeholder comments on this – one confidential respondent and The Federation of Communications Services commented on BT's (high) market share in Northern Ireland in the fixed narrowband retail services markets in general. They questioned whether it was appropriate to conclude that there was a single market for the UK excluding Hull.

³² In Hull KCOM faces little competition in the supply of ISDN30 (there is no cable, LLU or WLR). There is no effective demand side substitution, and supply side substitution from the rest of the UK is limited by the absence of wholesale access infrastructure.

- 4.69 We do not have information on the numbers of channels provided by self supply (other than from BT Northern Ireland³³ to BT Retail) specifically in Northern Ireland. However, we do have information on the number of channels provided by WLR to BT and others. The number of ISDN30 channels provided by WLR in Northern Ireland (including channels provided by BT Retail) is very small in relation to total provision across the UK. Only around 2% of total WLR channels provided across the UK are based in Northern Ireland (based on data at Q1 2009).
- 4.70 BT Retail accounts for about 3% of ISDN30 WLR channels in Northern Ireland, this compares to around 75% of ISDN30 WLR channels across the UK as a whole³⁴. Due to the relatively small size of the market for ISDN30 services in Northern Ireland we would expect to see fewer new entrants using WLR ISDN30 services so the fact that BT has a higher market share of WLR ISDN30 is not surprising. However, we see no evidence which suggests that competition is structurally different from the rest of the UK i.e. the presence of a WLR product means barriers to entry are low and do not appear to be substantively different from the rest of the UK.
- 4.71 In the UK excluding Hull, on the demand-side customers are only able to choose between CPs that operate in their geographic area so the ability to switch may therefore be limited compared to other areas e.g. where a customer lives in an area that is not served by cable. We also note that some CPs offer bespoke pricing. However, BT's prices are uniform across the UK and, given that competitors tend to price relative to BT, this suggests that pricing has a national dimension. Overall, we do not consider that competition has a particular geographic dimension. Accordingly, we remain of the view that there is a single UK market excluding Hull and a separate Hull market.

European Commission's Recommendation on Markets

- 4.72 In 2003, the European Commission issued its *Recommendation on relevant product and services markets* identifying product and service markets within the electronic communications sector in which *ex ante* regulation may be warranted. The Commission revised the Recommendation in December 2007, reducing the number of markets on the list.
- 4.73 In formulating our proposals, we have taken utmost account of the Recommendation on Markets (together with the Explanatory Memorandum and the SMP Guidelines).
- 4.74 The Commission has in its Recommendation defined the following as a relevant market in accordance with Article 15(3) of the Framework Directive:
- “Access to the public telephone network at a fixed location for residential and non-residential customers.”
- 4.75 As set out in the retail consultation, we provisionally defined 8 separate access markets (four for the UK (excluding Hull) and four for the Hull area), which are narrower than and, therefore, different to the Commission's market definition. We concluded on 6 of these markets in the retail statement. The remaining two retail markets are discussed here.

³³ This is the equivalent of BT Wholesale in Northern Ireland.

³⁴ Based on the number of internal and external ISDN30 rentals taken from BT's Current Cost Financial Statements for 2009, available at

<http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2009/CurrentCostFinancialStatements.pdf> page 39.

- 4.76 In order to identify markets that are susceptible to *ex ante* regulation, it is appropriate to apply the following three cumulative criteria set out in the Explanatory Memorandum to the Recommendation, namely:
- Barriers to entry and the development of competition
 - Dynamic aspects – no tendency towards competition
 - Relative efficiency of competition law and *ex ante* regulation
- 4.77 We consider some of these issues in further detail within our market analysis set out in the Section 5. We are mindful that the three criteria test is different from the SMP assessment and specifically that the three criteria test focuses on the general characteristics of a market, whilst an SMP assessment is made in relation to a specific CP in a given market. However, as certain issues are relevant to both the three criteria test and to a consideration of market power we have kept such discussion in a single section of this document to avoid unnecessary repetition. Further, even where we assess a market not to meet the three criteria test, we are obliged under sections 84 and 86 of the Act to conduct market analyses where we intend to revoke SMP conditions that are currently in force.
- 4.78 In relation to the proposed market for the UK excluding Hull we consider that, given the overlap between the three criteria test and our considerations for the SMP assessment, on this occasion it is more appropriate to discuss the three criteria test in tandem with our SMP analysis. Therefore we discuss our proposal for this market in Section 5.
- 4.79 In relation to the proposed market for the Hull area, we consider that the three criteria test is met. In relation to the first two tests we consider that barriers to entry remain high and that there is no evidence of the market tending toward competition, evidenced, in part, by the fact that there has been no (or little) entry into the market. We discuss these issues in more detail in paragraphs 5.34 to 5.44. We further consider that, given the conditions in this particular market, reliance upon competition law in the absence of *ex ante* regulation would be insufficient.
- 4.80 We have given careful consideration to the Recommendation, the Explanatory memorandum and the SMP Guidelines and we consider that the market definitions which we propose in this section are consistent with the approach set out in those documents.

Provisional Conclusion

- 4.81 We consider that there remains distinct ISDN30 retail markets for:
- the UK excluding Hull; and
 - the Hull area

Question 4.1 Do you agree or disagree with our market definition? Please give reasons for your view.

Section 5

Retail market power assessment

Introduction

5.1 The purpose of this assessment is to determine the effectiveness of competition in the ISDN30 retail market. This assessment will inform our proposal as to whether the market is competitive or whether a single company holds SMP, either individually or collectively. Where we propose that no company has SMP, there is no continuing requirement for company specific regulation. Where SMP is proposed, we are obliged to consider what remedial regulations may be required to address the competitive failure.

Summary

5.2 We are proposing that:

- No company holds SMP in the retail ISDN30 access market in the UK excluding Hull; and
- KCOM holds SMP in the retail ISDN30 access market in the Hull area.

5.3 Our provisional conclusion for the UK excluding Hull has changed relative to the retail consultation where we concluded provisionally that BT had SMP. The reasons for this change are discussed below.

Our Approach

5.4 Our approach to the market power assessment is set out in detail in Section 3 and Annex 7.

5.5 To assess whether a firm has SMP we regard the following criteria as most important:

- Market shares;
- Barriers to entry and expansion;
- Prices and profitability; and
- Customer switching costs and the intensity of competition in the market.

5.6 However, in making our SMP assessment, no one piece of evidence is likely to be decisive. We therefore consider the impact of the different competitive constraints in the round. It is important to bear in mind that in overall assessments on SMP it is possible that some markets will display both features consistent with a no SMP finding and features consistent with an SMP finding. That is, by its very nature a binary SMP finding (either SMP or no SMP) summarises a much richer assessment of the competitive conditions in a particular market.

The retail consultation

- 5.7 In the retail consultation we concluded provisionally that:
- BT had SMP in the UK excluding Hull; and
 - KCOM had SMP in the Hull area.
- 5.8 Three stakeholders commented on the ISDN30 SMP assessment for the UK excluding Hull. Two respondents agreed with our SMP assessment. BT disagreed with the SMP assessment and commented that the finding of SMP was not justified for the following reasons:
- the strong competition from substitute products;
 - BT's decline in market share to a level below 50%, the lack of barriers to switching, and the high level of churn;
 - BT's declining revenues and limited profit margin at the retail level;
 - the fact that ISDN30 is widely purchased by major business customers with significant buying power, and a tendency to multi-source; and
 - the fact that BT gains no advantage from its vertical integration as a result of the existing wholesale remedies.
- 5.9 KCOM was the only respondent to comment on the SMP assessment for the Hull area. Its view was that the continuation of regulatory remedies at the retail level was not justified.

2010 assessment

- 5.10 Over a year has passed since our previous SMP assessment so we have reconsidered each factor in our assessment in light of new information. We have considered stakeholder responses to the retail consultation where appropriate.
- 5.11 In conducting our assessment we have drawn on information from a variety of sources including:
- information from the ISDN30 and IP service user surveys conducted for this review and published with this consultation document;
 - the regulatory returns of KCOM³⁵;
 - market share information for CPs that we compile quarterly; and
 - information provided by CPs to the S135 requests.
- 5.12 First we consider the UK excluding Hull, then the Hull area.

³⁵ http://www.kcomplc.com/aboutus/regulatoryinformation/docs/final_statements.pdf

UK excluding Hull

Market shares

- 5.13 Since the retail consultation BT's market share has continued to fall, and done so at a faster rate than we expected (see Table 5.1). BT's share of channels is now at 45%, a decline of around 20 percentage points since 2004. The total number of ISDN30 channels provided across all CPs has remained relatively constant since 2003 at around 3.2 million. Total retail revenues for ISDN30 were around £540 million in the last year (Q4 2008 to Q3 2009)³⁶.

Table 5.1 - Retail ISDN30 shares^{37 38} (%)

	Channels		Revenues	
	BT	Others	BT	Others
2003	60	40	69	31
2004	64	36	75	25
2005	63	37	74	26
2006	58	42	73	27
2007	53	47	70	30
2008	48	52	67	33
2009 Q1	47	53	65	35
Q2	46	54	65	35
Q3	45	55	64	36

Source: Ofcom/Operators

- 5.14 In addition to the large number of small WLR providers (discussed below) BT also faces competition from two larger players – Virgin Media and C&W who largely self-supply and have high market shares relative to the other non-BT CPs (at >% and >% respectively at Q3 2009). Virgin >
- 5.15 BT's share of revenues has also fallen but remains at a higher level than its comparative share of channels. This may suggest that BT is able to charge a price premium relative to competitors. We have considered below whether this is actually the case or whether there are other factors which could explain why BT's estimated share of revenues is much higher than its share of channels.

³⁶ The ISDN30 channel and revenue information in this section (including the market shares presented in Table 5.1) are our estimates based on CP data provided as part of our regular market data collection processes. We have used this information source as it provides a more reliable estimate of revenue market shares. We have also collected information on ISDN30 channels as part of the S135 requests for this market review (used in sections 6 and 7). The different data sources produce slightly different estimates for the number of ISDN30 channels. Using the estimates for channels provided in the S135 request BT's market share would be 48%. This would not alter our conclusions.

³⁷ Since the retail consultation we have updated the information used to calculate market shares. This means some of the market shares reported in Table 5.1 are different to those reported in the retail consultation. In particular, for 2007 we previously reported that BT's market share was 48%; we have now revised this figure to 53%. The market shares reported in Table 5.1 reflect the most accurate information available at this time.

³⁸ ISDN30 channels provided by KCOM outside of the Hull area are included in the calculation of the market share figures. ISDN30 channels provided by KCOM in Hull are not part of this market (UK excluding Hull), however, the number of channels provided by KCOM in Hull is small and this will not materially change the market shares reported in the table.

- 5.16 One factor which could be relevant is that BT is currently subject to certain restrictions in relation to bundles of SMP products (such as ISDN30 currently) and non-SMP products. This means that BT is required to publish prices for standard services which has prevented it from offering bespoke prices. These requirements are set out in the current SMP services conditions³⁹. BT's competitors may, however, bundle ISDN30 and other communications services in a variety of innovative ways. Indeed, our market research survey indicated that 29% of ISDN30 users purchase ISDN30 as part of a package of services.
- 5.17 In order to make the package of services attractive, CPs may provide ISDN30 or other services which form part of the overall package at a discount. CPs may, however, not allocate a specific discount to each individual element of the overall package and this may lead to discrepancies between each CP's share of channels and their reported share of revenues. BT Retail's revenue share may, therefore, be overstated.
- 5.18 As part of the S135 requests we also collected information from CPs on ISDN30 retail revenues, channels and the average price per channel. We have compared the average retail price at September 2009 for 7 larger CPs (including BT) who offer ISDN30 via WLR⁴⁰. This analysis revealed that BT charges the highest retail price on average. The average prices for the other CPs were 4-12% lower than BT – this suggests that BT's price premium is significantly smaller than indicated by the revenue share information presented in Table 5.1.

Barriers to entry and expansion

- 5.19 We noted in the retail consultation that barriers to entry are low. WLR allows CPs to offer a retail ISDN30 product without any significant physical investment, and regulated wholesale access prices mean new entrants can obtain the same access price as BT and this provides a level playing field. There has been considerable entry and over 300 currently CPs provide ISDN30 retail services via WLR.
- 5.20 In the retail consultation we were concerned that there may be barriers to expansion and larger scale entry because ISDN30 CPs may need to provide a wide range of communications products to attract customers, and because ISDN30 is purchased by a (relatively) small number of businesses (e.g. compared to the number of consumers buying residential exchange lines) making it more difficult and costly to reach them.
- 5.21 The ISDN30 survey has revealed that fewer end-users purchase a package of communications services including ISDN30 than we previously thought. 63% of ISDN30 users surveyed purchased it as a standalone service versus 29% who purchased it as part of a package (7% did not know). This could reflect the fact that around two thirds of the ISDN30 users sampled were supplied by BT, who is limited in providing bundles of SMP and non-SMP products as described above.

³⁹ The SMP services conditions referred to have not applied to businesses spending in excess of £1million per annum on BT's communications services since we published the statement entitled *Replicability: the regulation of BT's retail business exchange line services* in 2007

<http://www.ofcom.org.uk/consult/condocs/draftconsent/statement/>

⁴⁰ Some providers offer ISDN30 via both self supply and WLR. In this case we have specifically looked at the retail price for services provided via WLR.

Pricing and profitability

5.22 BT's list prices for ISDN30 have increased fairly modestly since 2007 (as shown in Table 5.2).

Table 5.2 BT ISDN 30 prices

ISDN30 rental per quarter exc. VAT per contract term ⁴¹	1 yr	3 yr	5 yr
Prior to 1 November 2007			
without Direct Dialling In quota	45.58	43.30	41.02
With quota	52.08	49.48	46.87
1st November 2007			
Without Direct Dialling In quota	47.76	45.37	42.98
With quota	54.57	51.84	49.11
1st November 2008			
Without Direct Dialling In quota	49.44	46.95	44.49
With quota	56.49	53.64	50.82
1st November 2009			
Without Direct Dialling In quota	50.70	48.12	45.60
With quota	57.90	54.99	52.11

Source: BT

5.23 As noted above, BT's prices appear to be around 4-12% higher than its competitors. Given the considerable amount of entry by WLR providers we might have expected to see greater price convergence between BT and its rivals. However, there are a number of factors in this market which may have discouraged this:

- BT is currently subject to a price publication remedy which ensures that all its prices are visible to competitors, and rivals will often compete by offering discounts relative to BT's prices (as ISDN30 is a relatively homogenous product competition takes place largely on the basis of price). Given this, BT has a limited incentive to compete aggressively by lowering its published retail prices.
- BT has been constrained in its ability to respond as flexibly as competitors (e.g. by offering a package of services) given the constraints on BT linking SMP and non-SMP services in its retail offers. Given these constraints, BT may have found it more profitable to modestly increase prices at the cost of losing customers. As

⁴¹ BT offers two line rental options, a basic option (called Non-Quota) which does not include an allocation of DDI telephone numbers and an enhanced option at a higher rental called Quota which includes an allowance of 10 DDI telephone numbers per ISDN channel. Under the basic option, DDI telephone numbers are rented separately.

such, removing or relaxing the present constraints on BT should increase competition and put downward pressure on prices.

- BT is the incumbent CP and a price premium for the first mover is consistent with a competitive market where rivals need to offer a discount to compensate for the switching costs incurred by customers for a relatively homogenous product.
- 5.24 Profitability information suggests that BT's ISDN30 retail prices are neither excessive nor below cost. BT Retail's return on sales⁴² for ISDN30 has generally been around 2% (the return on sales increased by 1 percentage point in 2007/8 but subsequently fell back in 2008/9).

Customer switching costs and the intensity of competition

- 5.25 The fact that BT's market share has fallen to 45% indicates that ISDN30 users are willing and able to switch to alternative CPs. Our ISDN30 user survey indicated that 16% of companies had switched their ISDN30 supplier in the last year. When asked why they had switched, the majority of companies (72%) mentioned that they had been offered a better deal by their new CP. Other reasons for switching CP were to receive a better quality of service (15%) and a better range of services (13%). This indicates that competition is primarily around price, but other aspects, such as being able to offer a range of services, are also an important factor.

Countervailing buyer power

- 5.26 In its response to the retail consultation, BT considered that the types of customers who purchase ISDN30 (e.g. business customers who multisource) had significant buying power which reduced BT's ability to exert market power. It is possible that the largest ISDN30 customers (particularly those who buy a range of communications services from a single CP and have a high spend on communications services) may have a degree of buyer power. However, we are not convinced that this is a significant factor, since the majority of companies purchasing ISDN30 are relatively small.
- 5.27 Our market survey showed that 59% of companies buy only one ISDN30 subscription (which supports up to 30 channels). We asked the ISDN30 companies surveyed how much they spent annually on business communication services within the UK. 30% of respondents did not know how much they spent or refused to answer this question. Of those that provided an answer, around 40% spent less than £24K and only 6% spent more than £500K a year.

Forward look

- 5.28 As discussed in the market definition section, going forward we expect the ISDN30 market to decline as businesses replace their systems and switch to IP-based solutions. It is unclear, however, how quickly the ISDN30 market will decline. Based on the additional evidence gathered, we consider that switching to IP services will likely happen at a slightly faster rate than envisaged in the retail consultation. While the ISDN30 user survey indicated that most companies are not currently considering switching away from ISDN30, some CPs and market analysts have indicated that the IP-based services market could increase towards the end of our forward look period.

⁴² Return on sales % = (revenue-cost)/revenue. Costs include wholesale charges.

5.29 Overall, IP-based solutions are likely to impose an increasing competitive constraint on ISDN30 going forward.

Provisional Conclusion

5.30 In the retail consultation we concluded that BT had SMP in the ISDN30 access market. Having looked at market trends and considered the additional evidence collected since then, we have now concluded provisionally that BT does not have SMP in the retail market for ISDN30 services. The key reasons for this conclusion are as follows:

- the wholesale remedies have led to the development of products which enable CPs to replicate the services offered by BT without making significant infrastructure investments. This has lowered barriers to entry and over 300 ISDN30 WLR CPs have entered the market;
- BT's market share of channels has continued to fall and shows no sign of abating. The decline in BT's market share has been steeper than we anticipated;
- the increasing competitive constraint of IP based solutions in the forward look, and anticipated decline in the ISDN30 market.

5.31 Section 84 of the Act requires us to revoke all SMP conditions applied to a person where they are found to no longer hold SMP. We are therefore proposing that the current retail SMP conditions applied to BT in the ISDN30 market be revoked⁴³. Having undertaken this market analysis, as required by our national legislation, we consider that this finding is consistent with the application of the three criteria test (discussed below) that suggests that our proposed market is not susceptible to ex ante regulation.

Three Criteria Test

5.32 In Section 4 we discussed how, in this market, we consider that the tests applied under the Commission's three criteria test are similar to the analysis done for our SMP assessment. We acknowledge that the three criteria test focuses on the general characteristics of a market whilst an SMP assessment is made in relation to a specific CP in a given market, however, we believe that in the context of this market, the assessment of both aspects together is an appropriate approach.

5.33 We consider the three criteria test is not met in the market for the UK excluding Hull for the following reasons:

- Barriers to entry. We consider that the barriers to entry are low, and there are fewer barriers to expansion than we previously thought. This is discussed at paragraphs 5.19-5.21.
- Dynamic aspects. We assess that the market is becoming increasingly competitive, noting a falling market share for BT and an ability to switch by customers. This is discussed in our discussion on market shares (paragraphs 5.13-5.18), prices and profitability (paragraphs 5.22-5.24) and within the discussions of switching costs and the intensity of competition (paragraph 5.25).

⁴³ As this is a statutory requirement it is not appropriate for us to consider an option of retaining any regulation.

- Relative efficiency of competition law and *ex ante* regulation. We consider that competition law is more appropriate to address concerns in this market than *ex ante* regulation given the low barriers to entry, growing competition, and the absence of substantial market power. In addition, we consider that, as we noted in the retail consultation last year, the existing remedies for SMP are not effectively promoting competition and may actually discourage BT from lowering prices for retail services by, for example, encouraging price following by competitors. As such, the absence of retail remedies may increase price competition in the market.

Question 5.1 Do you agree or disagree with our analysis in which we have provisionally concluded that BT does not have SMP in the retail ISDN30 exchange line services market in the UK excluding the Hull area? Please give reasons for your view.

Hull area

Market share

- 5.34 There are no CPs using KCOM's network to provide ISDN30 services in the Hull area⁴⁴. Some CPs offer ISDN30 services by alternative means (e.g. via leased lines). This is likely to be on a very small scale and these alternatives are only likely to be economically attractive for larger businesses.
- 5.35 The number of ISDN30 circuits provided by KCOM (as shown in Table 5.3) increased until 2007/8, and then remained flat in 2008/9.

Table 5.3 KCOM ISDN30 circuit numbers

	2006/7	2007/8	2008/9
Number of ISDN30 circuits	1070	1144	1145
% change over previous year	13%	7%	0%

Source: KCOM Regulatory Financial Statements year ended 31 March 2009

- 5.36 As KCOM is the only significant provider of ISDN30 in Hull we expect that their market share is close to 100%.

Barriers to entry and expansion

- 5.37 As noted above, it may be feasible for CPs to offer larger businesses ISDN30 services by alternative means (e.g. leased lines). However, there are no CPs offering ISDN30 via WLR. The prospect of significant entry into the ISDN30 market appears low.

Pricing and profitability

- 5.38 KCOM offers two call packages for ISDN30. The local call package includes line rental and inclusive local calls and the UK national call package includes line rental and inclusive UK national geographic calls. Discounts are available depending on contract duration and the number of channels taken, and a discount is also available for paying by direct debit. The different options and discounts available mean that KCOM's ISDN30 list prices range from £163⁴⁵ to £257⁴⁶ per channel per year.

⁴⁴ KCOM's regulatory Financial Statements 2008/9 report no external sales for ISDN30.

⁴⁵ Price (excluding VAT) for the ISDN30 local package where a 5 year contract is taken for 400+ channels and payment is by direct debit. Source:
http://www.kcomplc.com/eastyorkshire/pricemanual/P03-S07_ISDN_30.htm

KCOM's price packages are not directly comparable to BT's due to the different package options available. However, as an indicative comparison BT's list prices range from £182⁴⁷ to £232⁴⁸ per channel per year. While KCOM's prices have a wider range than BT's, they are not noticeably out of alignment.

- 5.39 KCOM's return on turnover and return on mean capital employed for their ISDN30 retail business both remained flat in 2008 and 2009, at 17% and 13% respectively. It would seem that there is little competitive pressure on prices or profits.

Customer switching costs and the intensity of competition

- 5.40 As noted above, there are few alternative CPs in the Hull area for some customers and no alternatives for many which means there is little or no scope for switching.

Countervailing buyer power

- 5.41 No one company purchasing ISDN30 in Hull is likely to account for a sufficiently large proportion of KCOM's revenues such that they would be able to exert countervailing buyer power.

Forward look

- 5.42 We might expect the ISDN30 market to decline slowly as businesses replace their systems and switch to IP based solutions. We do not anticipate significant entry in this market and therefore it is unlikely that competition will intensify.
- 5.43 KCOM's response to the retail consultation stated that we recognised that growth in ISDN30 is likely to slow, particularly as this is a product nearing the end of its lifecycle with customers opting for alternative technologies to provide the functionality they require. For these reasons KCOM suggested that the continued application of regulatory remedies would no longer be justified.
- 5.44 The fact that ISDN30 is nearing the end of its lifecycle as customers move to alternative technologies does not necessarily imply that the competitive constraints in the ISDN30 market have increased. In addition, the number of ISDN30 circuits provided in the Hull area has not fallen. We do not have any compelling evidence to suggest that the competitive constraints will increase significantly over the forward looking review period.

Provisional Conclusion

- 5.45 We remain of the view that KCOM has SMP in the retail market in the Hull area. The key reasons for this finding are:
- there are no significant competitors in the market; and
 - threat of entry is limited.

⁴⁶ Price (excluding VAT) for the ISDN30 UK national package where a 1 year contract is taken for 1-100 channels and payment is by invoice.

⁴⁷ ISDN30 rental price (excluding VAT) without direct dialling in quota where a 5 year contract is taken.

⁴⁸ ISDN30 rental price (excluding VAT) with direct dialling in quota where a 1 year contract is taken.

Question 5.2 Do you agree or disagree with our analysis in which we have provisionally concluded that KCOM has SMP in the provision of retail ISDN30 exchange line services in the Hull area? Please give reasons for your view.

Section 6

Wholesale market definition

Introduction

- 6.1 In the wholesale consultation we concluded provisionally that the relevant economic market was the supply of wholesale ISDN30 exchange lines on a narrowband network.
- 6.2 This market definition included both exchange lines provided to vertically integrated retailers (self-supply) and exchange lines provided to third party retailers (e.g. using WLR). The market definition included the supply of ISDN30 exchange lines using any form of access network, including LLU. However, wholesale IP products, such as Hosted VoIP and SIP Trunking were considered to be outside the boundaries of the relevant economic market.
- 6.3 This market definition was based on two key arguments. First, as wholesale ISDN30 exchange lines are an essential input into the supply of retail ISDN30 exchange lines, there is no possibility of (direct) demand-side substitution. Second, as Hosted VoIP and SIP Trunking lay outside our provisional retail market definition ('the retail supply of ISDN 30 exchange lines') indirect competitive constraints were likely to be limited.
- 6.4 This wholesale market definition was broadly supported by all respondents to the wholesale consultation other than Openreach.
- 6.5 Openreach's response included a detailed critique of our market definition and market power analysis. In summary:
 - Openreach made a number of criticisms of our market definition analysis, including our treatment of indirect competitive constraints, and the definition of the focal product;
 - While Openreach did not explicitly reject our market definition, it argued that we had not presented sufficient evidence to rule out alternative candidate market definitions;
 - Openreach made a number of criticisms of our SMP analysis including our interpretation of its profitability data;
 - In Openreach's view ISDN 30 is a product in terminal decline as businesses increasingly switch to alternative IP technologies, in particular SIP Trunking;
 - As a consequence, Openreach argued that it does not have SMP in ISDN30 exchange line services, particularly on a forward look; and
 - In Openreach's view increased regulation, including cost orientation and possibly a charge control, would be both inappropriate and disproportionate.
- 6.6 In this section we review our market definition assessment in light both of responses to the wholesale consultation and new information that we have obtained.

- 6.7 To define the relevant economic market we apply the SSNIP test. We begin with an assessment of the appropriate focal product and then consider whether there are any direct demand or supply-side substitutes to the focal product which should be included in the relevant economic market. We then consider whether the market definition should be expanded to include indirect competitive constraints that arise from the potential of end-users to switch to retail solutions that do not require wholesale ISDN30 exchange lines (e.g. SIP Trunking, Hosted VoIP, and ISDN 2).

Focal product

- 6.8 To implement the SSNIP test we first need to define the focal product. The focal product is the narrowest candidate market definition and this is usually the product under investigation⁴⁹. In the context of this market review, where we are reviewing the overall effectiveness of competition in the supply of wholesale ISDN30 exchange lines on narrowband networks, it is natural to take this definition as the focal product⁵⁰.
- 6.9 This focal product includes both wholesale ISDN30 exchange lines that are self-supplied (including via LLU) and those where the exchange line is provided to a third-party retailer, e.g. WLR.

Direct competitive constraints

Demand-side substitution

- 6.10 The immediate purchasers of wholesale ISDN30 exchange lines are ISDN30 retailers. They can obtain wholesale access from a variety of sources including:
- Self-supply, i.e. retailers using their own PSTN, cable or fibre network, or using LLU;
 - Obtaining access to Openreach's network using WLR; and
 - Negotiating third-party access to a non-Openreach network;
- 6.11 The major ISDN30 retailers predominantly obtain access through self-supply. BT Retail exclusively self-supplies, while its two biggest rivals, C&W and Virgin Media use their own networks to meet the bulk of their retail demand, although they also purchase small amounts of WLR. This is largely to meet demands in locations where they have no network coverage.
- 6.12 In contrast the smaller ISDN30 retailers tend to rely upon WLR to obtain ISDN30 access. Openreach is obliged to offer access to its network to third parties, and while other CPs could choose to offer third party access none currently do so on any significant scale.
- 6.13 Overall, self-supply accounts for 79% of all ISDN30 wholesale channels, with the remaining 21% of channels supplied by WLR⁵¹. For non-BT retailers, self-supply is also the most popular means of obtaining wholesale ISDN30 access. However,

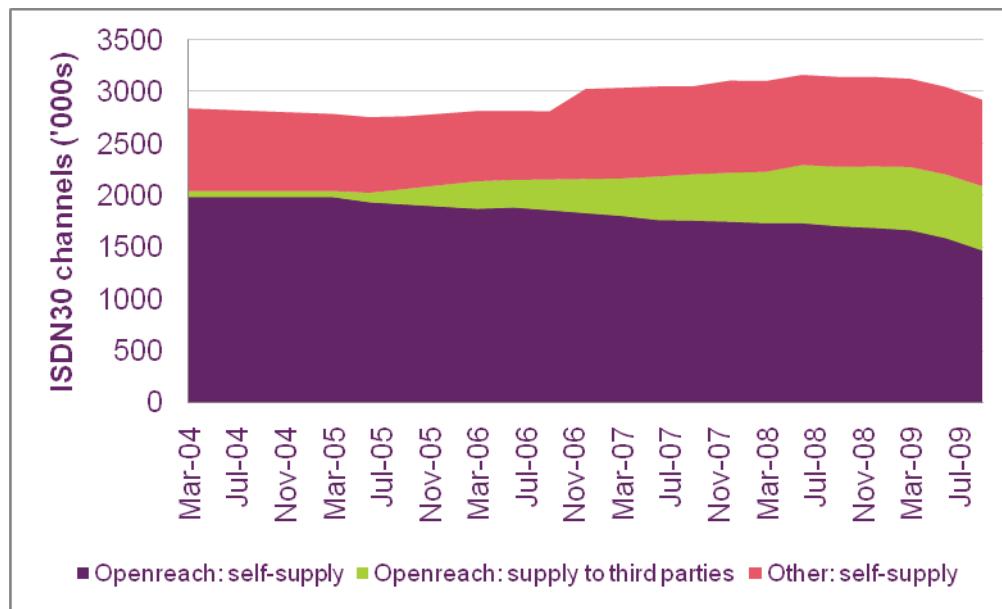
⁴⁹ See OFT 403, Market Definition, 2004, paragraph 2.9

⁵⁰ It is possible to define a narrower focal product, e.g. the wholesale supply of ISDN 30 exchange lines via WLR. However, in the context of a market review, we believe it is appropriate to include all providers of ISDN30 wholesale services in any candidate market definition.

⁵¹ Based on the S135 requests.

Openreach WLR has grown rapidly and now accounts for 42% of retail channels provided to non-BT retailers.

Figure 6.1: Wholesale supply of ISDN30



Source: *the S135 requests*

- 6.14 The supply of wholesale ISDN30 channels has remained relatively constant over the period of our review at 2.8 to 3.1 million channels (see Figure 6.1). BT's self-supply has fallen over the period, reflecting its loss of retail market share. The loss of BT Retail market share has been offset to some extent by third-party growth. We have, however, noticed that Openreach's entire ISDN30 base has reduced quite significantly in the past year.
- 6.15 Self-supply, WLR, and third-party access to non-BT networks are functionally equivalent. In particular, there is no technical or other distinction between ISDN30 retail lines provided using the different types of wholesale access. We therefore consider that the relevant economic market includes wholesale exchange lines provided over all narrowband networks.
- 6.16 Other types of exchange lines, such as ISDN 2, and IP based technologies, do not provide a direct demand-side substitute as a retailer of ISDN30 exchange lines needs to purchase wholesale ISDN30 inputs in order to supply their ISDN30 retail customers.
- 6.17 As a consequence, if the charge for wholesale ISDN30 exchange lines were to increase by 5-10% above the competitive level, aggregate demand would only decline to the extent to which end-consumers switched to IP-based solutions (or other potential substitutes such as ISDN2). This indirect constraint on the wholesale demand for ISDN30 access is considered below.
- 6.18 Leased lines do not provide a demand-side substitute for wholesale ISDN30 exchange lines as they provide transmission capacity only.

Supply-side substitution

- 6.19 It is usually appropriate to include supply-side substitutes in the relevant economic market where they impose a significant and immediate competitive constraint on the price of the focal product. To warrant inclusion supply-side substitution needs to be both technically feasible and economically likely, i.e. that firms would rapidly switch to supplying ISDN30 wholesale exchange lines in response to a 5-10% increase in charges above the competitive level.
- 6.20 In terms of technical feasibility, in principle, any type of access network could be upgraded to provide ISDN30 access. For example, a CP offering analogue exchange lines or broadband access could offer ISDN30 exchange lines by upgrading the call control/switching equipment at the exchange. Similarly it is possible to provide ISDN30 services using a fully unbundled LLU line through investments in upgrading call control/switching equipment. Leased lines could also be used to provide ISDN30 wholesale services. Although leased lines may be used to provide the bearer circuits for ISDN30 services, significant investments would be required in switching equipment and operational support systems updates to provide telephony services.
- 6.21 While technically feasible, it is unlikely that supply-side substitution from analogue lines, broadband, LLU or leased lines⁵² would act as an immediate competitive constraint because of the significant sunk costs involved (e.g. ISDN30 specific access and backhaul electronics). With the ISDN30 market forecast to decline over the medium term, such investments are unlikely to be economic given the limited time period over which such sunk costs could be recovered and the fact that adding further capacity to a market forecast to decline is likely to lead to a fall in the expected wholesale price of ISDN30 over the period of the investment.
- 6.22 In practice we have observed very limited supply-side substitution over time. For example, the number of ISDN30 exchange lines that are self-supplied by non-BT CPs has remained relatively constant at approximately 800,000 channels despite BT earning high and increasing profits over the period (see Table 7.4). This suggests that supply-side substitution has not provided an effective constraint on charges.
- 6.23 In addition, we note that a number of major CPs are already self-supplying wholesale ISDN30 to their downstream retail businesses. We therefore believe that the impact on competition of CPs is best measured by their current market shares as opposed to hypothetical shares based on the size of their narrowband networks.
- 6.24 For the above reasons we do not believe that supply-side substitution from alternative access networks or leased lines is sufficiently likely to warrant inclusion in the relevant economic market.

Indirect competitive constraints

- 6.25 While retailers of ISDN30 exchange lines have little alternative but to continue to purchase wholesale ISDN30 exchange lines were the wholesale price to rise by a small but significant amount above the competitive level, the price rise may nevertheless not be profitable were it to lead to end-consumers of ISDN30 access switching to substitute products such as SIP Trunking in sufficient numbers. In such circumstances it would be appropriate to include such indirect competitive constraints in the definition of the relevant economic market.

⁵² The 2003 review concluded that ISDN30 charges may be constrained by ISDN2 and PPCs

- 6.26 Indirect competitive constraints are more likely to be significant where an increase in the wholesale charge leads to a relatively large increase in retail prices, and where this in turn causes a significant number of consumers to switch to substitute retail products whose price is unchanged.
- 6.27 More specifically, indirect constraints are likely to be the strongest where:
- the wholesale charge accounts for a high proportion of the retail price (limited dilution effect);
 - wholesale margins are relatively low;
 - there is a high degree of competition between retailers using the wholesale inputs subject to the hypothetical price increase; and
 - There are close substitutes just outside the relevant retail market whose wholesale costs have not increased.
- 6.28 To estimate the effectiveness of indirect competitive constraints we look at each of these factors in turn. As these factors are inter-related we have conducted a critical loss analysis to estimate the overall impact of indirect competitive constraints on the wholesale charge of ISDN30 exchange lines.

Dilution effect

- 6.29 In most circumstances an increase in the wholesale charge of (say) 10% will lead to a smaller increase in retail prices as the other costs of retailing the product (other wholesale inputs and retailing costs) will be unchanged. The higher are these other costs, the more the wholesale charge increase will be “diluted”. For example, if the wholesale input controlled by the hypothetical monopolist accounted for 50% of the retail price, a 10% increase in the wholesale price would lead to only a 5% increase in the retail price⁵³.
- 6.30 The more the wholesale charge increase is diluted by other costs, the more feasible it is for a hypothetical monopolist to impose a 5-10% charge increase, as the lower implied retail price will cause fewer customers to switch to substitute retail products. Conversely, if the wholesale charge accounts for a relatively high proportion of the retail price, then an increase in the wholesale charge may lead to a sufficient loss of retail sales to make it unprofitable for a hypothetical monopolist to raise prices above the competitive level.
- 6.31 To assess the significance of the “dilution effect” we need information on wholesale and retail prices. It is difficult to estimate wholesale charges by considering self-supply data as the internal transfer ‘charge’ between a CP’s wholesale and retail divisions may not provide an accurate reflection of wholesale costs. We therefore use WLR prices to provide an estimate of average wholesale charges.
- 6.32 We compare these WLR wholesale charges with the corresponding retail price charged by individual ISDN30 retailers.
- 6.33 Openreach is required to charge all retailers, including BT Retail, the same wholesale charge for WLR. Currently the charge for a WLR ISDN30 exchange line is £141/channel per annum.

⁵³ This assumes that cost increases are passed on to consumers in full.

- 6.34 BT's standard ISDN30 retail tariff is £202.80⁵⁴. However, BT, like other retailers, offers significant discounts off its rate card for longer contract lengths, and its average retail price across all contract lengths is £150. BT's retail rivals in general charge a lower price in order to encourage customers to switch. Average retail prices across the market range from approximately £150 to £175 per channel.
- 6.35 The wholesale charge therefore accounts for between 81% and 94% of the retail price, implying that dilution effects are very limited.
- 6.36 The above analysis assumes that current WLR charges are competitive. If WLR charges were above competitive levels, then the dilution effect would be greater. However, as lower WLR charges would be likely to be reflected in lower retail prices, the increase in the dilution effect is likely to be relatively insignificant. For example, if the current price of WLR is 30% above the competitive price, then, assuming retailers make a fixed mark-up on the price of WLR, the dilution effect would lie between 74% and 92%.
- 6.37 For our critical loss analysis, which is set out in paragraphs 6.46-6.53, we assume that the wholesale price accounts for approximately 85% of the corresponding retail price. Assuming wholesale prices are passed on to consumers in full, this implies that a 10% increase in the wholesale price would lead to an 8.5% increase in retail prices.

Wholesale ISDN30 margins

- 6.38 Other things being equal, a hypothetical price increase is more likely to be profitable where the marginal costs of supplying a product account for a relatively high proportion of the price (i.e. where wholesale margins are low). The reason for this is that the lost revenues from consumers switching to substitute products will be compensated to an extent by the cost savings in not having to supply these customers.
- 6.39 Obtaining an estimate of the marginal cost of WLR (as a proportion of the competitive charge for WLR) is not straightforward. While we are able to derive estimates of Openreach's margin over operating costs from BT's Regulatory Financial Statements ('RFS')⁵⁵, operating costs may not provide a good proxy for marginal costs, particularly where, as here, there are complexities in allocating costs to different wholesale functions.
- 6.40 Estimating the competitive wholesale charge is also subject to considerable uncertainties as there are substantial economies of scope in supplying ISDN30 exchange lines along with other wholesale products. A further difficulty is that current WLR ISDN30 charges (and the implied margin over marginal costs) may already be substantially in excess of the competitive level. This is the so-called cellophane fallacy⁵⁶.
- 6.41 Based on our analysis of profitability for wholesale ISDN30, including our work to understand the impact on profitability of the heavily depreciated asset base for ISDN30, we think it is reasonable to assume a wholesale margin over marginal costs of 60-80% for the purpose of our critical loss analysis.

⁵⁴ This is the list price for a 1 year contract without DD in quota, November, 2009.

⁵⁵ <http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/index.htm>

⁵⁶ If a hypothetical monopolist has already raised prices to the level where a further price increase is not profitable, conducting the SSNIP test at this price level will lead to the erroneous conclusion that the market definition should be widened to include substitute products. This is usually referred to as the "cellophane fallacy".

- 6.42 This should not be regarded as a precise measure of profitability and, as explained elsewhere, we intend to continue looking at cost and profitability analysis in work on proposed ISDN30 charge controls going forward (see Section 10).

Competitiveness of the retail market

- 6.43 Our retail market assessment has found provisionally that the retail ISDN30 market is increasingly competitive, and that BT no longer has SMP. This suggests that retailers have little margin to absorb wholesale charge increases and that in the short- to medium-term they are likely to be passed on to consumers in full.

Closeness of substitutes to retail ISDN30 exchange lines

- 6.44 In our assessment of the retail market, we acknowledged the growing influence of IP solutions, and in particular SIP Trunking. However, we concluded that competition from IP solutions has not developed to the point where it was likely to impose a sufficient competitive constraint on the price of ISDN30 exchanges lines to warrant inclusion in the relevant retail market. For example, our consumer survey suggested that 84% of the sample of ISDN30 users was not considering switching from ISDN30 to SIP Trunking in the next two years. Our consumer research also revealed that consumer switching behaviour is often caused by an exogenous event such as moving offices, or the need to replace a PBX, rather than the relative prices of ISDN30 and IP based solutions.
- 6.45 While an increase in retail ISDN30 exchange line prices may prompt some businesses to bring forward their investment decisions and switch to SIP Trunking, the overall market demand of ISDN30 exchange lines is likely to be relatively price inelastic in the short to medium term.

Critical loss analysis

- 6.46 As noted above, the factors that influence the extent of indirect competitive constraints have different weights and interact with each other in a potentially complex way. To make an assessment of the overall impact of indirect competitive constraints, we have therefore sought to model the impact on profitability using a critical loss analysis. This estimates how much the retail demand for ISDN30 exchange lines would have to decline in order to make a 10% increase in the charge for wholesale ISDN30 exchange lines unprofitable. We can then compare this critical loss with the actual loss in market demand that we might expect from such an increase in the wholesale charge based on our assessment of competition in the retail market.
- 6.47 To make this analysis more tractable, we have made a number of simplifying assumptions, the most important of which are:
- retailers can only purchase from the hypothetical monopoly supplier of wholesale ISDN30 exchange lines;
 - Openreach has no strategic incentive to raise wholesale charges in order to distort competition at the retail level; and
 - wholesale ISDN30 charge increases are passed on in full by retailers.
- 6.48 Under these assumptions, for a 10% hypothesised increase in the charge for wholesale ISDN 30 exchange lines, the critical loss can be estimated as:

Critical loss elasticity = $-1 / \text{dilution} * [0.1 + \text{wholesale price cost margin}]$

- 6.49 For the reasons outlined in paragraph 6.37, we assume a dilution effect of 85%, i.e. a 10% increase in wholesale price leads to an 8.5% increase in retail price based on our estimates of wholesale and retail prices discussed above.
- 6.50 The results of our critical loss analysis are summarised in Table 6.2:

Table 6.2

Wholesale margin	Critical loss elasticity
60%	-1.7
70%	-1.5
80%	-1.3

- 6.51 The above analysis suggests that if a hypothetical monopoly supplier of wholesale ISDN30 exchange lines were to increase charges by 10%, this increase would be profitable provided that demand for retail ISDN30 exchange lines did not fall by more than 13% to 17% (depending on the wholesale margin). These critical loss estimates would be commensurately higher to the extent that wholesale charge increases are not passed on to end-consumers in full.
- 6.52 Our assessment of retail competition has concluded provisionally that while competition from IP solutions was growing, they lay outside the boundaries of the relevant economic market which is we have defined to include ISDN30 retail services only. This implies that a 10% increase in the wholesale charge for ISDN30 is unlikely to lead to significant switching to SIP Trunking. Moreover, our retail analysis found that the market demand for ISDN30 overall was relatively price inelastic. In particular our market research found that most switching takes place when firms change premises or where a PBX or switch needs to be replaced.
- 6.53 On the basis of this evidence, we consider it highly unlikely that a 10% increase in the wholesale charge of ISDN 30 would lead to a drop in demand for retail ISDN30 exchange lines that exceeded 13-17%.

Conclusion on product market

- 6.54 Our market definition analysis suggests that there are no direct demand-side constraints for wholesale ISDN30 exchange lines, while supply-side substitution is neither feasible nor likely because of the sunk costs in providing switches and the limited time period over which such investments are likely to be recouped. Although there is likely to be some competitive constraint from higher wholesale charges inducing consumers to switching away from ISDN30 to substitute products, our critical loss analysis suggests that consumers are highly unlikely to switch away from ISDN30 in sufficient numbers to make a 10% increase in the wholesale charge unprofitable.

Geographic market

- 6.55 In the wholesale consultation we proposed a single UK market excluding Hull, and a separate Hull market⁵⁷.
- 6.56 In the UK market, excluding Hull, customers are only able to choose between CPs that supply services in their geographic area. The ability of customers to switch may therefore be limited, where, for example, a customer lives in an area that is not served by cable or LLU. However, WLR is made available to retailers at the same charge across the UK. This is likely to limit the extent to which wholesalers could raise charges in locations where there are a fewer number of wholesale competitors⁵⁸.
- 6.57 Accordingly, we remain of the view that there is a single UK market excluding Hull and a separate market for the Hull area.

Commission's Recommendation on Markets

- 6.58 As we described at paragraphs 4.72 to 4.80, where an NRA seeks to define a market that is not within the list of markets within the Commission's recommendation on product and services markets the three criteria test should be applied to any proposed market to ensure that it is susceptible to *ex ante* regulation.
- 6.59 The Recommendation defines a wholesale market (market 4) for:

"Wholesale (physical) network infrastructure access (including shared or fully unbundled access) at a fixed location."
- 6.60 This is a wider market than our proposed market definition of wholesale ISDN30 exchange lines and therefore we have considered the application of the three criteria test.
- 6.61 In formulating our proposals, we have taken utmost account of the Recommendation on Markets together with the Explanatory Memorandum and the SMP Guidelines.
- 6.62 In applying the three criteria we have, as we did in Section 4, set out some of the arguments in the Section 7 in which we carry out our assessment of SMP.
- 6.63 This is because certain issues are relevant to both the three criteria test and to a consideration of market power we have kept such discussion in a single section of this document to avoid unnecessary repetition.
- 6.64 We have applied the three criteria test to the proposed markets for the UK excluding Hull and the Hull area. In relation to the proposed market for the UK excluding Hull we consider that the three criteria test is met and we discuss each of the three tests below:

⁵⁷ In Hull KCOM faces little actual competition in the supply of ISDN30 (there is no cable, LLU or WLR). There is no effective demand-side substitution, and supply-side substitution from the rest of the UK is limited by the absence of wholesale access infrastructure.

⁵⁸ The ability to compete using self-supply will vary to some extent across the UK as some areas are more attractive to serve e.g. where there is a relatively high concentration of business users.

- Barriers to entry. We consider that significant barriers to entry remain. This is discussed in more detail below in our section on barriers to entry and expansion (paragraphs 7.15 to 7.17).
 - Dynamic aspects. We assess that our proposed market does not display a tendency towards competition as Openreach has maintained a very high market share over time while there is evidence of excess profitability. This is discussed in more detail in the discussion on market shares (paragraphs 7.12 to 7.14) and prices and profitability (paragraphs 7.18 to 7.24).
 - Relative efficiency of competition law and *ex ante* regulation. We consider that competition law would not be sufficient to address concerns in this market. In particular, we consider that the compliance requirements of an intervention to redress a market failure would be extensive for this market and that frequent and/or timely intervention is also a requirement.
- 6.65 We consider that, in relation to the proposed market for the Hull area, that the three criteria test is met.
- Barriers to entry. We consider that significant barriers to entry remain.
 - Dynamic aspects. We assess that our proposed market does not display a tendency towards competition as KCOM has virtually a 100% share of the relevant market in which barriers to entry and expansion remain substantial and there is no effective countervailing buyer power.
 - Relative efficiency of competition law and *ex ante* regulation. We consider that competition law would not be sufficient to address concerns in this market. In particular, we consider that the compliance requirements of an intervention to redress a market failure would be extensive for this market and that frequent and/or timely intervention is also a requirement.
- 6.66 We therefore are of the view that our proposed market definitions satisfy the tests in the Commission's recommendation and it is appropriate to analyse these markets to determine whether any provider holds SMP. We have given careful consideration to the Explanatory Memorandum and we consider that the market definitions which we propose in this section are consistent with the approach set out in those documents.

Question 6.1 Do you agree or disagree with our market definition? Please give reasons for your view.

Section 7

Wholesale market power assessment

Introduction

7.1 In this section we consider the effectiveness of competition in the provision of ISDN30 wholesale services. This assessment will inform our decision as to whether any firm has SMP, either individually or collectively. Where SMP is found, we are obliged to consider what remedial regulations may be required to address the lack of effective competition in the market.

Summary

7.2 Our proposals are:

- Openreach holds SMP in the supply of wholesale ISDN30 exchange lines in the UK excluding Hull; and
- KCOM holds SMP in the supply of wholesale ISDN30 exchange lines in the Hull area.

7.3 These proposals are identical to those reached in the wholesale consultation and the 2003 review.

Our Approach

7.4 Our approach to market definition and SMP assessment is summarised in detail in Section 3.

7.5 To assess whether a firm has SMP we regard the following criteria as most important in this review:

- Market shares;
- Barriers to entry and expansion;
- Prices and profitability; and
- Countervailing buyer power.

The wholesale consultation

7.6 In the wholesale consultation we concluded provisionally that:

- Openreach had SMP in the UK excluding Hull; and
- KCOM had SMP in the Hull area.

7.7 The key arguments made to support this conclusion were:

- Openreach's market share remained unchanged since the 2003 review at approximately 67%;

- the anticipated increase in competition from PPCs and other self-supply had failed to materialise;
 - there had been no change in Openreach's nominal prices, despite a fall in both real and nominal costs; and
 - reported profits were very high (ROCE of 64%) and forecast to grow further as investment in ISDN30 declined.
- 7.8 This analysis was broadly supported by CPs who responded to the wholesale consultation. However, Openreach argued that it did not have SMP, particularly on a forward look. In its view, the cost and functionality advantages of SIP Trunking over ISDN30 make the decline in ISDN30 inevitable, and it believed that this will put increasing pressure on wholesale charges and profits. Openreach also pointed to evidence which it argued supported the view that the rate of migration from ISDN30 to SIP Trunking was accelerating and that ISDN30 was likely to decline more rapidly as a result. In this context, Openreach argued that any regulation of charges would be disproportionate and could result in unintended and adverse consequences, for example, causing scarce resources to be switched from investing in IP solutions to maintaining ageing ISDN30 infrastructure.
- 7.9 Openreach also criticised our interpretation of data on its profitability. In particular it argued that ISDN30 is a mature service with a heavily depreciated asset base, and that the level of profitability reported in the RFS should not therefore be considered excessive.

2010 assessment

- 7.10 In conducting our assessment we have drawn on information from a variety of new sources including:
- Information from the ISDN30 and IP service user surveys conducted for this market review and published alongside this consultation document;
 - The regulatory returns of BT⁵⁹ and KCOM⁶⁰;
 - Market share information for fixed CPs that we compile; and
 - Information provided by CPs in response to the S135 requests.

7.11 First we consider the UK excluding Hull, then the Hull area.

UK excluding the Hull area

Market shares

- 7.12 The market shares of the supply of wholesale ISDN30 exchange lines between March 2004 and September 2009 are presented in Table 7.1. Openreach's market share has remained constant over the period, fluctuating between 71% and 75%. This is higher than our estimated market share of 67% that we published in the

⁵⁹ <http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/index.htm>

⁶⁰ http://www.kcomplc.com/aboutus/regulatoryinformation/docs/final_statements.pdf

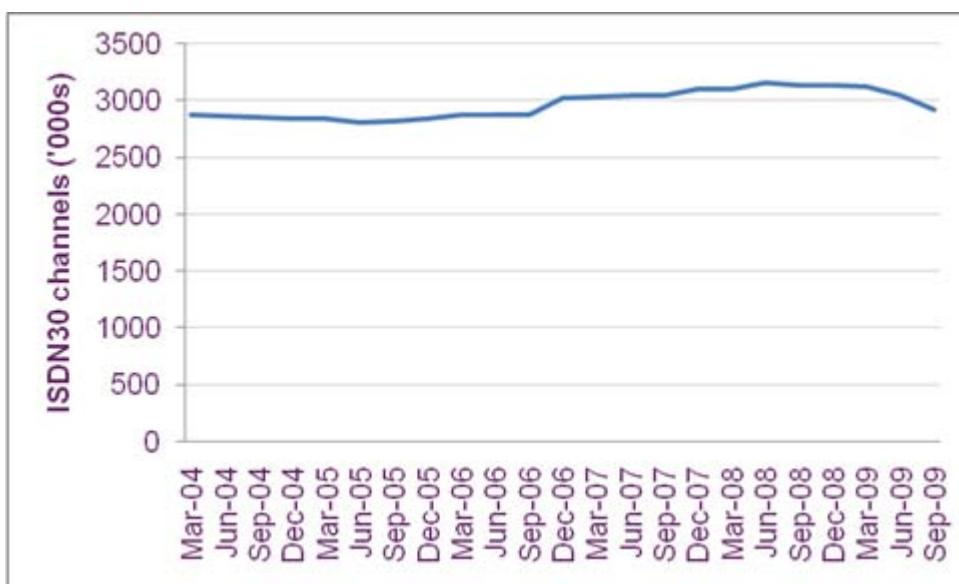
wholesale consultation⁶¹. Openreach faces competition from C&W and Virgin Media, as well as a limited number of smaller providers.

Table 7.1

	Sep-04	Sep-05	Sep-06	Sep-07	Sep-08	Sep-09
Openreach	71%	73%	75%	72%	72%	71%
C&W	✗	✗	✗	✗	✗	✗
Virgin	✗	✗	✗	✗	✗	✗
Others	✗	✗	✗	✗	✗	✗

Source: the S135 requests

- 7.13 While Openreach's market share has remained relatively constant, the composition of that market share has changed markedly, with the proportion of Openreach's sales accounted for by WLR supplies to third parties increasing from 3% in March 2004 to 30% in June 2009. As discussed above, while the increase in competition at the retail level has been largely driven by retailers obtaining access to third-party networks, this has had a very limited impact on Openreach's share of the wholesale market as Openreach is the only significant provider of third-party access.
- 7.14 The total number of wholesale ISDN30 channels has remained relatively constant over the period at an average of just under 3 million channels. The number of channels is now around 7% less than the peak in June 2008. However, the drop in the number of channels since then coincides with a very sharp decline in real and nominal GDP, and it is difficult to distinguish a possible structural decline in demand for ISDN30 from the effects of the recession.

Figure 7.2

⁶¹ The differences arises largely because of the use of different data sets. In the wholesale consultation we estimated Openreach's market share based on information collected by Ofcom as part of its routine market intelligence. In this review we have used information supplied to us by CPs in response to S.135 requests.

Source: the S135 requests

Barriers to entry and expansion

- 7.15 We noted in the wholesale consultation and in Section 6 that barriers to entry and expansion are high due to the large sunk costs that need to be incurred in order to provide an ISDN30 exchange line. To the extent that demand for ISDN30 is set to decline, these barriers to entry are likely to increase as there will be a shorter time period over which any sunk costs can be recovered.
- 7.16 If demand for ISDN30 declines because of a preference for new customers to adopt IP solutions, then there will be considerable fewer potential customers that a new entrant would be able to contest. This is likely to reduce the profitability of wholesale entry further as new entrants would need to persuade existing ISDN30 customers to switch suppliers through discounting prices.
- 7.17 It may be more plausible for new entrants to emerge through providing wholesale ISDN30 exchange lines over LLU. However, as noted in the March 2009 consultation, LLU has primarily been used to support analogue exchange line services, and the economics of LLU are driven primarily by the provision of broadband access. There remain non-trivial sunk costs (e.g. access and backhaul electronics) that need to be incurred to upgrade switches to allow an ISDN30 line to be provided over LLU. Given the limited time period over which such sunk costs could be recouped, and the competition faced both by incumbent ISDN 30 providers and new IP based suppliers, we would anticipate that entry with LLU is likely to be limited.

Pricing and profitability

- 7.18 Openreach's wholesale charges for ISDN30 are £35.25/channel per quarter. These are unchanged since the wholesale consultation, and indeed there has been no nominal price increase over the period of our review.
- 7.19 In the wholesale consultation, we explained our concerns about the profitability of ISDN30 wholesale service provided by Openreach. We referred to the returns on wholesale ISDN30 reported in BT's RFS. Table 7.3 shows Openreach's reported financial performance for ISDN30 for the last 5 years. This indicates that the profits for the service seem to be on a path that diverges further from the underlying cost base each year.

Table 7.3 – ISDN30: Openreach reported profitability for ISDN30

	2004	2005	2006	2007	2008	2009
Sales (£m) (internal and external)	281	325	325	334	339	348
Sales (internal volume, 000s) ⁶²			1,997	1,938	1,846	1,793
Sales (external volume, 000s)			181	312	458	584
Operating costs (£m)	206	180	191	156	149	124
Operating profit (£m)	75	145	134	178	190	224
Capital employed (£m)	566	473	398	336	295	301
Return on sales	27%	45%	41%	53%	56%	64%
Return on capital employed	13%	31%	34%	53%	64%	74%

⁶² BT's regulated accounts do not show volume of channels prior to 2006

Source: BT Regulatory Accounts

- 7.20 Our discussion in the wholesale statement noted a number of counter arguments to our concerns on profitability. ISDN30 is a mature product with a heavily depreciated asset base, and we acknowledged that this may result in higher levels of profitability when measured against a competitive level of charges, than we would expect in a steady state network. We noted that the price for the product has remained flat, which means that in real terms the price has been falling by the rate of inflation. Also, we explained that we were mindful that overly deep reductions in price may create a level of demand requiring new investment which could be inefficient given that new technology alternatives to ISDN30 are emerging. We have also considered the argument that we should look at lifetime profitability for the service rather than the level of profitability reported in the RFS for a service approaching the end of its life.
- 7.21 We have taken account of all of these points in our assessment of profitability, and will continue to do so in work on the proposed charge controls for ISDN30 (see Section 10).
- 7.22 With reference to the likely continuing life of the service, we understand that ISDN30 is based on legacy technology and that IP-based alternatives are emerging. However, as explained in Section 4, our research shows continuing demand for ISDN30 at the retail level over the forward look period. We believe that there will be a continuing demand for ISDN30 for the foreseeable future and therefore are concerned about excessive profitability going forward, and not with lifetime profitability.
- 7.23 To gain a better understanding of the level of forward looking costs expected for a steady state network, we have done some analysis to understand the impact of a heavily depreciated asset base on Openreach's profitability. We asked Openreach to provide information showing adjustments to asset valuations to reflect an ongoing rather than heavily depreciated ISDN30 asset base.
- 7.24 For the purpose of determining whether Openreach's charges are above the competitive level, we conducted a high level review of this and other relevant information. We did not seek to establish a precise forward looking measure of costs, but have used the information to assist in our market analysis and particularly in relation to the issue of whether current levels of charges can be identified as a market failure. We will, of course, conduct detailed analysis and modelling work in connection with our proposed further consultation on the setting of a charge control, discussed in Sections 9 and 10. We consider that even if an allowance is made for the fact that ISDN30 has a heavily depreciated asset base, it would appear that charges are currently above the competitive level. This is something that we seek to address by proposing appropriate SMP remedies, as discussed in Sections 9 and 10.

Countervailing buyer power

- 7.25 As explained above retailers have no effective choice of wholesaler as vertically integrated provided such as C&W and Virgin Media have very limited commercial incentive to supply rival providers. Accordingly retailers have very limited countervailing buyer power. Moreover, Openreach has limited incentive to keep WLR prices low as retailers using WLR compete with BT's downstream retail business, while low wholesale prices are unlikely to lead to a significant market expansion effect for ISDN30.

Forward look

- 7.26 As discussed in Section 4, we expect the ISDN30 market to decline gradually as businesses replace their systems and switch to IP-based solutions. It is unclear how quickly the ISDN30 market will decline. Based on the additional evidence gathered we consider that switching to IP services will happen at a faster rate than envisaged in the wholesale consultation. While the ISDN30 user survey indicated that most companies are not currently considering switching away from ISDN30, some communication providers and market analysts have indicated that the IP based services market could increase more rapidly over the period of the forward look.
- 7.27 However, given the structure of the market and the nature of competition, it is not clear the extent to which growing competition from IP solutions will have an impact on the wholesale price of ISDN30. It is notable that BT has not chosen to reduce its wholesale or retail prices to date. The evidence from our retail survey that price is likely to play only a limited role in decisions to switch away from ISDN30, and the fact that some customers are likely to continue to prefer ISDN30 because of its familiarity and reliability, means that Openreach and other wholesalers may choose to manage the decline of ISDN30 by keeping prices relatively constant rather than reducing them aggressively.

Proposals

- 7.28 In re-visiting our SMP assessment we have found:
- Openreach's market share is higher than our previous estimates at 71% (compared to 68%);
 - Competition does not appear to be very aggressive. For example, the wholesale price of ISDN 30 plays a minor role in self-supply decisions (which is the most prevalent form of competition). There has been almost no variation in Openreach's wholesale market share over the last 5 years;
 - Demand and supply side substitution is limited – for example, the emergence of indirectly substitutable services like SIP Trunking has not resulted in significantly lower demand for ISDN30 at the retail or wholesale levels; and
 - Openreach's reported profitability in the RFS is very significantly in excess of the cost of capital, and we believe this is strong evidence that wholesale charges for ISDN30 are currently significantly above the competitive level.
- 7.29 We therefore believe that Openreach continues to have SMP in the supply of wholesale ISDN30 exchange lines in the UK excluding the Hull area.

Question 7.1 Do you agree or disagree with our assessment in which we have provisionally concluded that Openreach has SMP in the provision of wholesale ISDN30 exchange line services in the UK excluding the Hull area? Please give reasons for your view.

Hull area

- 7.30 KCOM has virtually 100% share of the market for retail ISDN30 services in the Hull area and we are not aware of any CPs likely to enter the market. There would appear to be little appetite to enter the market for ISDN30 services at the retail or wholesale level in the Hull area, probably because the fixed costs that would be incurred to develop a presence in Hull are high in relation to a relatively small market. This acts

as a significant barrier to entry. Furthermore, to attract customers away from KCOM and overcome switching costs, a potential entrant would have to offer substantial discounts or a differentiated (and valued) service.

- 7.31 Additionally, although KCOM is required to meet reasonable requests to supply ISDN30 services in the Hull area, we are not aware of anyone seeking services in the Hull area and nor has anyone actually entered the market via this route (KCOM's regulatory Financial Statements 2008 report no external sales for ISDN30). KCOM is therefore not seemingly under threat from direct entry or indirect (wholesale) entry.
- 7.32 We do not believe that there have been any changes to the market since the wholesale consultation and therefore KCOM's strong market position remains intact. We therefore believe that KCOM continues to have SMP in the supply of wholesale ISDN30 exchange lines in the Hull area.

Question 7.2 Do you agree or disagree with our analysis assessment in which we have provisionally concluded that KCOM has SMP in the provision of wholesale ISDN30 exchange line services in the Hull area? Please give reasons for your view.

Section 8

Retail remedies for KCOM

Introduction

- 8.1 The retail consultation concluded provisionally that KCOM retained SMP in the provision of ISDN30 services in the Hull area and that it should continue to be subject to SMP services conditions requiring it to publish prices and not to discriminate unduly in the provision of such services. KCOM was the only respondent that commented in any detail on the proposal. KCOM's summary view was that regulatory remedies were no longer justified in a product nearing the end of its lifecycle where customers were opting for alternative technologies to provide the functionality they require.
- 8.2 We have considered all the evidence available on the ISDN30 market in the Hull area and have provisionally concluded that KCOM has SMP in the market for retail ISDN30 services. Therefore we consider that ongoing retail regulation is required.

Remedies

- 8.3 KCOM's retail ISDN30 business in Hull is subject to two SMP remedies:
 - No undue discrimination; and
 - Price publication.
- 8.4 We have observed that these remedies have not led to a significant entry of retail competitors.
- 8.5 We discuss the appropriate level of regulation at the wholesale level in Section 9. In the retail market we have considered 3 options:
 - Option 1 – Remove the existing remedies and rely exclusively on wholesale remedies;
 - Option 2 – Maintain the existing remedies; or
 - Option 3 – Introduce more direct intervention on pricing (e.g. price controls).

Option 1 Remove the existing remedies

- 8.6 Given the lack of competitive entry in the Hull area the case for reliance on wholesale remedies alone is in our view weak. Wholesale remedies have clearly, so far, not enabled or encouraged sufficient competitive entry. Accordingly we consider that the protection against abuse of its SMP position provided by the price publication and no undue discrimination remedies (which ensure that KCOM's actions are transparent and that KCOM does not discriminate) remains essential.

Option 2 (maintain existing remedies) vs Option 3 (introduce more direct intervention on pricing)

- 8.7 At present, KCOM's retail prices are not noticeably out of alignment with BT's prices (as discussed in paragraph 5.38). In the absence of direct competition, this is possibly due to the potential threat of price controls, the risk of encouraging market entry by exposing supernormal profits and the reaction of its customer base/shareholders (an overlapping group). There is no reason to expect this to change. Equally, it is not clear that price controls would lead to prices substantially below those currently being charged.
- 8.8 Given the lack of clear benefit from increased intervention and the costs of such an intervention, price controls would not appear justified at this time.
- 8.9 Based on the above we therefore propose that we should re-impose the following specific remedies:
- Requirement not to unduly discriminate; and
 - Requirement to publish prices.
- 8.10 We discuss, below, how each of these remedies addresses our competition concerns in the market and how they satisfy the legal tests set out in the Act.
- 8.11 In this market we consider that it is important to see how the remedies will (and have, to date) worked together. We consider that the proposed remedies effectively restrict KCOM from offering bespoke pricing to a customer without being forced to offer it to all customers. They also ensure that all its packages are visible to potential competitors and customers. The general objectives of these remedies, taken together, are to allow potential competitors to enter the market with confidence in the charges the incumbent sets and to avoid the incumbent selectively undercutting new entrants. While we have not seen any entry to date, we believe that removing these remedies would further increase the barriers to entry and deter potential competitors.

Legal tests: no undue discrimination

- 8.12 We have considered our duties under section 3 of the Act. We consider that a no undue discrimination condition will further the interests of citizens and consumers in the relevant market by reducing barriers to entry, and hence promote competition.
- 8.13 We have also considered the Community requirements as set out in section 4 of the Act. The proposed remedy would promote competition in relation to the provision of electronic communications networks and encourage the provision of network access for the purpose of securing efficient and sustainable competition in markets for electronic communications networks and services.
- 8.14 We consider that the proposed remedy meets the criteria set out in section 47(2) of the Act, in particular it is:
- objectively justifiable, as having provisionally assessed that KCOM has SMP it could exercise that power to act in a way to discriminate between transactions and customers where such discrimination was not justified. Without such an obligation we consider that barriers to entry would be increased and KCOM's position of SMP would be strengthened;

- non-discriminatory as it is only imposed on KCOM who we are proposing holds SMP in the market;
- proportionate since it does not prevent the application of dissimilar conditions to different transactions where there objective reasons for doing so. It is therefore the least burdensome means of achieving this aim; and
- transparent as we have set out the proposed requirements on KCOM and our justifications for those requirements.

Legal tests: price publication

- 8.15 We have considered our duties under section 3 of the Act. We consider that a price publication condition will support the proposed no undue discrimination condition and therefore further the interests of citizens and consumers in the relevant market by increasing transparency within the market which will help to reduce barriers to entry, and hence promote competition.
- 8.16 We have also considered the Community requirements as set out in section 4 of the Act. The proposed remedy would, in supporting the proposed no undue discrimination condition, promote competition in relation to the provision of electronic communications networks and encourage the provision of network access for the purpose of securing efficient and sustainable competition in markets for electronic communications networks and services.
- 8.17 We consider that the proposed remedy meets the criteria set out in section 47(2) of the Act, in particular it is:
- objectively justifiable as general and reliable visibility of KCOM's prices will enable competitors or potential competitors to assess the suitability for market entry, thus promote retail competition by reducing barriers to entry. The proposed condition would also allow competitors and us to monitor KCOM's prices for possible anti-competitive behaviour;
 - non-discriminatory as it is only imposed on KCOM who we are proposing holds SMP in the market;
 - proportionate since the obligation only requires publication of prices, not advance notice and we regard this as the least burdensome method of addressing the identified competition concern; and
 - transparent as we have set out the proposed requirements on KCOM and our justifications for those requirements.

Question 8.1 Do you agree or disagree with our continued imposition of retail price publication and no undue discrimination remedies on KCOM in Hull. Please give reasons for your view.

Section 9

Wholesale remedies for Openreach and KCOM

Introduction

- 9.1 In this section we consider and propose remedies in order to address BT and KCOM's SMP in the wholesale markets for ISDN30. We first set out a summary of what remedies we are proposing in this consultation, we then explain the options that we have considered and finally, we set out why we consider each proposed remedy appropriate given our market analysis as set out in Section 7.

Summary – SMP conditions to be applied to Openreach

- 9.2 It is useful to set out the remedies that currently apply to Openreach in the wholesale ISDN30 market. The remedies listed below were set under the *Review of the fixed narrowband line, call origination, conveyance and transit markets* ('the 2003 review')⁶³ published on 28 November 2003 and currently remain in force:
- Requirement to provide Network Access on reasonable request;
 - Requirement not to unduly discriminate;
 - Requirement to provide Wholesale Line Rental ISDN30;
 - Requests for new network access;
 - Requirement to publish a reference offer;
 - Requirement to notify charges, terms and conditions;
 - Requirement to publish technical information.
 - Transparency as to quality of service; and
 - Requirement to account separately.
- 9.3 We consider that these remedies have been successful in enabling an increasingly competitive downstream retail market such that we are now proposing removal of the SMP designation in the retail market for ISDN30 services in the UK (except the Hull area). We believe, given our provisional finding that Openreach has SMP in the wholesale market, that the re-imposition of these remedies, subject to appropriate amendment in certain cases, is appropriate.
- 9.4 Additionally, as discussed in Section 7, we consider that Openreach is likely to be earning an excessive return for ISDN30, indicating that they are able to set the wholesale price above the competitive level. In the circumstances, we consider that it is appropriate to impose a charge control in order to address this identified market failure. We are therefore proposing in this consultation that a charge control would be

⁶³ http://www.ofcom.org.uk/consult/condocs/narrowband_mkt_rvw/nwe/fixednarrowbandstatement.pdf

the appropriate remedy. However, for reasons that we explain below, we consider that it would be appropriate to consult separately on such a control.

- 9.5 In the draft Notification at Annex 5 to this document we confirm proposals for the 2003 conditions to be formally withdrawn and new proposed SMP Conditions will to be applied to Openreach in order to remain consistent with the approach that we have taken in the other narrowband markets, which we reviewed last year.

Summary – SMP conditions to be applied to KCOM

- 9.6 The 2003 review described and set the remedies that currently apply to KCOM, which are:
- Requirement to provide Network Access on reasonable request;
 - Requirement not to unduly discriminate;
 - Requirement to publish a reference offer;
 - Requirement to notify charges, terms and conditions; and
 - Requirement to publish technical information
- 9.7 We consider that the current obligations remain largely appropriate given the need to strike an appropriate balance between KCOM's SMP in the Hull Area, whilst recognising that the absence of actual competition in the area means that conditions that impose too much regulation on the dominant provider without promoting competition would be likely to be disproportionate.

Remedies Considered Openreach

- 9.8 In Section 7 we explain our provisional conclusion that Openreach has SMP in the wholesale market for ISDN30 in the UK excluding the Hull Area. We therefore consider that Openreach has the ability and incentive to behave to an appreciable extent independently of competitors, customers and ultimately consumers. We also consider that there is little prospect of competition developing to such an extent that Openreach will no longer have SMP during the forward look of this review.
- 9.9 In this section we set out our proposals for remedies to be imposed on Openreach in order to address these concerns. We start by discussing three general options for remedies:
- Option 1: no remedies (i.e. removal of existing remedies);
 - Option 2: general access and no undue discrimination remedies (i.e. the continuation of current remedies); and
 - Option 3: charge controls in addition to Option 2 remedies.

In this discussion, we take account of the effectiveness of the general access and no undue discrimination remedies which currently exist in this market.

Option 1 (no regulation)

- 9.10 As set out in Section 7, we consider that Openreach has SMP in the market and that there is little potential for competition to develop.
- 9.11 In the absence of *ex ante* regulation, Openreach would be able to exploit its market power in a way which is damaging to markets and the interests of citizens and consumers. For example, it would be able to withhold access and set wholesale charges that are above the competitive level.
- 9.12 As explained below, Openreach is currently subject to general access, no undue discrimination and transparency requirements in this market. These remedies have been successful in enabling an increasingly competitive downstream retail market such that we are now proposing removal of the SMP designation in the retail market for ISDN30 services in the UK (except the Hull area). We believe, given our provisional finding that Openreach has SMP in the wholesale market, that the continuation of these remedies is appropriate to ensure that the retail market is not distorted by SMP in the upstream wholesale market in future.
- 9.13 For these reasons, we consider that *ex-ante* regulation is required.

Option 2 (access and no undue discrimination obligations)

- 9.14 As set out above, in the absence of regulatory remedies in the market, Openreach would not have the incentive to provide access to all CPs and this could restrict competition in the provision of retail services.
- 9.15 As such, in order to promote competition in the provision of downstream ISDN30 access, a suite of regulatory remedies requiring Openreach to provide network access and the specific provision of a WLR product would be required. These remedies would aim to ensure that other providers can obtain wholesale products from Openreach, and would operate in the same way as the requirements to provide network access on reasonable request, and the requirement to provide WLR which currently apply in this market.
- 9.16 Requiring Openreach to provide network access would enable CPs to compete in the downstream market by allowing them to access the products they need, but cannot replicate themselves due to the high costs of deploying the network needed to provide these products.
- 9.17 The Network Access provided by Openreach should be that required by third parties to compete in the retail market. However, as now, we consider that it is appropriate to require Openreach to meet those requests that are reasonable only.
- 9.18 If Openreach is only required to provide Network Access it may discriminate in favour of BT's retail divisions. As alternative sources of supply are very limited, this would limit their ability to compete with BT in the downstream market. This discrimination could take the form of setting excessive prices for wholesale products or in providing products of inferior quality or functionality.
- 9.19 Therefore, the obligation to provide Network Access will only be fully effective if supported by an obligation not to discriminate unduly. Currently, Openreach is subject to an obligation not to discriminate unduly in the provision of wholesale ISDN30 services, and we propose to continue with this obligation as a result of this market review.

- 9.20 In order to ensure that Openreach is complying with the obligations to provide Network Access and the requirement not to discriminate unduly, additional obligations related to ensuring transparency may also be required. In addition, transparency obligations would provide CPs with access to the information they need in order to make informed decisions about purchasing Openreach's wholesale products. Without these obligations, not only would it be difficult for third parties to assess whether Openreach was meeting its obligations to provide Network Access and not discriminate unduly, it may also be the case that third parties would not have sufficient information in order to decide whether, or how, to enter the downstream market by purchasing Openreach's wholesale products. This could ultimately result in fewer CPs, and therefore less choice, for consumers.
- 9.21 As with the obligation to supply and the requirement to not discriminate unduly, obligations requiring transparency already exist in this market and have worked well. Currently, Openreach is required to publish a reference offer, notify charges, notify technical information, and provide transparency as to quality of service. We propose to continue these obligations as a result of this market review. Given that in this market Openreach holds a position of SMP, in the absence of regulation it would have no incentive to provide products on the same terms to competitors of downstream divisions of BT. Therefore, we have provisionally concluded that the existing framework of supply, non-discrimination, and transparency obligations is necessary going forward to ensure continuing competitiveness in the downstream retail market.

Option 3 (price controls)

- 9.22 In a competitive market, the charges for services would be set on the basis of the commercial judgements of individual companies and could be expected to deliver cost reflective prices. However, where competition cannot be expected to provide effective constraints, *ex-ante* regulation may be desirable to prevent charges from being set at an excessive level. Such intervention could also have as its objectives the aim of promoting efficiency and of allowing the development of effective competition in downstream markets.
- 9.23 In this market, Openreach has SMP and, as discussed in Section 7, there is little likelihood of new entry or expansion. We do not consider that entry, or the threat of entry, will act to constrain Openreach's wholesale charges. As such, Openreach is likely to have the incentive to set charges above the competitive level. Retail CPs who do not self-supply and rely on Openreach for wholesale service would be forced to pay these high charges in order to provide an ISDN30 service.
- 9.24 We consider that there are four possible approaches to charge regulation:
- No specific charge control;
 - a cost orientation obligation;
 - a safeguard cap; or
 - a charge control.

No specific charge control

- 9.25 In the absence of specific charging obligations, Openreach may be constrained by other SMP conditions imposed within the market. The requirement to provide

Network Access and the obligation not to discriminate unduly would mean that Openreach would be required to provide access on fair and reasonable terms, conditions and charges. Additionally, it would not be permitted to discriminate unduly between customers and this would restrict its ability to set different charges.

Regulation set on this basis may be considered to provide a light touch approach and could be sufficient in certain circumstances, for example when we consider a market is moving towards being competitive or there is a risk that specific charge regulation could deter investment. Openreach would also be subject to the requirements of the Chapter II obligations in the Competition Act.

- 9.26 In this market we have identified, however, that Openreach is able to maintain charges that are excessive and significant entry is unlikely during the forward look period of this review. We consider that the position of SMP held by Openreach is entrenched and the market is not moving towards becoming effectively competitive.
- 9.27 Therefore, we are of the view that *ex ante* pricing obligations are required to address Openreach's SMP. All the other options we consider below would to different degrees constrain Openreach's ability to set excessive charges.

Cost orientation

- 9.28 As discussed above, we believe that, without some additional constraint on charges, Openreach would have the ability to charge excessive prices in order to maximise profits and increase revenues. Excessive charges at the wholesale level are likely to result in high retail prices and therefore consumers would be likely to be paying more for a service than they would if wholesale charges were constrained by effective competition.
- 9.29 A cost orientation obligation would require Openreach to set charges based on its costs incurred in providing wholesale ISDN30.
- 9.30 If we were to impose just a cost orientation obligation on Openreach, along with guidance as to the interpretation of this (for example, we could provide guidance that Openreach's charges must, as a "first order test", be between DLRIC⁶⁴ and DSAC⁶⁵), Openreach would be required to adjust its charges to comply with the obligation if its charges were outside this range. As such, Openreach's charges would be constrained based on the costs incurred in providing ISDN30.
- 9.31 However, as we are proposing that Openreach is dominant in the market, it is unlikely to be incentivised to set charges at the competitive level. It would be likely to be able to exploit the pricing freedom available under a cost orientation requirement to recover higher costs through setting charges at the ceilings allowed by such a requirement. Whilst this might meet a cost orientation test, it would result in charges being set higher than the competitive level. Higher charges would be likely ultimately to be passed on in higher retail charges. A cost orientation obligation on its own is therefore unlikely to be an appropriate remedy for the existence of charges above the competitive level.

Safeguard Cap

- 9.32 The key benefit of a safeguard cap is that it would set a maximum level for charges. However, other than basing this maximum level on the costs of provision (as

⁶⁴ Distributed Long Run Incremental Cost.

⁶⁵ Distributed Stand Alone Costs.

discussed below in relation to a charge control), it is not clear what would be the basis for the maximum level. Previously, we have set safeguard caps based on current prices (via either a fixed ceiling, RPI-0% or RPI-RPI approach), but in this market where charges have not been regulated and in light of evidence of high returns on capital employed, it is not clear that charges reflect costs.

- 9.33 The danger, therefore, of a ceiling or an RPI-0% or RPI-RPI cap set for the duration of the forward look period is that, if charges are currently above the competitive level, Openreach could maintain charges at the present level, irrespective of the costs that would be expected to be incurred by an efficient CP in a competitive market.

Charge Control

- 9.34 Where there is a risk of a firm setting excessive charges due to a lack of competition in the market, a charge control with transparent and easy to monitor compliance conditions could help ensure that firms were not able to abuse their dominant position.
- 9.35 As discussed above, while a cost orientation obligation would provide some constraint on charge levels, it would not require charges to be set at the competitive level. Under our preferred method of charge control regulation, RPI+/-X, charges are set such that they are at a competitive level at the end of the control period. Additionally, if the firm can reduce its costs below the level expected when the cap was set, then the firm retains the increased profits, at least for the period the control is in place.
- 9.36 Communications markets experience significant economies of scope. This means that it is more efficient for the same CP to supply a number of different services than for each to be provided by a different CP. It also means that there are likely to be significant common costs that cannot be attributed to the provision of any one service. In these cases it may be difficult to determine if prices are excessive in one market, without understanding the recovery of costs from related markets. A charge control would include the allocation of common costs to the provision of regulated services.
- 9.37 A charge control would result in charges being based on a forward-look view of the costs⁶⁶ related to the provision of wholesale ISDN30 services at the end of the period. The control would provide certainty for CPs in that the maximum charge of WLR ISDN30 would be known and it would also allow Openreach to make a reasonable return.
- 9.38 A charge control may, however, have negative effects. If the charge control was too stringent, then inefficient investment and purchasing signals could be sent to the market that could artificially alter demand and distort competition.

Conclusion on ex ante charging obligations

- 9.39 We propose that, given our analysis that Openreach is making excessive returns on ISDN30, we should impose a charge control. In Section 7 we have discussed Openreach's historic returns in ISDN30 and the anticipated life of the product and its replacement by IP-based technologies. However, without a charge control, there is a concern that Openreach could set and maintain charges at an excessive level.

⁶⁶ We propose to consider the specifics of the charge control, including the relevant costs, in a separate consultation.

9.40 We propose to consult separately on the detail of the charge control. We would need to consider the level of returns that Openreach should be allowed to make for ISDN30. In this assessment, our aim, as discussed above, would be to ensure that Openreach would be constrained from exploiting its position as the dominant CP, while being allowed to make an appropriate return given the nature of ISDN30 as a legacy product.

Proposed conditions for Openreach

9.41 Based on the above, we propose to continue with the following obligations which currently apply:

- Requirement to provide Network Access on reasonable request;
- Requirement not to unduly discriminate;
- Requirement to provide Wholesale Line Rental ISDN30;
- Requests for new network access;
- Requirement to publish a reference offer;
- Requirement to notify charges, terms and conditions;
- Requirement to publish technical information;
- Transparency as to quality of service; and
- Requirement to account separately

In addition, we propose the following new obligations:

- Cost accounting; and
- Charge control (with an initial safeguard cap).

9.42 We discuss each of the non charge control conditions later in this section, specifically in relation to how they address our competition concerns in the market. We deal with our proposal to implement a charge control for this market in Section 10.

Remedies considered – KCOM

9.43 In Section 7 we explain our provisional conclusion that KCOM has SMP in the wholesale market for ISDN30 in the Hull Area. We therefore consider that KCOM has the ability and incentive to behave to an appreciable extent independently of competitors, customers and ultimately consumers. We also consider that there is little prospect of competition developing to such an extent that KCOM will no longer have SMP during the forward look of this review.

9.44 In this section we set out our proposals for remedies to be imposed on KCOM in order to address these concerns. We start by discussing three general options for remedies:

- Option 1: no remedies (i.e. the removal of current remedies);

- Option 2: general access, non-discrimination and transparency remedies (i.e. the continuation of current remedies); and
- Option 3: charge controls in addition to Option 2 remedies.

In this discussion, we take account of the general access and no undue discrimination remedies which currently exist in the market.

Option 1 (no regulation)

- 9.45 As set out in Section 7, we consider that KCOM has SMP in the market and that there is little potential for competition to develop. Currently there is no competitive provision of ISDN30 in the Hull area.
- 9.46 In the absence of *ex ante* regulation and in the event that competition develops in the Hull area requiring provision of wholesale services by KCOM, KCOM would be able to exploit its market power in a way which could be damaging to markets and the interests of citizens and consumers. For example, it would be able to restrict access in the provision of services to downstream markets.
- 9.47 For these reasons, we consider that *ex-ante* regulation is required. KCOM is currently subject to general access, no undue discrimination and transparency requirements. Whilst KCOM has not been required to provide a wholesale ISDN30 service, we believe these remedies have been proportionate and effective in providing a framework in which competitive provision would be possible based on a wholesale KCOM service in the event that there was reasonable demand for such a service. Therefore we do not believe it would be appropriate to remove this level of regulation.

Option 2 (access and no undue discrimination obligations)

- 9.48 As set out above, in the absence of regulatory remedies in the market, KCOM would not have the incentive to provide access to other CPs in the event that they requested access and this could restrict competition in the provision of retail services. An absence of wholesale products is unlikely to encourage entry by other CPs.
- 9.49 As such, in order to promote competition in the provision of downstream ISDN30 access, a suite of regulatory remedies requiring KCOM to provide Network Access would be required. These remedies would aim to ensure that other CPs could obtain wholesale products from KCOM, and would operate in the same way as the requirement to provide network access on reasonable terms which currently applies in this market.
- 9.50 Requiring KCOM to provide Network Access would allow CPs to compete in the downstream market if they found it profitable to do so by allowing them to access the products they need, but cannot replicate themselves due to the high costs of deploying the network needed to provide these products.
- 9.51 The Network Access provided by KCOM should be that required by third parties to compete in the retail market. However, it would only be appropriate to require KCOM to meet requests that were reasonable.
- 9.52 If KCOM was only required to provide Network Access it may discriminate in favour of its own retail divisions in the event that a competitive market develops. As any competitors would be unlikely to have other sources of supply, this would limit their

ability to compete with KCOM in the downstream market. Discrimination may take the form of setting excessive charges for wholesale products or in providing products of inferior quality or functionality.

- 9.53 Therefore, the obligation to provide Network Access would be more likely to be effective if it supported by an obligation not to discriminate unduly. Currently, KCOM is subject to an obligation not to discriminate unduly in the provision of wholesale ISDN30 services in the event that it were to provide them, and we propose to continue with this obligation as a result of this market review.
- 9.54 In order to ensure KCOM is complying with the obligations to provide Network Access and the requirement not to discriminate unduly, additional obligations related to ensuring transparency may also be required. Transparency obligations would provide third parties with access to the information they need in order to make informed decisions about purchasing KCOM's wholesale products. Without these obligations, not only would it be difficult for third parties to assess whether KCOM was meeting its obligations to provide Network Access and to not discriminate unduly, third parties may not have sufficient information in order to decide whether, or how, to enter the downstream market by purchasing KCOM's wholesale products. This could ultimately result in fewer providers and, therefore, less choice for consumers. As with the obligation to supply and the requirement for no undue discrimination, obligations requiring transparency already exist in this market.
- 9.55 Currently, KCOM is required to publish a RO, notify charges, and notify technical information. We propose to continue with these obligations as a result of this market review. Given the size of the market and the fact that currently there is no demand for wholesale ISDN30 services from KCOM, we do not think it would be proportionate to extend regulation beyond these existing requirements.

Option 3 (charge controls)

- 9.56 As explained in Section 7, KCOM is the only provider of ISDN30 services in the Hull area. Whilst we believe it is appropriate to keep in place general access and no undue discrimination remedies to ensure that future competitive entry is not foreclosed, we do not think it is appropriate to regulate wholesale charges in a market in which KCOM provides service currently only to its own downstream retail operation. Creation of charge control remedies in these circumstances would not be a proportionate use of regulation and would not therefore meet the requirements of section 47(2) of the Act. We are not therefore proposing any ISDN30 charge control remedies for KCOM.

Proposed conditions for KCOM

- 9.57 Based on the above, the following are the specific remedies we propose to re-impose on KCOM, all of which are based on obligations which currently apply:
- Requirement to provide Network Access on reasonable request;
 - Requirement not to unduly discriminate;
 - Requirement to publish a reference offer;
 - Requirement to notify charges, terms and conditions;
 - Requirement to publish technical information

Proposed SMP conditions

- 9.58 The remainder of the section explains each of the SMP remedies we are proposing for Openreach and KCOM in further detail, with the exception of our charge control proposals for Openreach which are covered in detail in Section 10. Where we are proposing to apply the same remedy to both Openreach and KCOM we consider its application together, given the underlying similarities in the competition issues that apply to the respective markets in these cases.

Requirement to provide network access on reasonable request

- 9.59 We propose to impose remedies requiring Openreach and KCOM to meet reasonable requests for network access in the wholesale ISDN30 markets.
- 9.60 Section 87(3) of the Act authorises us to set SMP services conditions requiring the dominant CP to provide network access as we may, from time to time, direct. These conditions may, pursuant to section 87(5), include provision for securing fairness and reasonableness in the way in which requests for network access are made and responded to, and that the conditions are complied with within the periods and at the times required.
- 9.61 When considering the imposition of such conditions, we must have regard to the six factors set out in section 87(4) of the Act, including, *inter alia*, the technical and economic viability of installing other competing facilities and the feasibility of the proposed network access.

Aim of regulation

- 9.62 This remedy is designed to promote competition in downstream markets by requiring CPs with SMP to provide wholesale access to their network facilities. The level of investment required by a third party to replicate Openreach and KCOM's networks in order to compete at this level is a significant barrier to entry. We consider that in the absence of such a requirement, the dominant CP would have an incentive not to provide access. The ability of competing CPs to gain wholesale access could facilitate the development of competition in retail markets.

Proposed condition

- 9.63 The proposed condition would require requests made to Openreach and KCOM for network access to be 'reasonable'. The condition would also require Openreach and KCOM to provide network access in response to a reasonable request and that access should be provided on fair and reasonable terms, conditions and charges.

Legal tests

- 9.64 We have considered our duties under section 3 of the Act. We consider that, in ensuring Network Access at the reasonable request of third parties, the proposed condition would in particular further the interests of citizens and consumers in relevant markets by the promotion of competition.
- 9.65 We have considered the Community requirements as set out in section 4 of the Act. The proposed obligation would promote competition in relation to the provision of electronic communications networks and encourage the provision of network access for the purpose of securing efficient and sustainable competition in markets for electronic communications networks and services. We have taken account of the

current existence of a requirement to provide network access on reasonable request in relation to wholesale ISDN30, and that it has been effective in enabling increasingly competitive conditions in the downstream retail market in the UK outside of the Hull area. We believe that removal of the requirement could harm or reverse this.

9.66 We consider that the proposed condition meets the criteria set out in section 47(2) of the Act. The proposed condition is:

- objectively justifiable, as its intention is to promote retail competition by ensuring third parties are able to acquire wholesale access on fair and reasonable terms where they are unable to replicate the networks of Openreach or KCOM;
- non-discriminatory, as it is only imposed on CPs who are found to have SMP and we propose that both these CPs should be subject to the same obligation;
- proportionate, since without such an obligation Openreach and KCOM could refuse to provide access and this would mean other CPs would not be able to effectively compete in markets where we are proposing Openreach and KCOM hold SMP, but does not require Openreach and KCOM to provide access where it is not technically feasible or reasonable; and
- transparent as it is clear the intention is to ensure that Openreach and KCOM provide access to their networks in order to facilitate competition.

9.67 The proposed condition would apply to the market for provision of wholesale ISDN30 in the UK except the Hull area, and the market for provision of wholesale ISDN30 in the Hull area.

Question 9.1 Do you agree or disagree that Ofcom should impose a requirement to provide network access on reasonable request on Openreach and KCOM in the markets for wholesale provision of ISDN30 services? Please give reasons for your view.

Requirement not to discriminate unduly

9.68 We propose to impose the condition on Openreach and KCOM not to discriminate unduly in relation to the provision of wholesale ISDN30 services.

9.69 Section 87(6)(a) of the Act authorises the setting of a SMP services condition requiring the dominant CP not to discriminate unduly against particular persons, or against a particular description of persons, in relation to matters connected with the provision of Network Access.

Aim of regulation

9.70 Where dominant CPs are vertically integrated like KCOM, or part of a larger group of companies incorporating downstream activities, like Openreach, they may have an incentive to provide wholesale services on terms and conditions that favour their own or affiliated retail activities in a way that would have a material adverse effect on competition. In particular, they may charge competing CPs different amounts for the same service, thereby increasing the costs of some competing CPs and giving others an unfair competitive advantage. They might also provide services on different terms and conditions, for example with different delivery timescales, which would disadvantage retail competitors and in turn consumers.

- 9.71 An obligation to provide network access on its own is not adequate to promote downstream competition. In the absence of a requirement not to discriminate unduly, Openreach and KCOM could favour downstream businesses, which would have the effect of restricting or distorting competition in the retail market.
- 9.72 We have considered whether allegations or evidence of discriminatory behaviour could be adequately addressed through competition law. However, we consider that in order to meet our objective to promote efficient and sustainable competition at the wholesale level, a no undue discrimination condition is necessary. This condition would ensure that all parties were treated on the same basis, thereby creating the right environment for competition to develop.

Legal tests

- 9.73 Together with an obligation to provide Network Access, the proposed obligation would in particular encourage the provision of Network Access and service interoperability for the purpose of efficiency and sustainable competition in downstream markets by ensuring that Openreach and KCOM were not permitted to discriminate unduly. This would ensure a competitive playing field and could lead to the promotion of competition and the interests of consumers through the maximisation of choice in downstream markets.
- 9.74 Therefore, we consider that the proposed condition in particular furthers the interests of citizens and consumers in relevant markets by the promotion of competition in line with section 3 of the Act. We have taken account of the current existence of a requirement not to discriminate unduly in relation to wholesale provision of ISDN30 services, and that it has been effective in enabling increasingly competitive conditions in the downstream retail market in the UK outside of the Hull area. We believe that removal of the requirement could harm or reverse this.
- 9.75 We have considered the Community requirements as set out in section 4 of the Act. The proposed condition would encourage the provision of network access and service interoperability for the purpose of securing efficient and sustainable competition in the retail markets for access and calls, by ensuring Openreach and KCOM were not permitted to unfairly favour particular retail businesses and therefore distort competition.
- 9.76 We consider that the proposed condition meets the criteria set out in section 47(2) of the Act. We believe the proposed condition is:
- objectively justifiable, as it would provide a safeguard to prevent Openreach and KCOM from favouring their own or affiliated businesses, to the disadvantage of their competitors;
 - not unduly discriminatory, as it would be imposed only on CPs who are found to have SMP and we propose that both CPs should be subject to the same obligation;
 - proportionate, as it is intended to prohibit discrimination that is undue only, that is discrimination that would materially affect the ability of Openreach and KCOM's competitors to compete on equal terms; and
 - transparent, as it is clear that its intention is to prevent discrimination that is undue.

- 9.77 The proposed condition would apply to the market for provision of wholesale ISDN30 in the UK except the Hull area, and the market for provision of wholesale ISDN30 in the Hull area.

Question 9.2 Do you agree or disagree that Ofcom should impose a requirement not to discriminate unduly on Openreach and KCOM in the markets for wholesale provision of ISDN30 services? Please give reasons for your view.

Transparency

- 9.78 We consider that it is appropriate to ensure that there is transparency of charges, terms and conditions in a market in which one CP is dominant. In the absence of requirements obliging an SMP CP to publish information, they might offer differential charges, terms and conditions to both its downstream division and also between other CPs. Third party CPs would not be able to check that they were being charged the same rate, or that the terms and conditions that they were offered were also the same.
- 9.79 Section 87(6)(b) of the Act authorises the setting of SMP services conditions which require a dominant CP to publish all such information, and in such manner as we may direct, for the purpose of securing transparency. Section 87(6)(c) of the Act authorises the setting of SMP services conditions requiring the dominant CP to publish, in such manner as we may direct, the terms and conditions on which it is willing to enter into an access contract. Section 87(6)(d) also permits the setting of SMP services conditions requiring the dominant CP to include specified terms and conditions in the reference offer. Finally, section 87(6)(e) permits the setting of SMP services conditions requiring the dominant CP to make such modifications to the reference offer as we may direct from time to time.
- 9.80 We propose to impose the following obligations to provide transparency in the markets for wholesale provision of ISDN30 services:
- requirement to publish a reference offer;
 - requirement to notify charges;
 - requirement to notify technical information;
 - transparency as to quality of service; and
 - requirement to account separately.

Requirement to publish a reference offer

- 9.81 We propose to require Openreach and KCOM to publish a reference offer ('RO') for services and products offered in the markets for wholesale provision of ISDN30 services. In the case of KCOM, the requirement for a RO would only apply in the event that a wholesale service was reasonably requested. Presently this is not the case, but it would be if such a request was received.

Aim of regulation

- 9.82 The main reasons for requiring the publication of a RO would be to assist with transparency in monitoring for potential anti-competitive behaviour and to give visibility to the terms and conditions on which other CPs would be able to purchase

wholesale ISDN30 services. The publication of a RO would therefore help to ensure stability in markets and that incentives to invest would not be undermined.

- 9.83 The publication of a RO would allow for speedier negotiations and might avoid possible disputes. Together with a no undue discrimination requirement, the publication of a RO would give confidence to those purchasing wholesale ISDN 30 services that they were being provided on non-discriminatory terms. We have taken account of the current existence of a requirement to publish a RO for wholesale ISDN30 services, and that it has been effective in enabling increasingly competitive conditions in the downstream retail market in the UK outside of the Hull area. We consider that removal of the requirement could harm or reverse this.

Proposed condition

- 9.84 We consider that it is appropriate for the published RO to include:
- a clear description of the services on offer;
 - terms and conditions including charges and ordering, provisioning, billing and dispute resolution procedures. The RO should provide sufficient information to enable providers to make technical and commercial judgements such that there is no material adverse effect on competition;
 - information relating to technical interfaces and points of interconnection. Such information should ensure that CPs were able to make full and effective use of all the services provided;
 - conditions relating to maintenance and quality (service level agreements and guarantees). The inclusion of service levels, as part of the contractual terms of the RO, that provide for a minimum acceptable level of service, would ensure that services would be provided in a fair, reasonable, timely and non-discriminatory fashion; and
 - terms and conditions that were fair and reasonable. This would ensure that products were offered on terms and conditions as they would in a competitive market and that they were sensible, practical, and did not impose a margin squeeze on competitors.

Legal tests

- 9.85 The requirement to publish a RO would, in combination with a requirement not to discriminate unduly, facilitate service interoperability, secure freedom of choice for wholesale customers of Openreach and KCOM and allow CPs to make informed decisions about wholesale investment. Further, the proposed obligation would promote the interests of purchasers of wholesale ISDN30 by enabling them to adjust their downstream offerings in competition with Openreach or KCOM, in response to changes in their terms and conditions. Finally, the proposed obligation would make it easier for CPs in the relevant market and us to monitor any instances of discrimination which was undue.
- 9.86 For the reasons set out above, we consider that the proposed condition in particular furthers the interests of citizens and consumers in relevant markets by the promotion of competition in line with section 3 of the Act.

- 9.87 We consider that the proposed condition meets the Community requirements set out in section 4 of the Act. In particular, the proposed condition could promote competition and encourage the provision of Network Access and service interoperability for the purpose of securing efficient and sustainable competition for the maximum benefit of consumers. The publication of a RO would mean that CPs would have the necessary information readily available to allow them to make informed decisions about entry into the market.
- 9.88 We consider that the proposed condition meets the criteria set out in section 47(2) of the Act. The proposed obligation is:
- objectively justifiable, in that would require that terms and conditions were published allowing competing CPs the ability to ensure they were receiving offers that did not discriminate unduly in favour of the dominant CP's own retail operations, therefore encouraging competition to the benefit of consumers;
 - not unduly discriminatory, as would be applied only to CPs who hold SMP and we propose that both are subject to the same obligation;
 - proportionate, in that only information that is necessary to ensure that there is no material adverse effect on competition would be required to be provided; and
 - transparent, as it is clear the obligation would be designed to ensure that potential competitors have sufficient information to make investment decisions about entry into this market.
- 9.89 The proposed condition would apply to the market for provision of wholesale ISDN30 in the UK except the Hull area, and the market for provision of wholesale ISDN30 in the Hull area.

Question 9.3 Do you agree or disagree that Ofcom should impose a requirement to publish a reference offer on Openreach and KCOM in the markets for wholesale provision of ISDN30 services? Please give reasons for your view.

Requirement to notify charges, terms and conditions

- 9.90 We consider that it is appropriate to retain a requirement on Openreach and KCOM to publish any planned changes to charges in advance of those changes taking place. We consider that 28 days' notice is appropriate in both cases and this retains the status quo. In the case of KCOM, the requirement to notify charge changes would only apply in the event that a wholesale service is supplied. Presently this is not the case, but it would be if a reasonable request were made to KCOM for access.

Aim of regulation

- 9.91 Notification of changes to services at the wholesale level can further assist competition, as it means other CPs would have the opportunity to consider whether these changes require amendments to their own retail offerings.
- 9.92 The notification of charges at the wholesale level has the joint purpose to assist transparency for the monitoring of potential anti-competitive behaviour and to give advanced warning of charge changes to competing providers who purchase wholesale ISDN30 services. The latter purpose ensures that competing providers would have sufficient time to plan for such changes. Notification of changes therefore

helps to ensure stability in markets without which incentives to invest might be undermined and market entry made less likely.

Proposed condition

9.93 We consider that the notice should include:

- A description of the service;
- The location of terms and conditions in the RO;
- The effective date or period from which the changes will have effect; and
- Other charges for services that would be directly affected by the proposed change.

Legal tests

- 9.94 The requirement to notify charges would, in combination with a requirement not to discriminate unduly, allow CPs to make informed decisions about wholesale investment. Further, the proposed obligation would promote the interests of purchasers of wholesale ISDN30 by enabling them to adjust their downstream offerings in competition with Openreach and KCOM in response to changes in Openreach or KCOM's charges. The proposed obligation would also make it easier for us to monitor any instances of discrimination. We have taken account of the current existence of a requirement to notify charges, terms and conditions for wholesale ISDN30, and that it has been effective in enabling increasingly competitive conditions in the downstream retail market in the UK outside of the Hull area. We believe that removal of the requirement could harm or reverse this.
- 9.95 For the reasons set out above, we consider that the proposed condition in particular furthers the interests of citizens and consumers in relevant markets by the promotion of competition in line with section 3 of the Act.
- 9.96 We consider that the proposed condition meets the Community requirements set out in section 4 of the Act. In particular, the proposed condition could promote competition and secure efficient and sustainable competition for the maximum benefit of consumers by ensuring that CPs have the necessary information to allow them to make informed decisions about competing in the relevant market.
- 9.97 We consider that the proposed condition meets the criteria set out in section 47(2) of the Act. It is:
- objectively justifiable, because general and reliable visibility of a dominant CP's charges is needed to enable competitors to set prices for their services that are based on purchasing the regulated inputs. It would also allow CPs and us to monitor Openreach and KCOM's charges for possible anti-competitive behaviour;
 - not unduly discriminatory, as it is only imposed on CPs who have SMP and we propose that both CPs should be subject to the same obligation;
 - proportionate, in that only information that other CPs would need to know in order to adjust for any changes would have to be notified. The period of 28 days is proposed to be the minimum required to allow changes to be reflected in retail offers; and

- transparent, as it is clear the intention is to ensure that Openreach and KCOM notify CPs who purchase wholesale access of changes to charges.

9.98 The proposed condition would apply to the market for provision of wholesale ISDN30 in the UK except the Hull area, and the market for provision of wholesale ISDN30 in the Hull area.

Question 9.4 Do you agree or disagree that Ofcom should impose a requirement to notify charges, terms and conditions on Openreach and KCOM in the markets for wholesale provision of ISDN30 services? Please give reasons for your view.

Requirement to notify technical information

9.99 We consider that it is appropriate to propose a requirement on Openreach and KCOM to notify technical information a minimum of 90 days in advance of providing new wholesale ISDN30 services or amending existing technical terms and conditions. In the case of KCOM, the requirement to notify technical information would only apply in the event that a wholesale service was required. Presently this is not the case, but it would be if a reasonable request were made to KCOM for access.

Aim of regulation

- 9.100 The aim of an obligation to provide advance notification of technical characteristics is to ensure that competing CPs have sufficient time to respond to changes that may affect them. For example, a competing CP may need to introduce new equipment or modify existing equipment or systems to support a new or changed technical interface.
- 9.101 Technical information includes new or amended technical characteristics, including information on network configuration, locations of the points of network access and technical standards (including any usage restrictions and other security issues).

Proposed condition

- 9.102 The existing condition requires the notification of new technical information 90 days in advance of providing new wholesale services or amending existing technical terms and conditions. We continue to believe that 90 days notice is the minimum time that competing CPs would need to make modifications to their network to support changes.
- 9.103 This condition for 90 days' notice relates to changes to technical information related to SMP services. All CPs are required to comply with General Condition 2⁶⁷, which obliges them to apply compulsory standards, or in the absence of these, voluntary standards. Such changes should be agreed through NICC⁶⁸. Therefore, agreement of such standards should normally have been agreed at NICC prior to this 90 day period.

Major changes and NGN

- 9.104 For major changes to the existing network and migration to NGNs, we consider that industry consultation (including through NICC) continues to be an appropriate way to

⁶⁷ http://www.ofcom.org.uk/telecoms/ioi/g_a_regime/

⁶⁸ NICC is a technical forum for the UK communications sector that develops interoperability standards for public communications networks and services in the UK. See <http://www.niccstandards.org.uk/>.

progress modifications. This consultation and agreement phase would not fall within the notice period; therefore the formal 90 day notification period would follow the industry process. That is, the notification should be made only following the conclusion of the consultation process.

Legal tests

- 9.105 We consider that, by ensuring that CPs' systems are interoperable with any changes to technical specifications that might affect their businesses, the proposed condition in particular furthers the interests of citizens and consumers in relevant markets by the promotion of competition in line with section 3 of the Act.
- 9.106 We consider that the proposed condition meets the Community requirements set out in section 4 of the Act. In particular, the proposed condition could promote competition and secure efficient and sustainable competition for the maximum benefits of consumers by ensuring that CPs have sufficient notification of technical changes to the dominant CP's network to enable them to compete. We have taken account of the current existence of a requirement to notify technical information in relation to wholesale ISDN30, and that it has been effective in enabling increasingly competitive conditions in the downstream retail market in the UK outside of the Hull area. We believe that removal of the requirement could harm or reverse this.
- 9.107 We consider that the proposed condition meets the criteria set out in section 47(2) of the Act. It is:
- objectively justifiable, as it would enable CPs to make full and effective use of network access. The period would allow CPs time to react to proposed changes without imposing an unnecessarily long notification period on Openreach and KCOM that may restrict their ability to develop and deploy new features or products;
 - not unduly discriminatory, as we only imposed on CPs who have SMP and we that both should be subject to the same obligation;
 - proportionate, in that 90 days, notice is considered the minimum period necessary to allow CPs to modify their networks; and
 - transparent, in that it is clear in its intention that Openreach and KCOM notify technical information.
- 9.108 The proposed condition would apply to the market for provision of wholesale ISDN30 in the UK except the Hull area, and the market for provision of wholesale ISDN30 in the Hull area.

Question 9.5 Do you agree or disagree that Ofcom should impose a requirement to notify technical information on Openreach and KCOM in the markets for wholesale provision of ISDN30 services? Please give reasons for your view.

Transparency as to quality of service

- 9.109 As discussed earlier, dominant CPs in wholesale markets have the ability to favour their own downstream or affiliated businesses over third party CPs, by differentiating on price or terms and conditions including quality of service (either in service provision and maintenance or in the quality of network service provided by the dominant CP to external CPs compared to its own retail operations). This has the

potential to distort competition at the retail level by placing third party CPs at a disadvantage in terms of the services they can offer consumers to compete in downstream retail markets. Distortions can also be caused by provision of wholesale services with varying levels of service quality. We consider it appropriate to continue to require Openreach to provide transparency as to the quality of service it provides. No requirement for this currently applies to KCOM and, given the size of the market and the current lack of demand for a wholesale service, we do not believe it would be proportionate to extend regulation of KCOM into this area.

Aim of regulation

- 9.110 The intention of the transparency of quality of service remedy is to monitor whether any undue discrimination is occurring by requiring the publication of data regarding the delivery of wholesale services by Openreach to downstream BT businesses versus other third party CPs. We believe that it is necessary for quality of service to be measured and transparent. We propose, however, to modify the existing requirements in line with changes made in relation to other wholesale services as set out in the September statements.
- 9.111 This requirement does not apply to KCOM, and we do not propose to impose it now.

Existing regulation

- 9.112 The 2009 narrowband market reviews imposed a requirement on Openreach to publish data on specified Key Performance Indicators (KPIs) in the analogue and ISDN2 exchange line markets. This requirement was made under a Direction made under SMP condition AAA7. Previous KPIs which applied to those markets were withdrawn. As we did not conclude on the ISDN30 market, in order to maintain consistency with the other exchange line markets, Openreach voluntarily agreed to provide the same KPI returns for ISDN30, pending the conclusion of this review.

Proposed regulation

- 9.113 We consider that service provision and fault repair remain critical areas in which to maintain transparency of Openreach's service levels. These areas remain critical as they are where differentiated service levels could be key determinants of a positive customer experience and could cause consumers to switch.
- 9.114 We now propose, therefore, that it would be appropriate to make a new Direction in order that it formally requires Openreach to supply the same KPIs for ISDN30 as currently required for the analogue and ISDN2 exchange line markets.
- 9.115 Table 9.1 sets out the KPIs that currently apply to analogue and ISDN2 WLR.

Table 9.1: Proposed KPIs

Proposed KPIs to be monitored	
Indicators	KPI(i) Percentage of orders rejected
	KPI(ii) Percentage of orders provisioned on time
	KPI(iii) Percentage of new provisions reported as faulty
	KPI(iv) Percentage of installed base reported as faulty

	KPI(v) Average time to restore service
	KPI(vi) Percentage of repeat faults
	KPI(vii) Gateway availability (1)
	KPI(viii) Gateway availability (2)
Volumes	KPI(i) Volume of orders submitted
	KPI(ii) Volume of orders completed
	KPI(iii) Volume of installed base
	KPI(iv) Volume of faults reported

9.116 Openreach's online KPI reporting tool provides CPs with instant access to KPIs that track performance against service levels guaranteed in standard contracts.

9.117 Annex 6 sets out the proposed KPI direction.

Legal tests

9.118 We consider that, in ensuring the Network Access that third party CPs receive from Openreach is on the same terms as downstream BT divisions the proposed condition, in particular, would further the interests of citizens and consumers in relevant markets by the promotion of competition in line with section 3 of the Act.

9.119 We have considered the Community requirements in section 4 of the Act and believe that the proposed condition promotes competition and secures efficient and sustainable competition by ensuring transparency through comparison of the service levels Openreach provides to downstream business divisions and third parties.

9.120 We consider that the proposed SMP condition, AAA(IS)7, meets the requirements in section 47. The proposed condition is:

- objectively justifiable, as in the absence of a requirement to publish specific quality of service information, it would not be possible to monitor if there any undue discrimination in the quality of service provided by Openreach was taking place;
- not unduly discriminatory, as it would applies to CPs with SMP only. We do not propose to impose this obligation on KCOM as we do not consider that such an obligation would be justifiable as information provided would not be statistically meaningful given the number of CPs active in the Hull area;
- proportionate, as Openreach would only be required to publish data related to the securing of transparency for quality of service. Any specific requirement would be made by a Direction which we will consult on separately and subject to section 49 of the Act; and
- transparent, as it is clear that its intention is to monitor for discrimination that is undue in the quality of service provided by Openreach.

9.121 We consider that the proposed KPI Direction meets the requirements in section 49. The proposed direction is:

- objectively justifiable, as we have identified a need to publish specific KPIs to ensure that we can monitor any discrimination that is undue in this market;
- not unduly discriminatory, as it would only apply to Openreach who are subject to proposed SMP transparency condition, and that it ensures that Openreach are subject to the same reporting requirements across all of the wholesale exchange line markets in which it holds SMP;
- proportionate, as Openreach would only be required to publish specific KPI data related to key business processes and it aligns the requirements across related exchange line services markets. Further, Openreach is already supplying such data on a voluntary basis, and has systems and procedures in place to supply the required information; and
- transparent, as it is clear from the Direction as to what information would be required to be published and supplied by Openreach.

9.122 The proposed condition and associated direction would apply to the market for provision of wholesale ISDN30 in the UK except the Hull area.

Question 9.6 Do you agree or disagree that Ofcom should impose a requirement to provide transparency as to quality of service on Openreach in the markets for wholesale provision of ISDN30 services, consistent with other WLR services? Please give reasons for your view.

Question 9.7 Do you agree or disagree with Ofcom that it is appropriate to extend the current KPI reporting requirement for other exchange line services to ISDN30? Please give reasons for your view.

Accounting Separation

9.123 We consider that it is appropriate to impose an accounting separation obligation on Openreach in relation to the market for provision of wholesale ISDN30 in the UK except the Hull area. Given the size of the market in the Hull area and the current lack of demand for a wholesale service there, we do not believe it would be proportionate to impose such an obligation on KCOM.

9.124 The accounting separation obligation would require Openreach to account separately for internal and external ‘sales’ and would allow CPs and us to monitor to ensure that Openreach does not discriminate unduly in favour of its own downstream business.

9.125 Under section 87(7) and 87(8) of the Act, appropriate accounting separation obligations may be imposed on the dominant CP in respect of the provision of network access, the use of the relevant network and the availability of relevant facilities. This means that the dominant CP may be required to maintain a separation for accounting purposes between such different matters relating to network access or the availability of relevant facilities.

9.126 Openreach are required to produce a range of outputs, which support compliance with a no undue discrimination remedy, according to requirements set out in the RFS.

9.127 We consider that it is appropriate to maintain this obligation in the market for provision of wholesale ISDN30 in the UK except the Hull area.

Legal tests

- 9.128 The imposition of an accounting separation obligation would specifically be justifiable and proportionate to promote competition in relation to the provision of electronic communications networks and service to ensure the provision of Network Access and service interoperability for the purpose of securing efficient and sustainable competition and the maximum benefit for end consumers. This is because the imposition of an accounting separation obligation would ensure that obligations designed to curb potentially damaging leverage of market power could be effectively monitored and enforced. In addition the imposition of an accounting separation obligation would allow us to monitor the profitability of Openreach.
- 9.129 For these reasons, we consider that the proposed condition furthers the interests of citizens and consumers in relevant markets by the promotion of competition in line with section 3 of the Act.
- 9.130 We have considered the Community requirements set out in section 4 of the Act and consider that the proposed condition meets these requirements. Specifically, section 4(8), where the obligation has the purpose of securing efficient and sustainable competition in the markets for electronic communications networks and services, by ensuring dominant CPs do not favour their own downstream businesses, thereby disadvantaging third party CPs.
- 9.131 We consider that the proposed condition meets the criteria set out in section 47(2) of the Act. The obligation is:
- objectively justifiable, as it relates to the need to ensure competition develops fairly, to the benefit of consumers;
 - non-discriminatory, as Openreach is the only provider to hold SMP in the relevant market;
 - proportionate, as it is necessary as a mechanism to allow CPs and us to monitor for discriminatory behaviour by Openreach; and
 - transparent, as it is clear the intention is to monitor compliance with specific remedies, and the particular accounting separation requirements of Openreach are clearly set out in our statement published in 2004 ('the Financial Reporting Statement')⁶⁹.
- 9.132 The accounting separation condition would apply to the market for provision of wholesale ISDN30 in the UK except the Hull area.

Question 9.8 Do you agree or disagree that Ofcom should impose an obligation on Openreach to comply with obligations governing accounting separation as set out by Ofcom in the market for provision of wholesale ISDN30 in the UK except the Hull area? Please give reasons for your view.

⁶⁹ 'The regulatory financial reporting obligations on BT and Kingston Communications, Final Statement and notification: Accounting separation and cost accounting', 22 July 2004,
http://www.ofcom.org.uk/consult/condocs/fin_reporting/fin_report_statement/

Requirement to provide Wholesale Line Rental (WLR)

- 9.133 WLR is a service which allows CPs to provide exchange lines to end-users. CPs take on the full retail relationship with the customer. Openreach is currently required to provide WLR for:
- analogue exchange line services;
 - ISDN2 exchange line services; and
 - ISDN30 exchange line services.
- 9.134 The original obligation to provide WLR derived from the 2003 review which imposed SMP condition AA10 on Openreach for analogue, ISDN2 and ISDN30 variants of WLR. The September statements concluded that the regulatory requirements for WLR on analogue exchange lines and ISDN2 exchange lines should continue. However, the September statements did not conclude on the markets for retail and wholesale ISDN30 services and therefore the present SMP obligations date back to the 2003 review.
- 9.135 We did not set equivalent conditions on KCOM in the September statements in the markets for analogue and ISDN2 wholesale services and we do not propose to do so for ISDN30. Given the size of the market in the Hull area and the current lack of demand for a wholesale service there, we do not believe it would be proportionate to impose such an obligation on KCOM.

Proposed regulation

- 9.136 Further to our preliminary conclusion that Openreach has SMP in the market for provision of wholesale ISDN30 in the UK except for Hull, we now propose to impose a new WLR condition on Openreach. This proposed new condition is consistent with the September statements.
- 9.137 The proposed WLR condition is different from the existing ISDN30 WLR condition. We propose to retain the core function of the condition which requires Openreach to provide WLR products to CPs but consider that there is scope to remove other elements, such as detailed cost allocation and recovery methods. We consider WLR to be a mature product with embedded systems and processes, which make it unnecessary to include this level of detail going forward. This is the same change that was made to the analogue and ISDN2 markets and would bring the regulation of ISDN30 into line with those other exchange line markets.

Legal tests

- 9.138 We consider that the proposed condition is consistent with our duties under section 3 of the Act. We consider that the condition furthers the interests of citizens and furthers the interests of consumers in relevant markets by the promotion of competition.
- 9.139 We consider that the proposed condition meets the requirements set out in section 4 of the Act. In particular, the condition promotes competition and secures efficient and sustainable competition for the maximum benefit of consumers by enabling CPs to compete in downstream access markets. We have taken account of the current existence of a requirement for WLR, and that it has been effective in enabling

increasingly competitive conditions in the downstream retail market. We believe that removal of the requirement could harm or reverse this.

9.140 We consider the proposed condition meets the criteria set out in section 47(2) of the Act. The condition is:

- objectively justifiable, in that it relates to the need to ensure that competition develops to the benefit of consumers. The growth of competition based on WLR has delivered benefits to consumers in terms of competition. Removing the obligation to provide WLR could result in Openreach withdrawing the product or otherwise changing it to the detriment of the competition that has developed;
- not unduly discriminatory, as the obligation on KCOM to provide network access on reasonable request is sufficient based on the market conditions of the Hull area;
- proportionate, in that it is necessary to enable competition but is not unduly burdensome on Openreach, specifically by reducing regulation where we consider this is not necessary, for example the functional specification; and
- transparent, in that it is clear in its intention to ensure that Openreach provides WLR products.

9.141 In addition, we have taken into account the factors set out in section 87(4) and, in particular, the economic viability of CPs building an alternative direct access network and the feasibility of providing WLR.

9.142 The proposed condition would apply to the market for provision of wholesale ISDN30 in the UK except the Hull area.

WLR Functional Specification

9.143 Openreach is currently required to provide wholesale ISDN30 according to the specifications set out in the WLR functional specification, imposed under the 2003 review. Analogue WLR was required to be provided in line with a functional specification published in 2003, but this was reviewed and not imposed in the wholesale statement. It is our intention not to impose the ISDN30 functional specification as a result of this market review. We consider that such regulation would not now be appropriate for this market where the product is well established. This would also be consistent with the WLR requirements imposed following the wholesale statement.

Proposed change to existing regulation

9.144 We consider that a detailed functional specification for ISDN30 is no longer required for a number of reasons. Firstly, and most significantly, the Undertakings⁷⁰ came into effect on 22 September 2005 and they require Openreach to provide wholesale service on an ‘Equivalence of Inputs’ (EOI) basis (i.e. the same service it makes available to its retail businesses should also be available to competitors). Large sections of the functional specification covered requirements regarding the provision of services on an equivalent basis and are therefore no longer necessary.

⁷⁰ *Undertakings given to Ofcom by BT pursuant to The Enterprise Act 2002*, consolidated version published 19 December 2008 <http://www.ofcom.org.uk/telecoms/btundertakings/consolidated.pdf>

- 9.145 Secondly, after five years in operation, we now consider WLR ISDN30 to be mature, with accepted standards and processes and make the requirement for a detailed functional specification less essential. The growth of WLR lines suggests that the products generally meet the requirements of CPs and customers alike.
- 9.146 Finally, improvements to WLR products are agreed and implemented through industry working groups and the OTA framework. We consider that the existing accepted product specifications provide a base from which changes in the future should be based on agreement between Openreach and industry. Collaboration can be seen in a variety of other areas (i.e. improvements to the SoR process, KPI online system), and we are keen to ensure that, while regulation requires the provision of specific products, there is sufficient flexibility in the remedy for the life of the review period, to allow Openreach and industry to discuss, agree and implement improvements as required.

Question 9.9 Do you agree or disagree that Ofcom should impose an obligation on Openreach to provide WLR products in the ISDN30 exchange line market? Please give reasons for your view.

Question 9.10 Do you agree or disagree that Ofcom does not need to impose an obligation on Openreach to comply with a functional specification for ISDN30? Please give reasons for your view.

Requests for new Network Access

- 9.147 We consider that it is appropriate to impose an obligation on Openreach regarding its SoR process. Given the size of the market in the Hull area and the current lack of demand for a wholesale service there, we do not believe it would be proportionate to impose such an obligation on KCOM.

Aim of regulation

- 9.148 Regulation of Openreach was considered appropriate in 2003 due to evidence suggesting that the industry negotiated SoR process was not working sufficiently well. The process for making requests for new network access, and the way these were subsequently dealt with, was not effective in getting new products delivered in a timely fashion, and was not sufficiently transparent to allow CPs certainty in how requests were being treated. Therefore, we concluded there was a need to include timings in the process in order to reduce Openreach's incentive to delay and felt that a transparent process would provide clarity if a dispute arose.

Existing regulation

- 9.149 The existing SoR condition covers:

- the publication of reasonable guidelines on requesting a new product;
- the provision of information for the purpose of making a request for a new product; and
- a process for dealing with requests for new products.

Proposed changes to existing regulation

- 9.150 During the life of the previous remedies, the Undertakings were introduced and as such the SoR process is now applicable to two separate BT divisions: Openreach and BT Wholesale.
- 9.151 Whilst issues have occurred with the handling of SoRs using the SoR process set in place by the previous regulation, there have not been significant or formal complaints to us regarding the process. In addition, there have been some developments to the process agreed by Openreach and industry to improve the process. This means the process in place may not be in line with that set out in the previous condition, but is more likely to meet the needs of industry.
- 9.152 The condition has acted primarily as a safety-net by providing regulated timeframes for the completion of each step of the process. While we are aware of existing deficiencies in the current process, we do not believe that to make the condition more prescriptive would necessarily be beneficial in aiding the long term, ongoing development of the process. We consider that including more detail in the condition will not allow sufficient scope for ongoing improvements to be implemented during the life of the remedy. In addition, we are mindful that ISDN30 is a legacy service, and so requests for new access or variants of the current service are less likely than for other wholesale and access services.
- 9.153 We consider that there are certain key principles that a SoR process should meet. Therefore, the condition we propose to impose would require Openreach to have in place, and follow for each SoR, an SoR process which:
- is documented end-to-end and this documentation is available to CPs;
 - has reasonable timescales for each stage of the process;
 - clearly identifies the criteria by which a SoR will be judged;
 - sets out the information that should be provided in order for an SoR to be accepted; and
 - should be agreed between Openreach and industry.
- 9.154 This would be consistent with the requirement for other wholesale and access services.
- 9.155 We are of the view that the SoR process as documented in the previous condition meets these criteria, but that changes to the existing process that better meet the requirements of industry should be made if agreed by industry and Openreach.

Legal tests

- 9.156 Section 87(3) of the Act authorises the setting of SMP services conditions in relation to the provision of network services. We consider that under section 87(5)(a) of the Act, the proposed condition would assist in securing fairness and reasonableness in the way in which requests for network access were responded to. The condition provides a framework for agreeing and implementing improvements to the existing system, while retaining a 'safety-net'.
- 9.157 We have considered our duties under section 3 of the Act. We consider that, in ensuring requests can be made for new network access at the reasonable request of third parties, the proposed condition would in particular further the interests of

citizens and further the interests of consumers in relevant markets by the promotion of competition.

- 9.158 We have considered the Community requirements set out in section 4 of the Act and consider that the proposed condition meets the requirements. Specifically, section 4(8), as the proposed condition has the purpose of securing efficient and sustainable competition in the markets reviewed.
- 9.159 We consider that the proposed condition meets the criteria set out in section 47(2) of the Act. The proposed condition is:
- objectively justifiable, as it recognises that a process for handling new requests is needed but that the condition should be flexible to allow for process improvements;
 - not unduly discriminatory, as it only applies to Openreach. We do not propose to impose this obligation on KCOM as the different market conditions in the Hull area mean that there is not the same level of demand for network access;
 - proportionate, as it continues to provide a SoR process based on the currently implemented process while allowing scope for industry to be involved in agreeing process improvements; and
 - transparent, as its intention is to ensure that changes to Openreach's SoR process are reflective of industry feedback.

- 9.160 The proposed condition would apply to the market for provision of wholesale ISDN30 in the UK except the Hull area.

Question 9.11 Do you agree or disagree that Ofcom should impose an obligation on Openreach to follow a statement of requirements process to handle new requests for network access in the market for provision of wholesale ISDN30 in the UK except the Hull area? Please give reasons for your view.

Question 9.12 Do you agree or disagree that the condition should allow changes to be made to the current SOR process if agreed by Openreach with industry? Please give reasons for your view.

Cost accounting

- 9.161 We consider that it is appropriate to impose a new cost accounting obligation on Openreach in relation to services supplied in the market for the provision of wholesale ISDN30 in the UK except the Hull area. Given the size of the market in the Hull area and the current lack of demand for a wholesale service there, we do not believe it would be proportionate to impose such an obligation on KCOM.
- 9.162 As discussed in Section 10, we believe that a charge control is appropriate for Openreach's ISDN30 services, and we believe a cost accounting requirement would add transparency by requiring Openreach to demonstrate how charges and costs could be reconciled.
- 9.163 Under sections 87(9) to 87(11) and 88 of the Act, appropriate cost accounting obligations may be imposed on dominant CPs in respect of the provision of network access, the use of the relevant network and the availability of relevant facilities. Cost

accounting rules may be made in relation to charge controls, the recovery of costs and cost orientation.

9.164 Where Openreach is subject to a cost accounting obligation they are required to comply with obligations governing cost accounting systems and processes as set out in the Financial Reporting Statement. The outputs include:

- Generic cost orientation and non-discrimination requirements:
 - Preparation of a variety of financial statements;
 - Preparation of extensive supporting documentation explaining how the financial statements have been put together;
 - Provision of an independent assurance statement;
 - Publication of most of the information; and
 - Preparation of reconciliation statements;
- Cost orientation specific requirements:
 - Preparation of service level cost data (LRIC and FAC) compared to average charges;
 - Preparation of costs of network components used to deliver services; and
 - Analysis of service cost stack by component;
- Non-discrimination specific requirements:
 - Analysis of internal and external sales including volume data.

9.165 We consider that it is appropriate for these requirements to be applied to Openreach in the market for provision of wholesale ISDN30 in the UK excluding the Hull area and therefore proposes to impose those SMP conditions⁷¹, as set out in the Financial Reporting Statement, to this market, in order to ensure that the regulatory framework for cost accounting is in place.

9.166 Those SMP conditions set the framework under which specific financial reporting obligations are set by direction. Currently only accounting separation obligations apply to Openreach in this market, so the direction will need to be amended in order to impose specific cost accounting obligations. We review the mechanics of the financial reporting obligations on an annual basis. Any changes to the relevant direction, including the addition of cost accounting obligations for the ISDN30 market will be made under that review, which will be conducted prior to the end of the financial year 2010/2011.

Legal tests

9.167 We have considered our duties under section 3 of the Act. In particular, the imposition of a cost accounting obligation would specifically be justifiable and

⁷¹ SMP Conditions OA1 – 28 and OA32 – 33.

proportionate to promote competition in relation to the provision of electronic communications networks and services; to ensure the provision of Network Access and service interoperability for the purpose of securing efficient and sustainable competition and the maximum benefit for the persons who are customers of CPs. This is because the imposition of the obligation would ensure that obligations designed to curb potentially damaging leverage of market power – in particular the setting of charges at excessive levels – could be effectively monitored and enforced.

- 9.168 We have considered the Community requirements set out in section 4 of the Act and believes that the proposed condition meets the requirements. Specifically, Section 4(8), where the obligation has the purpose of securing efficient and sustainable competition in the markets for electronic communications networks and services, by ensuring dominant CPs comply with cost orientation and charge control remedies implemented to promote competition.
- 9.169 We consider that the proposed conditions meets the criteria set out in section 47(2) of the Act. The conditions are:
- objectively justifiable, as it relates to the need to ensure competition develops fairly, to the benefit of consumers;
 - non-discriminatory, as Openreach is the only CP to hold SMP in the relevant market;
 - proportionate, as it is necessary as a mechanism to allow third parties sight of regulatory accounts to ensure compliance with a charge control remedy; and
 - transparent, as it is clear the intention is to monitor compliance with specific remedies and the particular cost accounting requirements of Openreach are clearly documented.
- 9.170 The cost accounting condition would apply to the market for provision of wholesale ISDN30 in the UK except the Hull area.

Question 9.13 Do you agree or disagree that Ofcom should impose an obligation on Openreach to comply with obligations governing cost accounting systems and processes as set out by Ofcom in the market for provision of wholesale ISDN30 in the UK except the Hull area? Please give reasons for your view.

Section 10

Price regulation of wholesale ISDN30 services

Introduction

- 10.1 In addition to the general remedies set out in Section 9, this section considers the appropriateness of imposing price regulation on Openreach, further to our preliminary conclusion in Section 9 that a charge control is the appropriate remedy to address the concerns that we have identified in our market analysis.

Background

- 10.2 While Openreach was found to have SMP in ISDN30 exchange lines as a result of the 2003 market review, no direct regulation of charges was imposed. This was primarily due to the existence of supply-side substitutes (such as the use of PPCs), and the expectation of downward pressure on pricing during the review period from the supply of business ISDN2, which was subject to a basis of charges of obligation.
- 10.3 More specifically, the 2003 review argued that the market conditions for ISDN30 were different from other markets and that potential supply side substitutes existed, such as ISDN30 over a 2Mbit/s leased line (which may be cost effective as long as utilisation is high).
- 10.4 The 2003 review also argued that there was further downward pressure on ISDN30 charges from regulation of ISDN2 and the potential substitution between the two services. The 2003 review said that it may be possible to substitute multiple ISDN2 lines for a low-utilisation ISDN30 line (we consider that this is still the case). It may have been difficult therefore to sustain a charge per channel for ISDN30 that was significantly higher than the charge per channel for ISDN2. A cost orientation requirement on ISDN2, which would operate in conjunction with a requirement not to discriminate unduly placed on both ISDN2 and ISDN30 wholesale services, would act as a constraint on ISDN30 wholesale charges. The available evidence, discussed in Section 7, shows that in fact these potential supply-side substitutes played a much more limited role.

Market analysis

- 10.5 In Section 7 we provide data on Openreach's market share and a profitability analysis based on its RFS. Openreach's market share has remained high. Whilst forecasts predict volume decline, we think this will happen gradually as our survey information and other discussions with end-users indicate a high degree of customer satisfaction with ISDN30 and no urgent impetus to switch to new technology alternatives.
- 10.6 As explained in Section 7, the profitability analysis for ISDN30 also provides us with some concern. Reported profitability is significantly above Openreach's cost of capital and has trended higher in recent years (Table 7.3 shows Openreach's reported profitability for ISDN30, 2004-2009).

- 10.7 Also as explained in Section 7, we understand, however, that reported returns may not tell the whole story on profitability. We have considered the impact of a heavily depreciated asset base on ISDN30 profitability, and this will continue to be a feature of our financial analysis as we proceed with our work on the appropriate regulated charges for ISDN30. We also understand that an efficient level of charging should not result in stimulation of the market to the extent that investment in ISDN30 or emerging technology services is skewed away from an efficient level.
- 10.8 However, we believe that some regulation of charges is now appropriate due to the limited charging constraint applied by substitution and the increasing returns Openreach is able to generate.

Previous consultation

- 10.9 We consulted on options for regulation of ISDN30 wholesale charges in the wholesale consultation. Specifically we asked whether:
 - Based on Openreach's reported returns, we should impose additional obligations on Openreach in relation to wholesale ISDN30 exchange lines;
 - a cost orientation obligation would be sufficient to address our concerns about Openreach's returns; and
 - a charge control would be a proportionate response to our concerns about Openreach's returns.
- 10.10 Of the 16 stakeholders who submitted responses to the wholesale consultation, 7 commented on these specific ISDN30 questions. Responses were mixed. Most respondents agreed that some additional obligations were appropriate, but opinions on what form of new regulation was appropriate – and specifically on whether it should be cost orientation (basis of charges) or charge control or a combination of the two – were mixed.

Proposed charge cap

- 10.11 We are now making proposals based on all the evidence we have gathered over the course of the narrowband market reviews, and subsequently in our more targeted review of ISDN30 markets.
- 10.12 As indicated above, we believe that the evidence of excessive returns combined with the lack of substitutes for ISDN30 means that new regulation of wholesale ISDN30 charges is appropriate. We believe a charge cap, set using the RPI-X formula, is likely to be the most appropriate form of charge control for wholesale ISDN30.

Charge cap implementation

- 10.13 We are not proposing the mechanics of the charge control in this document, and intend to consult separately on these issues. We consider that this will ensure that we are able to fully analyse the relevant cost data and ensure that, as this will be done in tandem with consultations for other charge controls on Openreach access products there will be a consistency of regulation of charges across such services.
- 10.14 We believe it is important that charge controls be set consistently and, for Openreach services, this means we should make use of consistent cost information. This is why

we are proposing use of a common modelling approach between ISDN30, LLU and WLR charge controls.

- 10.15 The need for consistency has been explicitly recognised in previous regulatory decisions. For example, the current WLR charge control was set with a short duration in order to make it easier to manage consistency when both controls are reviewed ahead of their now synchronised endings in March 2011.
- 10.16 The case of ISDN30 is different in that LLU and WLR share a greater proportion of common costs with one another than either of them do with ISDN30, and LLU and WLR are both inputs to a common downstream market. So, it may be that the need for consistency is not so strong between ISDN30 and other services (LLU and WLR) as it is between those services.
- 10.17 However, consistency is still important since there are some common costs between the services. This means, in the event that a charge control for ISDN30 was set before the review of the LLU and WLR controls, we would likely need to include a review of the ISDN30 charge controls in 2011 to ensure that adjustments could be made in the event that there are material differences in the common data used to set the controls. This would be necessary as the planned updating of modelling information for the reviews of LLU and WLR charge controls would not be available for work on the ISDN30 charge control review. Whilst mid-term reviews for charge control periods can be appropriate to ensure consistency where there are common costs, they can also have a dilutive effect on the dynamic efficiency incentives of price caps or charge controls since the regulated firm will enter the control period with the knowledge that the control may change before its term is complete.
- 10.18 We have recently published our consultations in the review of the Wholesale Local Access market⁷² and the review of the Wholesale Broadband Access markets⁷³. In those reviews we proposed that charge controls are appropriate remedies to be imposed on Openreach and BT in order to address identified competition concerns in the relevant markets. We indicated, in those reviews, that we would separately consult on the charge control remedy for the market. Consequently, we consider that it is appropriate to adopt a consistent approach in this review which will allow the analysis of Openreach costs for all relevant access markets at the same time.
- 10.19 Were we to complete the setting of an ISDN30 charge control in 2010 (say in October), it would need to be reviewed almost immediately.
- 10.20 Taking account of these factors, we believe it is better to synchronise the setting of an ISDN30 charge control with the planned work to review the LLU and WLR charge caps.

Interim control

- 10.21 Synchronisation of the modelling work for ISDN30 with work on LLU and WLR means there may be a short delay between the conclusion of our market analysis and the setting of a charge controls to address our competition concern that Openreach may be able to set excessive charges. Therefore, we believe that, in those circumstances and assuming the concerns we have identified about the level of Openreach's reported profitability for ISDN30 services are maintained in our final conclusions, we need to consider whether an interim measure is appropriate in order to protect the

⁷² <http://www.ofcom.org.uk/consult/condocs/wla/wlacondoc.pdf>

⁷³ <http://www.ofcom.org.uk/consult/condocs/wba/wbacondoc.pdf>

downstream market and end users from the harm which may result if there were increases to charges in the period between the conclusion of this market review and the setting of charge controls.

10.22 We have considered the following options for the setting of an interim measure:

- No specific charge control (the “do nothing” option);
- Impose a cost orientation obligation; or
- Impose a safeguard cap.

No specific charge control

10.23 We do not consider that it would be appropriate not to impose any control. This would mean that we would be reliant on the proposed general access remedies, as set out in Section 9 to constrain BT’s charges. We have proposed that Openreach should be required to provide access on reasonable terms and conditions, including charges. In making any increase in its charges Openreach would have to ensure that they remained fair and reasonable in accordance with that obligation. In addition, we have proposed that Openreach should be subject to a no undue discrimination condition and therefore any increase in charges would all CPs equally.

10.24 Whilst such conditions offer some protection for Openreach’s customers we believe that they would not protect Openreach customers and end-users against price increases. In light of our market analysis we consider that a clear interim measure specifically controlling charges is appropriate in the circumstances. For this reason we propose to reject this option.

Basis of charges (cost orientation)

10.25 We do not consider that cost orientation to be an appropriate interim control in this market. Although a cost orientation obligation would require Openreach to set charges for ISDN30 based on its costs and therefore may serve to reduce charges, for this remedy to be effective, those costs need to be clear.

10.26 Whilst Openreach produces the costs of providing wholesale ISDN30 as part of the RFS, the costs of efficiently providing an ongoing ISDN30 service are not clear. We describe above the fact that the charge control review, which will be conducted subsequently to this review, will consider the appropriate cost base for regulation. Whilst the burden of proving compliance with a SMP condition is a matter for the CP subject to the obligation, we consider that, on current information it would be difficult accurately to assess cost levels. In such circumstances it would mean that there would be potentially wide variations between the cost floor and the ceiling and therefore reliance upon a condition that required such estimates would fail to provide the predictability and certainty that should be achieved by an *ex ante* obligation. We consider that the imposition of a basis of charges obligation as an interim measure, in these circumstances where uncertainty remains as to how it may be applied, would not be appropriate, and therefore we reject this option.

Safeguard Cap

10.27 We consider that the appropriate interim remedy for this market is the imposition of a safeguard cap applied as a fixed ceiling based on current charges. Such a remedy would ensure that, in real terms, the charge continues to fall equal to the value of

RPI, and may protect consumers against any actual price increases during the time that we consider the possible application of a substantive charge control. Such a cap could be easily applied and would not require an understanding or analysis of the underlying costs of providing the service. It would also have the advantage of being transparent and providing certainty to industry in the interim period.

- 10.28 The disadvantage of such a cap is that it is not a remedy that reflects the underlying costs of the service, and therefore, if charges are too high it does not address the need for them to be reduced; this is the reason that, in Section 9, we specifically reject a safeguard cap as an appropriate long term remedy. However, it would be difficult to impose a cost-based remedy in advance of the full cost modelling that we will undertake as part of the charge control consultation.

Conclusion on Interim Remedy

- 10.29 We are proposing that a safeguard cap, set as a fixed charge ceiling, is the most appropriate interim remedy to impose on WLR ISDN30 services (rental, connections and transfer) during the period between the ending of this market review and the ending of the charge control reviews. A safeguard cap does address to some extent the concerns identified in our analysis, and we consider that it is an appropriate light touch remedy to be imposed in conjunction with our commitment to fully analyse the costs of the service in the charge control consultation.

Legal tests – Interim safeguard cap

- 10.30 We have considered our duties under section 3 of the Act and consider that in providing a degree of certainty and addressing the identified competition concern that the interim safeguard cap will further the interests of citizens and further the interests of consumers in relevant markets.
- 10.31 We have also considered the Community requirements set out in section 4 of the Act. In particular, the proposed price regulation has the purpose of securing efficient and sustainable competition for the maximum benefit of consumers as it will constrain Openreach's ability to raise prices in the wholesale market which would likely result in price increase in the downstream retail market.
- 10.32 We consider that a condition requiring Openreach to comply with an interim safeguard cap during the period between completion of the market review and conclusion of the charge control review meets the criteria set out in section 47(2) of the Act, to be objectively justifiable, non-discriminatory and transparent.
- 10.33 An interim safeguard cap during the period between completion of this market review and the conclusion of the charge control review would be objectively justifiable based on the evidence outlined in this section that Openreach's revenue appears to be high based on the underlying cost base shown in the RFS. Without full assessment of the underlying cost base it would not be appropriate to attempt to set a cost based control, and this cap will ensure that prices do not increase (and do decrease in real terms) in the interim period before such an assessment can be carried out.
- 10.34 This condition would not unduly discriminate as it only applies to Openreach whom we have assessed as having SMP and being in a position to charge excessive prices. While we do not propose to extend regulation to KCOM this is consistent with the way we treat KCOM in relation to other remedies and it reflects the different market conditions in that no other CP has yet requested KCOM to provide an

ISDN30 wholesale product, and KCOM would still be required to provide any such product on reasonable terms.

- 10.35 The proposed condition is proportionate as it provides a control on the prices that Openreach can charge, but is limited to being a interim remedy and does not seek to reduce prices to a cost based standard when that analysis has not been finalised.
- 10.36 The proposed condition is transparent as it is clear the intention is to constrain Openreach's ability to increase ISDN30 charges before a full charge control review is completed.
- 10.37 The evidence presented in this section clearly demonstrates that expected competitive constraints on ISDN30 are not placing pressure on Openreach to reduce prices in line with reductions in the costs of providing the service. Therefore, we feel that it is appropriate to consider the imposition of pricing regulation based on the identification of this issue.

Section 88

- 10.38 Our proposed condition also meets the requirements of section 88 of the Act under which we may not set price controls unless there is a relevant risk of adverse affects arising from price distortions. As we discuss in Section 7 above we have identified a risk that Openreach can charge excessive prices in this market. Further, the setting of any price control condition has to be appropriate to
 - promote efficiency,
 - promote sustainable competition, and
 - confer the greatest possible benefits on end-users.
- 10.39 We consider that the tests in section 88 have been met. We consider that the setting of a safeguard cap may promote efficiency by ensuring that charges cannot rise. Although the remedy is only intended to be in place for a relatively short period and is unlikely in itself to create long term incentives, we consider that, as the proposed condition ensures that wholesale charges cannot be increased by Openreach, it provides security and certainty to customers and, ultimately, end-users. The background to this analysis is that we will undertake a full cost analysis and consult on a modelled charge control for this market to ensure that appropriate efficiency and competition incentives are provided during the forward look period of this review.

Consultation for Charge Control

- 10.40 As we have discussed above we consider that a charge control is the appropriate long term remedy that will be required to address the identified competition concern that Openreach can and potentially has set its prices at an excessive level.
- 10.41 We cannot set the control until we have undertaken a full cost analysis which we intend to do separately from the main review and alongside the reviews for other price controls in related Openreach access markets.
- 10.42 Nevertheless, we consider that in principle a charge control on ISDN30 would meet the criteria set out in section 47 of the Act since that it would be objectively justifiable, non-discriminatory, proportionate and transparent. However we will consult on the specifics of the charge control later this year when we will specifically consider how

the tests in the Act are met. At this time, we consider that a charge control is, in principle:

- objectively justifiable, as BT has SMP in the market, it is unlikely to be incentivised to reduce its costs and set prices at the competitive level;
- not unduly discriminatory, as BT is the only operator to have SMP in the market;
- proportionate, as we will ensure that it will allow BT to make a return on investment whilst acting to constrain BT's ability to set prices above the competitive level which may result in consumers paying higher retail prices; and
- transparent, in that the condition, when we formulate our detailed proposals, will be clear in its intention.

10.43 We consider that the tests in section 88 have been met. We consider that the setting of a safeguard cap is appropriate to promote efficiency by ensuring that charges cannot increase. This remedy is only intended to be in place for a relatively short period and is therefore unlikely to create long term incentives. We consider, however, that, as the proposed condition ensures that wholesale charges cannot be increased by Openreach, it is appropriate for the promotion of competition by providing security and certainty to customers which should, ultimately, benefit end-users. The background to this analysis reflects that the proposed remedy is only to be imposed on an interim basis and that we will undertake a full cost analysis and consult on a modelled charge control for this market to ensure that appropriate efficiency and competition incentives are provided during the forward look period of this review.

10.44 Additionally we, consider that the basis for setting a charge control exists based upon the identified market conditions. Specifically, we have identified a relevant risk of adverse effects arising from price distortion, and therefore the gateway to setting a condition under section 88 is present.

10.45 Our further consultation on charge controls will have to, as part of its remit, assess the appropriateness of any proposed controls against the statutory tests laid down in sections 47 and 88 of the Act.

Question 10.1 Do you agree or disagree that, based on Openreach's reported returns, Ofcom should impose a charge cap on Openreach's charges for ISDN30 services? Please give reasons for your view.

Question 10.2 Do you agree or disagree that, in order to manage consistency in the setting of charge caps for Openreach services, the proposed charge cap for ISDN30 should be developed and set alongside the reviews of existing controls for other Openreach services, scheduled to complete in 2011? Please give reasons for your view.

Question 10.3 Do you agree or disagree that a charge ceiling set at the current level of charges should be applied to wholesale WLR ISDN30 services provided by Openreach to prevent increases to charges in the period between the ending of the market review and setting of the charge cap? Please give reasons for your view.

Annex 1

Responding to this consultation

How to respond

- A1.1 Ofcom invites written views and comments on the issues raised in this document, to be made **by 5pm on 15 June 2010**.
- A1.2 Ofcom strongly prefers to receive responses using the online web form at <https://www.ofcom.org.uk/consult/condocs/isdn30/howtorepond/form>, as this helps us to process the responses quickly and efficiently. We would also be grateful if you could assist us by completing a response cover sheet (see Annex 3), to indicate whether or not there are confidentiality issues. This response coversheet is incorporated into the online web form questionnaire.
- A1.3 For larger consultation responses – particularly those with supporting charts, tables or other data – please email michael.galvin@ofcom.org.uk attaching your response in Microsoft Word format, together with a consultation response coversheet.
- A1.4 Responses may alternatively be posted or faxed to the address below, marked with the title of the consultation.

Michael Galvin
Ofcom
Competition Group Riverside House
2A Southwark Bridge Road
London SE1 9HA
Fax: 020 7783 4109

- A1.5 Note that we do not need a hard copy in addition to an electronic version. Ofcom will acknowledge receipt of responses if they are submitted using the online web form but not otherwise.
- A1.6 It would be helpful if your response could include direct answers to the questions asked in this document, which are listed together at Annex 4. It would also help if you can explain why you hold your views and how Ofcom's proposals would impact on you.

Further information

- A1.7 If you want to discuss the issues and questions raised in this consultation, or need advice on the appropriate form of response, please contact Michael Galvin on 020 7783 4158.

Confidentiality

- A1.8 We believe it is important for everyone interested in an issue to see the views expressed by consultation respondents. We will therefore usually publish all responses on our website, www.ofcom.org.uk, ideally on receipt. If you think your response should be kept confidential, can you please specify what part or whether all of your response should be kept confidential, and specify why. Please also place such parts in a separate annex.

- A1.9 If someone asks us to keep part or all of a response confidential, we will treat this request seriously and will try to respect this. But sometimes we will need to publish all responses, including those that are marked as confidential, in order to meet legal obligations.
- A1.10 Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use. Ofcom's approach on intellectual property rights is explained further on its website at
<http://www.ofcom.org.uk/about/account/disclaimer/>

Next steps

- A1.11 Following the end of the consultation period, Ofcom intends to publish a statement in the summer.
- A1.12 Please note that you can register to receive free mail Updates alerting you to the publications of relevant Ofcom documents. For more details please see:
http://www.ofcom.org.uk/static/subscribe/select_list.htm

Ofcom's consultation processes

- A1.13 Ofcom seeks to ensure that responding to a consultation is easy as possible. For more information please see our consultation principles in Annex 2.
- A1.14 If you have any comments or suggestions on how Ofcom conducts its consultations, please call our consultation helpdesk on 020 7981 3003 or e-mail us at
consult@ofcom.org.uk. We would particularly welcome thoughts on how Ofcom could more effectively seek the views of those groups or individuals, such as small businesses or particular types of residential consumers, who are less likely to give their opinions through a formal consultation.
- A1.15 If you would like to discuss these issues or Ofcom's consultation processes more generally you can alternatively contact Vicki Nash, Director Scotland, who is Ofcom's consultation champion:

Vicki Nash
Ofcom
Sutherland House
149 St. Vincent Street
Glasgow G2 5NW

Tel: 0141 229 7401
Fax: 0141 229 7433

Email vicki.nash@ofcom.org.uk

Annex 2

Ofcom's consultation principles

- A2.1 Ofcom has published the following seven principles that it will follow for each public written consultation:

Before the consultation

- A2.2 Where possible, we will hold informal talks with people and organisations before announcing a big consultation to find out whether we are thinking in the right direction. If we do not have enough time to do this, we will hold an open meeting to explain our proposals shortly after announcing the consultation.

During the consultation

- A2.3 We will be clear about who we are consulting, why, on what questions and for how long.
- A2.4 We will make the consultation document as short and simple as possible with a summary of no more than two pages. We will try to make it as easy as possible to give us a written response. If the consultation is complicated, we may provide a shortened Plain English Guide for smaller organisations or individuals who would otherwise not be able to spare the time to share their views.
- A2.5 We will consult for up to 10 weeks depending on the potential impact of our proposals.
- A2.6 A person within Ofcom will be in charge of making sure we follow our own guidelines and reach out to the largest number of people and organisations interested in the outcome of our decisions. Ofcom's 'Consultation Champion' will also be the main person to contact with views on the way we run our consultations.
- A2.7 If we are not able to follow one of these principles, we will explain why.

After the consultation

- A2.8 We think it is important for everyone interested in an issue to see the views of others during a consultation. We would usually publish all the responses we have received on our website. In our statement, we will give reasons for our decisions and will give an account of how the views of those concerned helped shape those decisions.

Annex 3

Consultation response cover sheet

- A3.1 In the interests of transparency and good regulatory practice, we will publish all consultation responses in full on our website, www.ofcom.org.uk.
- A3.2 We have produced a coversheet for responses (see below) and would be very grateful if you could send one with your response (this is incorporated into the online web form if you respond in this way). This will speed up our processing of responses, and help to maintain confidentiality where appropriate.
- A3.3 The quality of consultation can be enhanced by publishing responses before the consultation period closes. In particular, this can help those individuals and organisations with limited resources or familiarity with the issues to respond in a more informed way. Therefore Ofcom would encourage respondents to complete their coversheet in a way that allows Ofcom to publish their responses upon receipt, rather than waiting until the consultation period has ended.
- A3.4 We strongly prefer to receive responses via the online web form which incorporates the coversheet. If you are responding via email, post or fax you can download an electronic copy of this coversheet in Word or RTF format from the 'Consultations' section of our website at www.ofcom.org.uk/consult/.
- A3.5 Please put any parts of your response you consider should be kept confidential in a separate annex to your response and include your reasons why this part of your response should not be published. This can include information such as your personal background and experience. If you want your name, address, other contact details, or job title to remain confidential, please provide them in your cover sheet only, so that we don't have to edit your response.

Cover sheet for response to an Ofcom consultation

BASIC DETAILS

Consultation title:

To (Ofcom contact):

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

CONFIDENTIALITY

Please tick below what part of your response you consider is confidential, giving your reasons why

Nothing

Name/contact details/job title

Whole response

Organisation

Part of the response

If there is no separate annex, which parts?

If you want part of your response, your name or your organisation not to be published, can Ofcom still publish a reference to the contents of your response (including, for any confidential parts, a general summary that does not disclose the specific information or enable you to be identified)?

DECLARATION

I confirm that the correspondence supplied with this cover sheet is a formal consultation response that Ofcom can publish. However, in supplying this response, I understand that Ofcom may need to publish all responses, including those which are marked as confidential, in order to meet legal obligations. If I have sent my response by email, Ofcom can disregard any standard e-mail text about not disclosing email contents and attachments.

Ofcom seeks to publish responses on receipt. If your response is non-confidential (in whole or in part), and you would prefer us to publish your response only once the consultation has ended, please tick here.

Name

Signed (if hard copy)

Annex 4

Consultation questions

Question 4.1 Do you agree or disagree with our market definition? Please give reasons for your view.

Question 5.1 Do you agree or disagree with our analysis in which we have provisionally concluded that BT does not have SMP in the retail ISDN30 exchange line services market in the UK excluding the Hull area? Please give reasons for your view.

Question 5.2 Do you agree or disagree with our analysis in which we have provisionally concluded that KCOM has SMP in the provision of retail ISDN30 exchange line services in the Hull area? Please give reasons for your view.

Question 6.1 Do you agree or disagree with our market definition? Please give reasons for your view.

Question 7.1 Do you agree or disagree with our analysis in which we have provisionally concluded that Openreach has SMP in the provision of wholesale ISDN30 exchange line services in the UK excluding the Hull area? Please give reasons for your view.

Question 7.2 Do you agree or disagree with our analysis assessment in which we have provisionally concluded that KCOM has SMP in the provision of wholesale ISDN30 exchange line services in the Hull area? Please give reasons for your view.

Question 8.1 Do you agree or disagree with our continued imposition of retail price publication and no undue discrimination remedies on KCOM in Hull. Please give reasons for your view.

Question 9.1 Do you agree or disagree that Ofcom should impose a requirement to provide network access on reasonable request on Openreach and KCOM in the markets for wholesale provision of ISDN30 services? Please give reasons for your view.

Question 9.2 Do you agree or disagree that Ofcom should impose a requirement not to unduly discriminate on Openreach and KCOM in the markets for wholesale provision of ISDN30 services? Please give reasons for your view.

Question 9.3 Do you agree or disagree that Ofcom should impose a requirement to publish a reference offer on Openreach and KCOM in the markets for wholesale provision of ISDN30 services? Please give reasons for your view.

Question 9.4 Do you agree or disagree that Ofcom should impose a requirement to notify charges, terms and conditions on Openreach and KCOM in the markets for wholesale provision of ISDN30 services? Please give reasons for your view.

Question 9.5 Do you agree or disagree that Ofcom should impose a requirement to notify technical information on Openreach and KCOM in the markets for wholesale provision of ISDN30 services? Please give reasons for your view.

Question 9.6 Do you agree or disagree that Ofcom should impose a requirement to provide transparency as to quality of service on Openreach in the markets for wholesale provision of ISDN30 services, consistent with other WLR services? Please give reasons for your view.

Question 9.7 Do you agree or disagree with Ofcom that it is appropriate to extend the current KPI reporting requirement for other exchange line services to ISDN30? Please give reasons for your view.

Question 9.8 Do you agree or disagree that Ofcom should impose an obligation on Openreach to comply with obligations governing accounting separation as set out by Ofcom in the market for provision of wholesale ISDN30 in the UK except the Hull area? Please give reasons for your view.

Question 9.9 Do you agree or disagree that Ofcom should impose an obligation on Openreach to provide WLR products in the ISDN30 exchange line market? Please give reasons for your view.

Question 9.10 Do you agree or disagree that Ofcom does not need to impose an obligation on Openreach to comply with a functional specification for ISDN30? Please give reasons for your view.

Question 9.11 Do you agree or disagree that Ofcom should impose an obligation on Openreach to follow a statement of requirements process to handle new requests for network access in the market for provision of wholesale ISDN30 in the UK except the Hull area? Please give reasons for your view.

Question 9.12 Do you agree or disagree that the condition should allow changes to be made to the current SOR process if agreed by Openreach with industry? Please give reasons for your view.

Question 9.13 Do you agree or disagree that Ofcom should impose an obligation on Openreach to comply with obligations governing cost accounting systems and processes as set out by Ofcom in the market for provision of wholesale ISDN30 in the UK except the Hull area? Please give reasons for your view.

Question 10.1 Do you agree or disagree that, based on Openreach's reported returns, Ofcom should impose a charge cap on Openreach's charges for ISDN30 services? Please give reasons for your view.

Question 10.2 Do you agree or disagree that, in order to manage consistency in the setting of charge caps for Openreach services, the proposed charge cap for ISDN30 should be developed and set alongside the reviews of existing controls for other Openreach services, scheduled to complete in 2011? Please give reasons for your view.

Question 10.3 Do you agree or disagree that a charge ceiling set at the current level of charges should be applied to wholesale WLR ISDN30 services provided by Openreach to prevent increases to charges in the period between the ending of the market review and setting of the charge cap? Please give reasons for your view.

Annex 5

Legal Instrument

NOTIFICATION OF PROPOSALS UNDER SECTIONS 48(2) AND 80 OF THE COMMUNICATIONS ACT 2003

Proposals for identifying markets, making market power determinations and the setting of SMP services conditions in relation to BT and KCOM under section 45 of the Communications Act 2003

Background

1. On 28 November 2003, the Director General of Telecommunications ('the Director') published a document entitled *Review of the fixed narrowband line, call origination, conveyance and transit markets*⁷⁴ ('the 2003 Wholesale Statement').
2. On 28 November 2003, the Director published a document entitled *Fixed Narrowband Retail Services Markets*⁷⁵ ('the 2003 Retail Statement')
3. In the 2003 Wholesale Statement and the 2003 Retail Statement, the Director set out his decisions on market definitions, market analyses and the setting, where appropriate, of Significant Market Power ('SMP') conditions for the markets under review including the markets for wholesale ISDN30 exchange line services (wholesale market) and Business ISDN30 exchange line services (retail market).
4. On 29 December 2003, Ofcom took over the functions and responsibilities under the Communications Act 2003 ('the Act') relating to the EC Communications Directives from the Director.
5. On 22 July 2004, Ofcom published its statement entitled *The regulatory financial reporting obligations on BT and Kingston Communications, Final Statement and notification: Accounting separation and cost accounting*⁷⁶ ('the financial reporting statement') which imposed SMP conditions on BT and KCOM in relation to financial reporting obligations in, amongst others, the wholesale ISDN30 markets.
6. On 19 March 2009, Ofcom published its consultation entitled a *Review of the fixed narrowband services wholesale markets : Consultation on the proposed markets, market power determinations and remedies*⁷⁷ ('the 2009 Wholesale Consultation') on proposals reviewing market definitions, market analyses, and where appropriate, the setting of SMP conditions. The 2009 Wholesale Consultation proposed markets for wholesale ISDN30 exchange line services for the UK excluding the Hull Area and the Hull Area, that BT and

⁷⁴ *Review of the fixed narrowband wholesale exchange line, call origination, conveyance and transit markets*, 28 Nov 2003 (http://www.ofcom.org.uk/consult/condocs/narrowband_mkt_rvw/nwe/)

⁷⁵ *Fixed Narrowband Retail Services Markets explanatory statement and notification*, 28 Nov 2003 (http://www.ofcom.org.uk/consult/condocs/narrowband_mkt_rvw/fixednarrowbandrsm.pdf)
⁷⁶

⁷⁷ *Review of the fixed narrowband services wholesale markets*, 19 March 2009 (http://www.ofcom.org.uk/consult/condocs/review_wholesale/)

KCOM had SMP in those respective markets, and that appropriate SMP conditions should be imposed on those providers.

7. On 19 March 2009, Ofcom also published its consultation entitled a *Fixed Narrowband Retail Services Markets* ('the 2009 Retail Consultation') on proposals reviewing market definitions, market analyses, and where appropriate, the setting of SMP conditions. The 2009 Retail Consultation proposed markets for ISDN30 access line services for the UK excluding the Hull Area and the Hull Area, that BT and KCOM had SMP in those respective markets, and that appropriate SMP conditions should be imposed on KCOM only.

8. On 15 September 2009, Ofcom published a statement and further consultation entitled *Review of the fixed narrowband services wholesale markets: Statement on the markets, market power determinations and remedies including further consultation*⁷⁸ ('the 2009 Wholesale Statement').

9. On 15 September 2009, Ofcom published a statement entitled Fixed Narrowband Retail Services Markets⁷⁹ ('the 2009 Retail Statement').

10. Having given careful consideration to every representation about the proposals made in relation to ISDN30 markets in relation to the 2009 Wholesale Consultation and 2009 Retail Consultation, Ofcom considered it appropriate to review its proposals in relation to those markets and confirmed in both the 2009 Wholesale Statement and 2009 Retail Statement that no decisions would be taken in relation to the proposed markets and a further review would be conducted.

Proposals

11. Ofcom hereby makes, in accordance with sections 48(2) and 80 of the Communications Act 2003 (the 'Act'), the following proposals for identifying markets, making market power determinations and the setting of SMP conditions by reference to such determinations.

Proposals relating to market definition and market power analysis

12. Ofcom proposes to identify the following markets for the purpose of making market power determinations:

- (a) for the United Kingdom, except the Hull Area:
 - (i) wholesale ISDN30 exchange line services; and
 - (ii) retail ISDN30 exchange line services.
- (b) for the Hull Area:
 - (i) wholesale ISDN30 exchange line services; and
 - (ii) retail ISDN30 exchange line services.

13. Ofcom proposes to make market power determinations that the following persons have significant market power:

- (a) in relation to the market set out in paragraph 12(a)(i) above, BT;
- (b) in relation to the markets set out in paragraph 12(b)(i) and (ii) above, KCOM.

⁷⁸ *Review of the fixed narrowband services wholesale markets*, 15 September 2009 (http://www.ofcom.org.uk/consult/condocs/wnmr_statement_consultation/main.pdf)

⁷⁹ *Fixed Narrowband Retail Services Markets*, 15 September 2009 (http://www.ofcom.org.uk/consult/condocs/retail_markets/statement/statement.pdf)

14. Ofcom proposes that the market set out at paragraph 12(a)(ii) above is effectively competitive and, therefore, is not proposing to determine any person as a person having significant market power in that market.

Proposals to set SMP service conditions

15. Ofcom proposes to set SMP conditions on the person referred to in paragraphs 13(a) above:

- (a) as set out in Schedule 1 to this Notification; and
- (b) SMP conditions OA1 – OA28 (excluding (a) to (c) and (f) of condition OA23) and OA32 to OA33, as set out in Schedule 2 to Annex 2 of the financial reporting statement.

16. Ofcom proposes to set SMP conditions on the person referred to in paragraphs 13(b) above:

- (a) as set out in Schedule 2 to this Notification; and
- (b) SMP conditions OB1 – OB27 (excluding (a) to (c) and (f) of condition OB23) and OB31 to OB32, as set out in Schedule 2 to Annex 3 of the financial reporting statement.

17. The effect of, and Ofcom's reasons for making, the proposals to identify the markets set out in paragraph 12 above and to make the market power determinations set out in paragraphs 13 and 14 above are contained in Sections 4 to 7 of the consultation document accompanying this Notification.

18. The effect of, and the Ofcom's reasons for making, the proposals to set the SMP conditions set out in Schedules 1 and 2 to this Notification and the SMP conditions set out in the financial reporting statement are contained in Sections 8 to 10 of the consultation document accompanying this Notification.

Proposals to revoke SMP service conditions

19. It is proposed that the conditions (as modified)⁸⁰ set out at Annex A of the 2003 Wholesale Statement applied to the markets for wholesale ISDN30 exchange line services be revoked in accordance with paragraph 21 below.

20. It is proposed that the conditions (as modified)⁷² set out at Annex D of the 2003 Retail Statement applied to the markets for Business ISDN30 exchange line services be revoked in accordance with paragraph 21 below.

21. The proposed revocations in paragraphs 19 and 20 above would take effect on the publication of any Notification under sections 48(1) and 79(4) of the Act adopting these proposals.

22. The effect of, and the Ofcom's reasons for making, the proposals to revoke SMP conditions set out in paragraphs 19 and 20 above are contained in Sections 5, 8 and 9 of the consultation document accompanying this Notification.

⁸⁰ The SMP conditions set in the 2003 Wholesale Statement and the 2003 Retail Statement (see footnotes 1 and 2 above), have been amended from time to time. The revocation of the substantive conditions includes any amendment that has subsequently been made to those conditions.

Ofcom's duties and legal tests

23. In identifying and analysing the markets referred to in paragraph 12 above, and in considering whether to make the proposals set out in this Notification, Ofcom has, in accordance with section 79 of the Act, taken due account of all applicable guidelines and recommendations which have been issued or made by the European Commission in pursuance of a Community instrument, and relate to market identification and analysis or the determination of what constitutes significant market power.

24. Ofcom considers that the proposed SMP conditions referred to in paragraph 15 and 16 above comply with the requirements of sections 45 to 47, 87, 88 and 90 of the Act, as appropriate and relevant to each such SMP condition and further that the proposed revocations of the SMP conditions referred to in paragraphs 19 and 20 above comply with the requirements of sections 45 to 47, 87 and 88 of the Act as appropriate and relevant to them.

25. In making all of the proposals referred to in paragraphs 11 to 20 of this Notification, Ofcom has considered and acted in accordance with section 3 of the Act and the six Community requirements in section 4 of the Act.

Making representations

26. Representations may be made to Ofcom about any of the proposals set out in this Notification and the accompanying consultation document by no later than **15 June 2010**.

27. Copies of this Notification and the accompanying consultation document have been sent to the Secretary of State for Business, Innovation and Skills in accordance with sections 50(1)(a) and 81 of the Act, as well as the European Commission and to the regulatory authorities of every other member State in accordance with sections 50(3) and 81 of the Act.

Interpretation

28. Save as to referring to markets identified in paragraph 12 of this Notification and except as otherwise defined in paragraph 29 of this Notification, words or expressions used shall have the same meaning as they have been ascribed in the Act.

29. In this Notification:

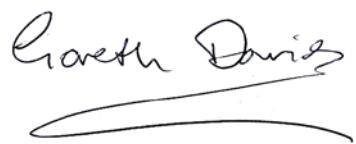
(a) "**BT**" means British Telecommunications plc, whose registered company number is 1800000, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006;

(b) "**Hull Area**" means the area defined as the 'Licensed Area' in the licence granted on 30 November 1987 by the Secretary of State under section 7 of the Telecommunications Act 1984 to Kingston upon Hull City Council and Kingston Communication (Hull) plc.

(c) "**KCOM**" means KCOM Group plc, whose registered company number is 2150618, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006.

30. The Schedules to this Notification shall form part of this Notification.

31. Unless otherwise stated in the Schedules, the decisions set out in this Notification shall take effect on the publication of this Notification.



A handwritten signature in black ink, appearing to read "Gareth Davis". The signature is written in a cursive style with a long horizontal flourish underneath.

A person duly authorised in accordance with paragraph 18 of the Schedule to the
Office of Communications Act 2002

4 MAY 2010

SCHEDULE 1

The SMP services conditions proposed to be imposed on BT under sections 45, 87, 88 and 90 of the Communications Act 2003 as a result of the analysis of the market set out in paragraph 12(a)(i) of the Notification in which it is proposed BT has significant market power (“SMP conditions”)

Part 1: Application, definitions and interpretation relating to the SMP conditions in Part 2

1. The SMP conditions in Part 2 of this Schedule 1 shall, except insofar as it is otherwise stated therein, apply to the market set out in paragraph 12(a)(i) of this Notification.
2. In this Schedule 1:
 - (a) “**Act**” means the Communications Act 2003 (c. 21);
 - (b) “**Access Charge Change Notice**” has the meaning given to it in Condition AAA(IS)6(a).2;
 - (c) “**Access Contract**” means:
 - (i) a contract for the provision by the Dominant Provider to another person of Network Access to the Dominant Provider’s Electronic Communications Network;
 - (ii) a contract under which Associated Facilities in relation to the Dominant Provider’s Public Electronic Communications Network are made available by the Dominant Provider to another person;
 - (d) “**Dominant Provider**” means British Telecommunications plc, whose registered company number is 1800000, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006;
 - (e) “**Exchange Line**” means Apparatus comprised in the Dominant Provider’s Electronic Communications Network and installed for the purpose of connecting a telephone exchange run by the Dominant Provider to a Network Termination Point comprised in Network Termination and Testing Apparatus installed by the Dominant Provider for the purpose of providing Electronic Communications Services at the premises at which the Network Termination and Testing Apparatus is located;
 - (f) “**Existing Line Transfer**” means the combination of transactions consisting of a customer (including but not limited to a customer who is a provider of a Public Electronic Communications Service) of the Dominant Provider for an Exchange Line terminating his contract (‘the customer contract’) with the Dominant Provider for the Exchange Line, and the Dominant Provider entering into a contract for that Exchange Line with a provider of a Public Electronic Communications Service (‘the Third Party contract’), except where the Third Party contract is entered into after the Dominant Provider has ceased the Exchange Line (in which case the Third Party contract shall be deemed to be a New Line Installation);
 - (g) “**ISDN**” means the integrated services digital network which is an Electronic Communications Network that provides for digital end-to-end connectivity to support a wide range of Public Electronic Communications Services, including voice and non-voice services, to which End-users have access by a limited set of standard multipurpose customer interfaces;

(h) “**Network Termination and Testing Apparatus**” means an item of Apparatus comprised in an Electronic Communications Network installed in a fixed position on Served Premises which enables:

- (i) Approved Apparatus to be readily connected to, and disconnected from, the Network;
- (ii) the conveyance of Signals between such Approved Apparatus and the Network;
- (iii) the due functioning of the Network to be tested, but the only other functions of which, if any, are:
 - (a) to supply energy between such Approved Apparatus and the Network;
 - (b) to protect the safety or security of the operation of the Network; or
 - (c) to enable other operations exclusively related to the running of the Network to be performed or the due functioning of any system to which the Network is or is to be connected to be tested (separately or together with the Network);

(i) “**Network Termination Point**” means the physical point at which a Relevant Subscriber is provided with access to a Public Electronic Communications Network and, where it concerns Electronic Communications Networks involving switching or routing, that physical point is identified by means of a specific network address, which may be linked to the Telephone Number or name of a Relevant Subscriber. Where a Network Termination Point is provided at a fixed position on Served Premises, it shall be within an item of Network Termination and Testing Apparatus;

(j) “**New Line Installation**” means a service for the installation of an Exchange Line, where some or all external (or internal) wiring has to be provided, or brought into use, by the Dominant Provider. For purposes of this definition, “external wiring” means wiring from the distribution point to the protection box (or where one would be fitted) at the premises at which the Network Termination and Testing Apparatus is located and “internal wiring” means wiring from the protection box up to and including the first main socket, block terminal or other Network Termination Point;

(k) “**Ordinary Maintenance**” means maintenance which is part of the service provided by the Dominant Provider in consideration of the charge for an Exchange Line and includes normal fault repair, as defined in the Dominant Provider's standard terms and conditions;

(l) “**Public Telephone Network**” means an Electronic Communications Network which is used to provide Publicly Available Telephone Services; it supports the transfer between Network Termination Points of speech communications, and also other forms of communication, such as facsimile and data;

(m) “**Reference Offer**” means the terms and conditions on which the Dominant Provider is willing to enter into an Access Contract;

(n) “**Relevant Subscriber**” means any person who is party to a contract with a provider of Public Electronic Communications Services for the supply of such Services;

(o) “**Services Market**” means each of the markets sets out in paragraph 12(a)(i) of the Notification;

(p) “**Third Party**” means either:

- (i) a person providing a Public Electronic Communications Network; or
- (ii) a person providing a Public Electronic Communications Service;

(q) “**Transfer Charge**” means the charge or price that is applied, or deemed to be applied, by the Dominant Provider to itself for the use or provision of an activity or group of activities. For the avoidance of doubt, such activities or group of activities include, amongst other things, products and services provided from, to or within the Services Market and the use of Network Components in that Services Market;

(r) “**Usage Factor**” means the average usage by any Communications Provider (including the Dominant Provider itself) of each Network Component in using or providing a particular product or service or carrying out a particular activity;

(s) “**Wholesale ISDN30 Line Rental**” means an Electronic Communications Service provided by the Dominant Provider to a Third Party for the use and Ordinary Maintenance of an ISDN30 Exchange Line;

(t) “**Wholesale Line Rental**” means any and all of the following provided by the Dominant Provider:

- (i) Wholesale Analogue Line Rental;
- (ii) Wholesale ISDN2 Line Rental; and
- (iii) Wholesale ISDN30 Line Rental;

3. For the purpose of interpreting the SMP conditions in Part 2:

- (a) except in so far as the context otherwise requires, words or expressions shall have the meaning assigned to them in paragraph 2 of this Part above and otherwise any word or expression shall have the same meaning as it has in the Act;
- (b) the Interpretation Act 1978 (c. 30) shall apply as if each of the SMP conditions in Part 2 were an Act of Parliament; and
- (c) headings and titles shall be disregarded.

Part 2: The SMP conditions

Condition AAA(IS)1(a) - Requirement to provide Network Access on reasonable request

AAA(IS)1(a).1 Where a Third Party reasonably requests in writing Network Access, the Dominant Provider shall provide that Network Access. The Dominant Provider shall also provide such Network Access as Ofcom may from time to time direct.

AAA(IS)1(a).2 The provision of Network Access in accordance with paragraph AAA(IS)1(a).1 above shall occur as soon as it is reasonably practicable and shall be provided on fair and reasonable terms, conditions and charges and on such terms, conditions and charges as Ofcom may from time to time direct.

AAA(IS)1(a).3 The Dominant Provider shall comply with any direction Ofcom may make from time to time under this Condition AAA(IS)1(a).

Condition AAA(IS)1(b) - Requests for new Network Access

AAA(IS)1(b).1 The Dominant Provider shall, for the purposes of transparency, publish reasonable guidelines, in relation to requests for new Network Access made to it. Such guidelines shall detail:

- (a) the form in which such a request should be made;

- (b) the information that the Dominant Provider requires in order to consider a request for new Network Access; and
- (c) the time-scales in which such requests will be handled by the Dominant Provider.

AAA(IS)1(b).2 These guidelines shall meet the following principles:

- (a) the process should be documented end-to-end;
- (b) the timescales for each stage of the process shall be reasonable;
- (c) the criteria by which requests will be assessed shall be clearly identified; and
- (e) any changes to the guidelines be agreed between BT and industry.

AAA(IS)1(b).3 The Dominant Provider shall, upon a reasonable request from a Third Party considering making a request for new Network Access, provide that Third Party with information so as to enable that Third Party to make a request for new Network Access. Such information shall be provided within a reasonable period.

AAA(IS)1(b).4 On receipt of a written request for new Network Access, the Dominant Provider shall deal with the request in accordance with the guidelines described at paragraph AAA(IS)1(b).1 above. A modification of a request for new Network Access which has previously been submitted to the Dominant Provider, and rejected by the Dominant Provider, shall be considered as a new request.

AAA(IS)1(b).5 The Dominant Provider is required to provide Ofcom with a description of the processes it has put in place to ensure compliance with this Condition AAA(IS)1(b). The Dominant Provider shall keep those processes under review to ensure that they remain adequate for that purpose. Where changes to the process are agreed with industry, BT should notify Ofcom of those changes.

Condition AAA(IS)2 - Requirement not to unduly discriminate

AAA(IS)2.1 The Dominant Provider shall not unduly discriminate against particular persons or against a particular description of persons in relation to matters connected with Network Access.

AAA(IS)2.2 In this Condition, the Dominant Provider may be deemed to have shown undue discrimination if it unfairly favours to a material extent an activity carried on by it so as to place at a competitive disadvantage persons competing with the Dominant Provider.

Condition AAA(IS)4 – Charge Control

AAA(IS)4.1 The Dominant Provider shall not charge more than:

- (a) for the annual rental for Wholesale ISDN30 Line Rental, £141.00 per channel (the charge for which shall be pro rated and levied on no less than a quarterly basis);
- (b) for New Line Installation (Wholesale ISDN30), £550.00; and
- (c) for Existing Line Transfer (Connection Charge per 30 Channel Access Bearer Per Bearer), £75.00;

Condition AAA(IS)5 - Requirement to publish a Reference Offer

AAA(IS)5.1 Except in so far as Ofcom may otherwise consent in writing, the Dominant Provider shall publish a Reference Offer and act in the manner set out below.

AAA(IS)5.2 Subject to paragraph AAA(IS)5.8 below, the Dominant Provider shall ensure that a Reference Offer in relation to the provision of Network Access includes at least the following:

- (a) a description of the Network Access to be provided, including technical characteristics (which shall include information on network configuration where necessary to make effective use of the Network Access);
- (b) the locations of the points of Network Access;
- (c) the technical standards for Network Access (including any usage restrictions and other security issues);
- (d) the conditions for access to ancillary, supplementary and advanced services (including operational support systems, information systems or databases for pre-ordering, provisioning, ordering, maintenance and repair requests and billing);
- (e) any ordering and provisioning procedures;
- (f) relevant charges, terms of payment and billing procedures;
- (g) details of interoperability tests;
- (h) details of traffic and network management;
- (i) details of maintenance and quality as follows:
 - (i) specific time scales for the acceptance or refusal of a request for supply and for completion, testing and hand-over or delivery of services and facilities, for provision of support services (such as fault handling and repair);
 - (ii) service level commitments, namely the quality standards that each party must meet when performing its contractual obligations;
 - (iii) the amount of compensation payable by one party to another for failure to perform contractual commitments;
 - (iv) a definition and limitation of liability and indemnity; and
 - (v) procedures in the event of alterations being proposed to the service offerings, for example, launch of new services, changes to existing services or change to prices;
- (j) details of measures to ensure compliance with requirements for network integrity;
- (k) details of any relevant intellectual property rights;
- (l) a dispute resolution procedure to be used between the parties;
- (m) details of duration and renegotiation of agreements;

- (n) provisions regarding confidentiality of non-public parts of the agreements;
 - (o) rules of allocation between the parties when supply is limited (for example, for the purpose of co-location or location of masts);
 - (p) the standard terms and conditions for the provision of Network Access;
 - (q) in relation to the services specified in paragraph AAA(IS) 4.1 the Transfer Charge for each service
- reconciled in each case to the charge payable by a Communications Provider other than the Dominant Provider.

AAA(IS) 5.3 In relation to those products and services subject to Condition AAA(IS)4, to the extent that the Dominant Provider provides to itself Network Access that:

- (a) is the same, similar or equivalent to that provided to any other Third Party; or
- (b) may be used for a purpose that is the same, similar or equivalent to that provided to any other Third Party,

in a manner that differs from that detailed in a Reference Offer in relation to Network Access provided to any other Third Party, the Dominant Provider shall ensure that it publishes a Reference Offer in relation to the Network Access that it provides to itself which includes, where relevant, at least those matters detailed in paragraphs AAA(IS)5.2(a) to (q) above.

AAA(IS)5.4 The Dominant Provider shall update and publish the Reference Offer in relation to any amendments or in relation to any further Network Access provided after the date this Condition AAA(IS)5 enters into force.

AAA(IS)5.5 Publication referred to above shall be effected by:

- (a) placing a copy of the Reference Offer on any relevant website operated or controlled by the Dominant Provider; and
- (b) sending a copy of the Reference Offer to Ofcom.

AAA(IS)5.6 The Dominant Provider shall send a copy of the current version of the Reference Offer to any person at that person's written request (or such parts which have been requested).

AAA(IS)5.7 The Dominant Provider shall make such modifications to the Reference Offer as Ofcom may direct from time to time.

AAA(IS)5.8 The Dominant Provider shall provide Network Access at the charges, terms and conditions in the relevant Reference Offer and shall not depart there from either directly or indirectly.

AAA(IS)5.9 The Dominant Provider shall comply with any direction Ofcom may make from time to time under this Condition AAA(IS)5.

Condition AAA(IS)6(a) - Requirement to notify charges

AAA(IS)6(a).1 Except in so far as Ofcom may otherwise consent in writing, the Dominant Provider shall publish charges and act in the manner set out below.

AAA(IS)6(a).2 Except where new or amended charges are directed or determined by Ofcom or where such charges are required by a notification or an enforcement notification given by Ofcom under sections 94 or 95 of the Act, the Dominant Provider shall send to Ofcom and to every Third Party with which it has entered into an Access Contract covered by Condition AAA(IS)1(a) a written notice of any amendment to the charges on which it provides Network Access or in relation to any charges for new Network Access (an “Access Charge Change Notice”) not less than 28 days before any such amendment comes into effect.

AAA(IS)6(a).3 The Dominant Provider shall ensure that an Access Charge Change Notice includes:

- (a) a description of the Network Access in question;
- (b) a reference to the location in the Dominant Provider’s current Reference Offer of the terms and conditions associated with the provision of that Network Access;
- (c) the date on which or the period for which any amendments to charges will take effect (the “effective date”);
- (d) the current and proposed new charge; and
- (e) the information specified in sub-paragraph (d) above with respect to that Network Access to which that paragraph applies.

AAA(IS)6(a).4 The Dominant Provider shall not apply any new charge identified in an Access Charge Change Notice before the effective date.

AAA(IS)6(a).5 In relation to those products and services subject to Condition AAA(IS)4, to the extent that the Dominant Provider provides to itself Network Access that:

- (a) is the same, similar or equivalent to that provided to any other Third Party; or
- (b) may be used for a purpose that is the same, similar or equivalent to that provided to any other Third Party, in a manner that differs from that detailed in an Access Charge Change Notice in relation to Network Access provided to any other Third Party, the Dominant Provider shall ensure that it sends to Ofcom an Access Charge Change Notice in relation to the Network Access that it provides to itself which includes, where relevant, at least those matters detailed in paragraphs AAA(IS)6(a).3(a) to (e).

Condition AAA(IS)6(b) - Requirement to notify technical information

AAA(IS)6(b).1 Save where Ofcom consents otherwise, where the Dominant Provider:

- (a) proposes to provide Network Access covered by Condition AAA(IS)1(a), the terms and conditions for which comprise new:
 - (i) technical characteristics (including information on network configuration where necessary to make effective use of the Network Access);

- (ii) locations of the points of Network Access; or
 - (iii) technical standards (including any usage restrictions and other security issues), or
- (b) proposes to amend an existing Access Contract covered by Condition AAA(IS)1(a) by modifying the terms and conditions listed in paragraph AAA(IS)6(b).1(a)(i) to (iii) above on which the Network Access is provided,

the Dominant Provider shall publish a written notice (the "Notice") of the new or amended terms and conditions not less than 90 days before either the Dominant Provider enters into an Access Contract to provide the new Network Access or the amended terms and conditions of the existing Access Contract come into effect. This obligation for prior notification shall not apply where new or amended charges or terms and conditions are directed or determined by the Office of Communications ("Ofcom") or are required by a notification or an enforcement notification given by Ofcom under sections 94 or 95 of the Act.

AAA(IS)6(b).2 The Dominant Provider shall ensure that the Notice includes:

- (a) a description of the Network Access in question;
- (b) a reference to the location in the Dominant Provider's Reference Offer of the relevant terms and conditions;
- (c) the date on which or the period for which the Dominant Provider may enter into an Access Contract to provide the new Network Access or any amendments to the relevant terms and conditions will take effect (the "effective date").

AAA(IS)6(b).3 The Dominant Provider shall not enter into an Access Contract containing the terms and conditions identified in the Notice or apply any new relevant terms and conditions identified in the Notice before the effective date.

AAA(IS)6(b).4 Publication referred to in paragraph AAA(IS)6(b).1 shall be effected by:

- (a) placing a copy of the Notice on any relevant website operated or controlled by the Dominant Provider;
- (b) sending a copy of the Notice to Ofcom; and
- (c) sending a copy of the Notice to any person at that person's written request, and where the Notice identifies a modification to existing relevant terms and conditions, to every Third Party with which the Dominant Provider has entered into an Access Contract covered by Condition AAA(IS)1(a). The provision of such a copy of Notice may be subject to a reasonable charge.

Condition AAA(IS)7

Transparency as to quality of service

AAA(IS)7.1 The Dominant provider shall publish all such information for the purposes of securing transparency as to the quality of service in relation to Network Access provided by the Dominant Provider, in such manner and form as Ofcom may from time to time direct.

AAA(IS)7.2 The Dominant Provider shall comply with any direction Ofcom may make from time to time under this Condition AAA(IS)7

Condition AAA(IS)10 - Requirement to provide ISDN30 Wholesale Line Rental.

AAA(IS)10.1 The Dominant Provider shall provide as soon as is reasonably practicable, or as directed by Ofcom, on reasonable terms to every Third Party who makes a reasonable request in relation to wholesale ISDN30 exchange line services.

AAA(IS)10.3 The Dominant Provider shall comply with any direction that Ofcom may make from time to time under this Condition AAA(IS)10.

AAA(IS)10.4 This Condition AAA(IS)10 is without prejudice to the generality of the provisions in Conditions AAA(IS)1(a) to AAA(IS)7 above.

SCHEDULE 2

The SMP services conditions proposed to be imposed on KCOM under sections 45, 87, 88 and 90 of the Communications Act 2003 as a result of the analyses of the markets set out in paragraph 12(b) of the Notification in which it is proposed KCOM has significant market power (“SMP conditions”)

Part 1: Application, definitions and interpretation relating to the SMP conditions in Part 2

Wholesale level SMP Conditions

1. The SMP conditions in Part 2 of this Schedule 2 shall, except insofar as it is otherwise stated therein, apply to the market set out in paragraph 12(b)(i) of this Notification.

Retail level SMP Conditions

2. The SMP conditions in Part 3 of this Schedule 2 shall, except insofar as it is otherwise stated therein, apply to the market set out in paragraph 12(b)(ii) of this Notification.

Definitions

3. In this Schedule 1:

(a) “**Act**” means the Communications Act 2003 (c. 21);

(b) “**Access Charge Change Notice**” has the meaning given to it in Condition AAB(IS)6(a).2;

(c) “**Access Contract**” means:

(i) a contract for the provision by the Dominant Provider to another person of Network Access to the Dominant Provider’s Electronic Communications Network;

(ii) a contract under which Associated Facilities in relation to the Dominant Provider’s Public Electronic Communications Network are made available by the Dominant Provider to another person;

(d) “**Dominant Provider**” means KCOM Group plc, whose registered company number is 2150618, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006;

(e) “**Exchange Line**” means Apparatus comprised in the Dominant Provider’s Electronic Communications Network and installed for the purpose of connecting a telephone exchange run by the Dominant Provider to a Network Termination Point comprised in Network Termination and Testing Apparatus installed by the Dominant Provider for the purpose of providing Electronic Communications Services at the premises at which the Network Termination and Testing Apparatus is located;

(f) “**Existing Line Transfer**” means the combination of transactions consisting of a customer (including but not limited to a customer who is a provider of a Public Electronic Communications Service) of the Dominant Provider for an Exchange Line terminating his contract (‘the customer contract’) with the Dominant Provider for the Exchange Line, and the Dominant Provider entering into a contract for that Exchange Line with a provider of a Public Electronic Communications Service (‘the Third Party contract’), except where the Third Party

contract is entered into after the Dominant Provider has ceased the Exchange Line (in which case the Third Party contract shall be deemed to be a New Line Installation);

(g) "**ISDN**" means the integrated services digital network which is an Electronic Communications Network evolved from the telephony integrated digital network that provides for digital end-to-end connectivity to support a wide range of Public Electronic Communications Services, including voice and non-voice services, to which End-users have access by a limited set of standard multipurpose customer interfaces;

(h) "**Network Termination and Testing Apparatus**" means an item of Apparatus comprised in an Electronic Communications Network installed in a fixed position on Served Premises which enables:

- (i) Approved Apparatus to be readily connected to, and disconnected from, the Network;
- (ii) the conveyance of Signals between such Approved Apparatus and the Network;
- (iii) the due functioning of the Network to be tested, but the only other functions of which, if any, are:
 - (a) to supply energy between such Approved Apparatus and the Network;
 - (b) to protect the safety or security of the operation of the Network; or
 - (c) to enable other operations exclusively related to the running of the Network to be performed or the due functioning of any system to which the Network is or is to be connected to be tested (separately or together with the Network);

(i) "**Network Termination Point**" means the physical point at which a Relevant Subscriber is provided with access to a Public Electronic Communications Network and, where it concerns Electronic Communications Networks involving switching or routing, that physical point is identified by means of a specific network address, which may be linked to the Telephone Number or name of a Relevant Subscriber. Where a Network Termination Point is provided at a fixed position on Served Premises, it shall be within an item of Network Termination and Testing Apparatus;

(j) "**New Line Installation**" means a service for the installation of an Exchange Line, where some or all external (or internal) wiring has to be provided, or brought into use, by the Dominant Provider. For purposes of this definition, "external wiring" means wiring from the distribution point to the protection box (or where one would be fitted) at the premises at which the Network Termination and Testing Apparatus is located and "internal wiring" means wiring from the protection box up to and including the first main socket, block terminal or other Network Termination Point;

(k) "**Ordinary Maintenance**" means maintenance which is part of the service provided by the Dominant Provider in consideration of the charge for an Exchange Line and includes normal fault repair, as defined in the Dominant Provider's standard terms and conditions;

(l) "**Public Telephone Network**" means an Electronic Communications Network which is used to provide Publicly Available Telephone Services; it supports the transfer between Network Termination Points of speech communications, and also other forms of communication, such as facsimile and data;

(m) "**Reference Offer**" means the terms and conditions on which the Dominant Provider is willing to enter into an Access Contract;

(n) "**Relevant Subscriber**" means any person who is party to a contract with a provider of Public Electronic Communications Services for the supply of such Services;

- (o) “**Services Market**” means each of the markets sets out in paragraph 12(a) of the Notification;
- (p) “**Third Party**” means either:
- (i) a person providing a Public Electronic Communications Network; or
 - (ii) a person providing a Public Electronic Communications Service;
- (q) “**Transfer Charge**” means the charge or price that is applied, or deemed to be applied, by the Dominant Provider to itself for the use or provision of an activity or group of activities. For the avoidance of doubt, such activities or group of activities include, amongst other things, products and services provided from, to or within the Services Market and the use of Network Components in that Services Market;
- (r) “**Usage Factor**” means the average usage by any Communications Provider (including the Dominant Provider itself) of each Network Component in using or providing a particular product or service or carrying out a particular activity;
- (s) “**Wholesale ISDN30 Line Rental**” means an Electronic Communications Service provided by the Dominant Provider to a Third Party for the use and Ordinary Maintenance of an ISDN30 Exchange Line;
- (t) “**Wholesale Line Rental**” means any and all of the following provided by the Dominant Provider:
- (i) Wholesale Analogue Line Rental;
 - (ii) Wholesale ISDN2 Line Rental; and
 - (iii) Wholesale ISDN30 Line Rental;

4. For the purpose of interpreting the SMP conditions in Part 2:

- (a) except in so far as the context otherwise requires, words or expressions shall have the meaning assigned to them in paragraphs 2 and 3 of this Part above and otherwise any word or expression shall have the same meaning as it has in the Act;
- (b) the Interpretation Act 1978 (c. 30) shall apply as if each of the SMP conditions in Part 2 were an Act of Parliament; and
- (c) headings and titles shall be disregarded.

Part 2: The SMP conditions (Wholesale level)

Condition AAB(IS)1 - Requirement to provide Network Access on reasonable request

AAB(IS)1.1 Where a Third Party reasonably requests in writing Network Access, the Dominant Provider shall provide that Network Access. The Dominant Provider shall also provide such Network Access as Ofcom may from time to time direct.

AAB(IS)1.2 The provision of Network Access in accordance with paragraph AAB(IS)1.1 above shall occur as soon as it is reasonably practicable and shall be provided on fair and reasonable terms, conditions and charges and on such terms, conditions and charges as Ofcom may from time to time direct.

AAB(IS)1.3 The Dominant Provider shall comply with any direction Ofcom may make from time to time under this Condition AAB(IS)1.

Condition AAB(IS)2 - Requirement not to unduly discriminate

AAB(IS)2.1 The Dominant Provider shall not unduly discriminate against particular persons or against a particular description of persons in relation to matters connected with Network Access.

AAB(IS)2.2 In this Condition, the Dominant Provider may be deemed to have shown undue discrimination if it unfairly favours to a material extent an activity carried on by it so as to place at a competitive disadvantage persons competing with the Dominant Provider.

Condition AAB(IS)4 - Requirement to publish a Reference Offer

AAB(IS)4.1 Except in so far as Ofcom may otherwise consent in writing, the Dominant Provider shall publish a Reference Offer and act in the manner set out below.

AAB(IS)4.2 Subject to paragraph AAB(IS)4.8 below, the Dominant Provider shall ensure that a Reference Offer in relation to the provision of Network Access includes at least the following:

- (a) a description of the Network Access to be provided, including technical characteristics (which shall include information on network configuration where necessary to make effective use of the Network Access);
- (b) the locations of the points of Network Access;
- (c) the technical standards for Network Access (including any usage restrictions and other security issues);
- (d) the conditions for access to ancillary, supplementary and advanced services (including operational support systems, information systems or databases for pre-ordering, provisioning, ordering, maintenance and repair requests and billing);
- (e) any ordering and provisioning procedures;
- (f) relevant charges, terms of payment and billing procedures;
- (g) details of interoperability tests;
- (h) details of traffic and network management;
- (i) details of maintenance and quality as follows:
 - (i) specific time scales for the acceptance or refusal of a request for supply and for completion, testing and hand-over or delivery of services and facilities, for provision of support services (such as fault handling and repair);
 - (ii) service level commitments, namely the quality standards that each party must meet when performing its contractual obligations;
 - (iii) the amount of compensation payable by one party to another for failure to perform contractual commitments;
 - (iv) a definition and limitation of liability and indemnity; and

- (v) procedures in the event of alterations being proposed to the service offerings, for example, launch of new services, changes to existing services or change to prices;
- (j) details of measures to ensure compliance with requirements for network integrity;
- (k) details of any relevant intellectual property rights;
- (l) a dispute resolution procedure to be used between the parties;
- (m) details of duration and renegotiation of agreements;
- (n) provisions regarding confidentiality of non-public parts of the agreements;
- (o) rules of allocation between the parties when supply is limited (for example, for the purpose of co-location or location of masts);
- (p) the standard terms and conditions for the provision of Network Access;
- (q) in relation to wholesale ISDN30 services the Transfer Charge for each service reconciled in each case to the charge payable by a Communications Provider other than the Dominant Provider.

AAB(IS) 4.3 to the extent that the Dominant Provider provides to itself Network Access that:

- (a) is the same, similar or equivalent to that provided to any other Third Party; or
- (b) may be used for a purpose that is the same, similar or equivalent to that provided to any other Third Party,

in a manner that differs from that detailed in a Reference Offer in relation to Network Access provided to any other Third Party, the Dominant Provider shall ensure that it publishes a Reference Offer in relation to the Network Access that it provides to itself which includes, where relevant, at least those matters detailed in paragraphs AAB(IS)4.2(a) to (q) above.

AAB(IS)4.4 The Dominant Provider shall update and publish the Reference Offer in relation to any amendments or in relation to any further Network Access provided after the date this Condition AAB(IS)4 enters into force.

AAB(IS)4.5 Publication referred to above shall be effected by:

- (a) placing a copy of the Reference Offer on any relevant website operated or controlled by the Dominant Provider; and
- (b) sending a copy of the Reference Offer to Ofcom.

AAB(IS)4.6 The Dominant Provider shall send a copy of the current version of the Reference Offer to any person at that person's written request (or such parts which have been requested).

AAB(IS)4.7 The Dominant Provider shall make such modifications to the Reference Offer as Ofcom may direct from time to time.

AAB(IS)4.8 The Dominant Provider shall provide Network Access at the charges, terms and conditions in the relevant Reference Offer and shall not depart there from either directly or indirectly.

AAB(IS)4.9 The Dominant Provider shall comply with any direction Ofcom may make from time to time under this Condition AAB(IS)4.

Condition AAB(IS)5(a) - Requirement to notify charges

AAB(IS)5(a).1 Except in so far as Ofcom may otherwise consent in writing, the Dominant Provider shall publish charges and act in the manner set out below.

AAB(IS)5(a).2 Except where new or amended charges are directed or determined by Ofcom or where such charges are required by a notification or an enforcement notification given by Ofcom under sections 94 or 95 of the Act, the Dominant Provider shall send to Ofcom and to every Third Party with which it has entered into an Access Contract covered by Condition AAB(IS)1 a written notice of any amendment to the charges on which it provides Network Access or in relation to any charges for new Network Access (an “Access Charge Change Notice”) not less than 28 days before any such amendment comes into effect.

AAB(IS)5(a).3 The Dominant Provider shall ensure that an Access Charge Change Notice includes:

- (a) a description of the Network Access in question;
- (b) a reference to the location in the Dominant Provider’s current Reference Offer of the terms and conditions associated with the provision of that Network Access;
- (c) the date on which or the period for which any amendments to charges will take effect (the “effective date”);
- (d) the current and proposed new charge; and
- (e) the information specified in sub-paragraph (d) above with respect to that Network Access to which that paragraph applies.

AAB(IS)5(a).4 The Dominant Provider shall not apply any new charge identified in an Access Charge Change Notice before the effective date.

Condition AAB(IS)5(b) - Requirement to notify technical information

AAB(IS)5(b).1 Save where Ofcom consents otherwise, where the Dominant Provider:

- (a) proposes to provide Network Access covered by Condition AAB(IS)1, the terms and conditions for which comprise new:
 - (i) technical characteristics (including information on network configuration where necessary to make effective use of the Network Access);
 - (ii) locations of the points of Network Access; or
 - (iii) technical standards (including any usage restrictions and other security issues), or

(b) proposes to amend an existing Access Contract covered by Condition AAB(IS)1 by modifying the terms and conditions listed in paragraph AAB(IS)5(b).1(a)(i) to (iii) above on which the Network Access is provided,

the Dominant Provider shall publish a written notice (the “Notice”) of the new or amended terms and conditions not less than 90 days before either the Dominant Provider enters into an Access Contract to provide the new Network Access or the amended terms and conditions of the existing Access Contract come into effect. This obligation for prior notification shall not apply where new or amended charges or terms and conditions are directed or determined by the Office of Communications (“Ofcom”) or are required by a notification or an enforcement notification given by Ofcom under sections 94 or 95 of the Act.

AAB(IS)5(b).2 The Dominant Provider shall ensure that the Notice includes:

- (a) a description of the Network Access in question;
- (b) a reference to the location in the Dominant Provider’s Reference Offer of the relevant terms and conditions;
- (c) the date on which or the period for which the Dominant Provider may enter into an Access Contract to provide the new Network Access or any amendments to the relevant terms and conditions will take effect (the “effective date”).

AAB(IS)5(b).3 The Dominant Provider shall not enter into an Access Contract containing the terms and conditions identified in the Notice or apply any new relevant terms and conditions identified in the Notice before the effective date.

AAB(IS)5(b).4 Publication referred to in paragraph AAB(IS)5(b).1 shall be effected by:

- (a) placing a copy of the Notice on any relevant website operated or controlled by the Dominant Provider;
- (b) sending a copy of the Notice to Ofcom; and
- (c) sending a copy of the Notice to any person at that person’s written request, and where the Notice identifies a modification to existing relevant terms and conditions, to every Third Party with which the Dominant Provider has entered into an Access Contract covered by Condition AAB(IS)1. The provision of such a copy of Notice may be subject to a reasonable charge.

Part 3 : The SMP conditions (Retail level)

Condition DA(IS)1 – Requirement not to unduly discriminate

DA(IS)1.1 The Dominant Provider shall not unduly discriminate against particular persons or a particular description of persons in relation to services offered.

DA(IS)1.2 Nothing done in any manner by the Dominant Provider shall be regarded as undue discrimination under this Condition if and to the extent that the Dominant Provider is required or expressly permitted to do such thing in that manner by or under any condition set under section 45 of the Communications Act which applies to the Dominant Provider.

Condition DA(IS)2 – Requirement to publish charges

DA(IS)2.1 Except in so far as Ofcom may otherwise consent in writing, the Dominant Provider shall publish charges, terms and conditions and act in the manner set out below.

DA(IS)2.2 The Dominant Provider shall publish charges, terms and conditions, including bundled charges, terms and conditions (whether or not those bundles include charges, terms and conditions for services supplied in markets to which this Condition does not apply).

DA(IS)2.3 The Dominant Provider shall publish any amendments to the charges, terms and conditions published under paragraph DA(IS)2.2, including charges, terms and conditions for any new services, within 24 hours of the time that the amendment comes into effect.

DA(IS)2.4 Publication referred to in paragraphs DA(IS)2.2 and DA(IS)2.3 shall be effected by placing a copy of the information on any relevant website operated or controlled by the Dominant Provider.

DA(IS)2.5 The Dominant Provider shall send to Ofcom a written notice of any amendment to the charges, terms and conditions published under paragraph DA(IS)2.2 (including charges, terms and conditions for any new services) within 24 hours of the time that the amendment comes into effect and shall send a copy of the notice to any person who may reasonably request such a copy.

DA(IS)2.6 Where it would be impractical for the Dominant Provider to publish under paragraphs DA(IS)2.2, DA(IS)2.3 or DA(IS)2.5 any charge or amended charge, the Dominant Provider shall instead publish the method to be adopted for determining that charge or amended charge.

DA(IS)2.7 The Dominant Provider shall provide services at the charges, terms and conditions published under this Condition, and shall not depart there from either directly or indirectly.

Annex 6

Legal Instrument (Directions)

NOTIFICATION UNDER SECTION 49 OF THE COMMUNICATIONS ACT 2003

Proposed direction made under section 49 of the Communications Act 2003 and Condition AAA(IS)7 proposed as a result of the analysis of the wholesale ISDN30 exchange line services market in the United Kingdom, excluding the Hull Area) in the Review of the retail and wholesale ISDN30 markets dated 4 May 2010

Proposal in this Notification

1. Ofcom hereby makes, in accordance with sections 49(4) of the Act, the following proposal for a direction in relation to the publishing of Wholesale Line Rental Key Performance Indicators for ISDN30.
2. The proposed direction is set out in the Schedule to this Notification.
3. The effect of, and the reasons for making the direction is set out at Section 9 in the accompanying consultation document.

Ofcom's Duties

4. In making the proposal set out in the Notification, Ofcom has considered and acted in accordance with its general duties in section 3 of the Act and the six Community requirements in section 4 of the Act.

Making representations

5. Representations may be made to Ofcom about this proposal set out in this Notification and the accompanying consultation document by no later than **15 June 2010**.
6. In accordance with section 50 of the Act, copies of this Notification have been sent to the Secretary of State, the European Commission and to regulatory authorities of every other Member State.

Interpretation

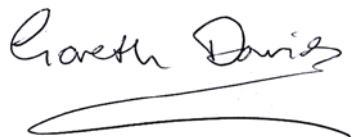
7. Except for references made to the identified services markets in this Notification and subject to paragraph 8 below, words or expressions used in this Notification shall have the same meaning as they have been ascribed in the Act.
8. In this Notification—
 - (a) “**Act**” means the Communications Act 2003 (c.21);
 - (b) “**BT**” means British Telecommunications plc, whose registered company number is 1800000, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 736 of the Companies Act 1985, as amended by the Companies Act 1989;
 - (c) “**Hull Area**” means the area defined as the ‘Licensed Area’ in the licence

granted on 30 November 1987 by the Secretary of State under section 7 of the Telecommunications Act 1984 to Kingston upon Hull City Council and Kingston Communications (Hull) plc;

9. For the purpose of interpreting this Notification—

(a) headings and titles shall be disregarded; and

(b) the Interpretation Act 1978 (c. 30) shall apply as if this Notification were an Act of Parliament.

A handwritten signature in black ink, appearing to read "Gareth Davis". Below the signature is a simple horizontal line.

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

4 MAY 2010

SCHEDULE

[Proposed] Direction under section 49 of the Communications Act 2003 and Condition AAA(IS)7 as a result of the analysis of the wholesale ISDN30 exchange line services market in the United Kingdom excluding the Hull Area in the ***Review of the retail and wholesale ISDN30 markets dated 4 May 2010***

Background

1. On 15 September 2009 Ofcom concluded its *Review of the fixed narrowband services wholesale markets* in which it identified markets, made market power determinations and set appropriate SMP conditions as set out in the Notification at Annex 7 to the review, and explained in the accompanying explanatory statement.
2. Ofcom determined in the review referred to in paragraph 1, above, that BT, as a Dominant Provider, has significant market power in, amongst others, the following markets in the United Kingdom, excluding the Hull Area:
 - i. wholesale analogue exchange line services
 - ii. wholesale ISDN2 exchange line services
3. At Annex 8 to the review referred to in paragraph 1 Ofcom made a direction under section 49 of the Communications Act 2003 and SMP Condition AAA7 requiring BT to publish and provide specified information relating to wholesale line rental key performance indicators ('KPIs') in respect of the markets referred to in paragraph 2(i) and (ii), above.
4. BT (through Openreach) further undertook to voluntarily produce the same information in relation to their ISDN30 product.
5. On [date of final statement] Ofcom concluded its [Title: *Review of the retail and wholesale ISDN30 markets*] in which it identified markets, made market power determinations and set appropriate SMP conditions as set out in the Notification at Annex [X] to the review, and explained in the accompanying explanatory statement.
6. Ofcom determined in the review referred to in paragraph 5, above, that BT, as a Dominant Provider, has significant market power in the markets in wholesale ISDN30 exchange line services market the United Kingdom, excluding the Hull Area.
7. SMP service Condition AAA(IS)7 (Transparency as to quality of service) was set in relation to, amongst others, the market referred to in paragraph 6.
8. This direction concerns matter to which Condition AAA(IS)7 relates by imposing the same reporting requirements on the ISDN30 market as were imposed, by the direction referred to in paragraph 3 above, on the wholesale analogue and ISDN2 exchange line services markets.
9. For the reasons set out in Section [X] of the explanatory statement accompanying this modification, Ofcom is satisfied that, in accordance with section 49(2) of the Act, this modification of the Direction is:

- i. objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;
 - ii. not such as to discriminate unduly against particular persons or against a particular description of persons;
 - iii. proportionate to what it is intended to achieve; and
 - iv. in relation to what it is intended to achieve, transparent.
10. For the reasons set out in Section [X] of the explanatory statement accompanying this modification, Ofcom is satisfied that it has acted in accordance with the relevant duties set out in sections 3 and 4 of the Act.
 11. Ofcom has considered every representation about the proposed modification of the Direction duly made to it and the Secretary of State has not notified Ofcom of any international obligation of the United Kingdom for this purpose.

Direction

12. Ofcom hereby, pursuant to section 49 of the Act and Condition AAA(IS)7, as set out in the Notification at Annex [X] of the accompanying explanatory statement, directs the Dominant Provider to act as prescribed in paragraphs 13 to 18 below:
13. The Dominant Provider shall publish the information specified in Parts 1 and 2 of Annex A to this Direction in relation to the provision of Wholesale ISDN30 Line Rental, as required in paragraph 16 below.
14. The Dominant Provider shall provide to individual Third Parties the information specified in Parts 1 and 2 of Annex A to this Direction in relation to the provision of Wholesale ISDN30 Line Rental, as required in paragraph 16 below.
15. The Dominant Provider shall provide to Ofcom, by means of electronic mail to such person in Ofcom as notified from time to time, the information specified in Parts 1 and 2 of Annex A to this Direction in relation to the provision of Wholesale ISDN30 Line Rental, as required in paragraph 16 below.
16. The information required by paragraphs 13, 14 and 15 above shall be published and provided as required by the Dominant Provider within 14 Working Days of the last Working Day of every month in respect of that month.
17. Annex A to this Direction forms part of the Direction.
18. Nothing in this Direction shall require the Dominant Provider to publish confidential information relating to its business or that of a Third Party.
19. For the purpose of interpreting this Direction the following definitions shall apply:

“Act” means the Communications Act 2003;

“Committed Order” means an Order which has passed validation and has been registered on the Dominant Provider’s operational support system and a Contract Delivery Date has been confirmed;

“Completed Order” means an Order which has been provisioned and for which all other related work has been carried out;

“Contract Delivery Date” means the date agreed between the Dominant Provider and a Third Party for an Order to become a Completed Order;

“Dominant Provider” means British Telecommunications plc, whose registered company number is 1800000, and any British Telecommunications plc subsidiary or holding company, or any subsidiary of that holding company, all as defined by Section 1159 of the Companies Act 2006;

“Exchange Line” means Apparatus comprised in the Dominant Provider’s Electronic Communications Network and installed for the purpose of connecting a telephone exchange run by the Dominant Provider to a Network Termination Point comprised in Network Termination and Testing Apparatus installed by the Dominant Provider for the purpose of providing Electronic Communications Services at the premises at which the Network Termination and Testing Apparatus is located;

“Fault” means a degradation or problem or with Wholesale ISDN30 Line Rental which is identified by the Dominant Provider or a Third Party and which is registered on the Dominant Provider’s operational support system;

“Hull Area” means the area defined as the ‘Licensed Area’ in the license granted on 30 November 1987 by the Secretary of State under section 7 of the Telecommunications Act 1984 to Kingston upon Hull City Council and Kingston Communications (Hull) plc;

“Installed Base” means the average number of Wholesale ISDN30 Line Rental lines that are in use during the Reporting Period;

“ISDN” means the integrated services digital network which is an Electronic Communications Network evolved from the telephony integrated digital network that provides for digital end-to-end connectivity to support a wide range of Public Electronic Communications Services, including voice and non-voice service to which End Users have access by a limited set of standard multi-purpose customer interfaces;

“KPI” means key performance indicator;

“Level 1 Care” means the level of care provided by the Dominant Provider which provides the standard level of response to a Fault on an Exchange Line, provided as part of the basic line rental;

“Level 2 Care” means the level of care provided by the Dominant Provider which provides an enhanced level of response to a Fault on an Exchange Line, guaranteeing a response within a specified time;

“Level 3 Care” means the level of care provided by the Dominant Provider which provides an enhanced level of response to a Fault on an Exchange Line, guaranteeing a response within a specified time and providing cover 24 hours per day, seven days a week including public and bank holidays;

“Newly Provisioned Lines” means an Order where any Wholesale ISDN30 Line Rental product/Exchange Line Service is not being provided by the Dominant Provider to the Third Party at the time of order;

“Order” means a request for ISDN30 Wholesale Line Rental submitted to the Dominant Provider by a Third Party;

“Pending Order” means an Order which has been approved by the Dominant Provider and is awaiting a Contractual Delivery Date;

“Rejected Order” means an Order which cannot be placed by the Dominant Provider on its operational support system;

“Reporting Period” means the month in respect of which the Dominant Providers required to publish or provide to Ofcom as required the Wholesale ISDN30 Line Rental KPIs;

“Restored Service” means the point at which the Wholesale ISDN30 Line Rental in relation to which a Fault was registered becomes available again for use by the Third Party;

“Scheduled Outages” means the defined periods of time whereby the Dominant Provider’s operational support system is not available for use by Third Parties in order for the Dominant Provider to perform certain tasks including, but not limited to, routine maintenance, changing configurations, software upgrades and updating facilities and may include specific maintenance activities whereby the Dominant Provider must have given as much notice as reasonably practicable and in any event not less than seven calendar days;

“Third Party” means either:

- i. a person providing a Public Electronic Communications Network; or
- ii. a person providing a Public Electronic Communications Service;

“Transferred Lines” means an Order where Wholesale ISDN30 Line Rental is being provided to the Third Party by another Third Party (including those provided by the Dominant Provider) at the time of order;

“Wholesale ISDN30 Line Rental” means an Electronic Communications Service provided by the Dominant Provider to a Third Party for the use and Ordinary Maintenance of an ISDN30 Exchange Line;

“WLR line rental package” includes a package containing a line rental charge and any included levels of service sold as part of a single marketed product.

“Working Day” means any day other than Saturdays, Sundays, public holidays or bank holidays in the United Kingdom.

20. Except insofar as the context otherwise requires, words or expressions shall have the meaning assigned to them and otherwise any word or expression shall have the same meaning as it has in the Act, or if it has no meaning there, in Part 1 of Schedule 1 to the Notification.
21. For the purpose of interpreting this Direction:
 - i. headings and titles shall be disregarded; and
 - ii. the Interpretation Act 1978 shall apply as if this Direction were an Act of Parliament.
22. This Direction shall take effect on the day it is published.

[SIGNATURE]

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

[DATE OF STATEMENT]

Annex A

Wholesale ISDN30 Line Rental KPIs

Part 1: Indicators

1. The Dominant Provider shall publish the information required in KPIs (i) to (viii) below in relation to the provision of Wholesale ISDN30 Line Rental, in at least the detail outlined below:
 - a) an industry average (for the avoidance of doubt this includes provision by the Dominant Provider to itself where it does so).
2. The Dominant Provider shall also publish the information required in KPIs (ii) to (vi) below in relation to the provision of Wholesale ISDN30 Line Rental to itself.
3. In relation to KPIs (ii) to (vi), the Dominant Provider should publish separate KPI results where options exist for third parties to purchase different ISDN30 WLR line rental packages.
4. The Dominant Provider shall provide to Ofcom KPIs (i) to (viii) as described in paragraphs 1, 2 and 3 above by electronic mail to the designated person.
5. The Dominant Provider shall also provide to Ofcom data relating to specific third parties upon request.
6. The Dominant Provider shall provide to each third party, on a confidential basis, the information required in KPIs (i) to (viii) below for that third party.
7. Where the Dominant Provider does not provide Wholesale ISDN30 Line Rental to itself, it shall instead publish or provide as required the information required in relation to the equivalent implicit wholesale product provided by the Dominant Provider to itself in order for it to provide downstream services to End Users.

KPI(i) - Percentage of orders rejected

the percentage of Committed Orders that became Rejected Orders during the Reporting Period;

KPI(ii) - Percentage of orders provisioned on time

the percentage of Completed Orders that were completed by the Contract Delivery Date during the Reporting Period in relation to each of:

- (a) Newly Provisioned Lines; and
- (b) Transferred Lines.

KPI(iii) - Percentage of new provisions reported as faulty

the percentage of Completed Orders that were reported as having a Fault during the Reporting Period whereby that Fault was reported within 30 calendar days of the date that it became a Completed Order;

KPI(iv) - Percentage of Installed Base reported as faulty

the number of network faults at the end of the Reporting Period, measured as a percentage of the mean of the Installed Base;

KPI(v) - Average time to restore service

the average time (in working hours) during the Reporting Period for the Dominant provider to achieve Restored Service after a Fault has been registered in relation to each of:

- (a) Level 1 Care;
- (b) Level 2 Care; and
- (c) Level 3 Care;

KPI(vi) - Percentage of repeat faults

the percentage of Faults that were reported as having a further Fault during the Reporting Period whereby the further Fault was registered within 30 calendar days of the Dominant Provider achieving Restored Service of the previous Fault;

KPI(vii) - Gateway availability (1)

the percentage of actual availability of the Dominant Provider's ordering gateway during the Reporting Period compared to the potential availability during the same period as published by the Dominant Provider, excluding any Scheduled Outages;

KPI(viii) - Gateway availability (2)

the percentage of actual availability of the Dominant Provider's ordering gateway during the Reporting Period compared to the potential availability during the same period as published by the Dominant Provider, including any Scheduled Outages.

Part 2: Volumes

1. The Dominant Provider shall publish the information required in KPIs (i) to (iv) below in relation to the provision of Wholesale ISDN30 Line Rental to all Third Parties (as an aggregate figure which, for the avoidance of doubt includes provision by the Dominant Provider of Wholesale Line Rental to itself);

2. The Dominant Provider shall provide to Ofcom by electronic mail the information required in KPIs (i) to (iv) below in relation to the provision of End User Access to itself. BT shall also provide to Ofcom data relating to specific third parties upon request.

3. Where the Dominant Provider does not provide End User Access to itself, it shall instead publish or provide as required the information required in relation to the equivalent implicit wholesale product provided by the Dominant Provider to itself in order for it to provide downstream services to End Users.

KPI(i) - Volume of orders submitted

the total number of Orders that became Pending Orders during the Reporting Period;

KPI(ii) - Volume of orders completed

the total number of Committed Orders that became Completed Orders during the Reporting Period in relation to each of:

- (a) Newly Provisioned Lines; and
- (b) Transferred Lines;

KPI(iii) - Volume of Installed Base

the Installed Base during the Reporting Period;

KPI(iv) - Volume of faults reported

the number of Faults where the Dominant Provider subsequently achieves Restored Service during the Reporting Period in relation to each of:

- (a) Level 1 Care;
- (b) Level 2 Care; and
- (c) Level 3 Care.

Annex 7

Market review process

Introduction

- A7.1 This Annex provides an overview of the market review process in order to provide additional context and understanding of the matters discussed in the main body of this document, as well as the legal instruments (in the form of 2 statutory notifications) published at Annexes 5 and 6.
- A7.2 Market review regulation is technical and complex, including the legislation and the recommendations and guidelines that will need to be considered as part of the process, of which there may be many depending on the market and/or issues in question. This overview does not purport to give a full and exhaustive account of all such materials that we have considered in reaching our views. Key aspects of materials relevant to this market review are, however, discussed in this document.

Market review concept

- A7.3 The concept of a market review refers to procedures under which we at regular intervals identify relevant markets appropriate to national circumstances, carry out analyses of these markets to determine whether they are effectively competitive and then decide on appropriate remedies (known as SMP obligations or conditions). We explain the concept of SMP (significant market power) below.
- A7.4 In carrying out this work, we act in our capacity as the sector-specific regulator for the UK communications industries, particularly relating to our role as the regulator for electronic communications. Our functions in this regard are to be found in Part 2 of the Act. We exercise those functions within the framework harmonised across the European Union for the regulation of electronic communications by the Member States (known as the “Common Regulatory Framework” or the “CRF”), as transposed by the Act. The applicable rules⁸¹ are contained in a package of five EC Directives, of which two Directives are immediately relevant for these purposes, namely:
- Directive 2002/21/EC on a common regulatory framework for electronic communications networks and services (the “Framework Directive”); and
 - Directive 2002/19/EC on access to, and interconnection of, electronic communications networks and associated facilities (the “Access Directive”).
- A7.5 The Directives require that NRAs (such as Ofcom) carry out reviews of competition in communications markets to ensure that SMP regulation remains appropriate and proportionate in the light of changing market conditions.
- A7.6 Each market review normally has three stages, namely:
- the procedure for the identification and definition of the relevant markets (the market definition procedure);

⁸¹ The Directives have recently been reviewed and amendments were adopted on 19 December 2009. The amendments will need to be transposed into the national legislation by 25 May 2011, and then apply with effect from 26 May 2011.

- the procedure for the assessment of competition in each market, in particular whether the relevant market is effectively competitive (the market analysis procedure); and
- the procedure for the assessment of appropriate regulatory obligations (the remedies procedure).

A7.7 These stages are normally carried out together.

Market definition procedure

- A7.8 The Act provides that, before making a market power determination⁸², we must identify the market, which is, in our opinion, the one which, in the circumstances of the UK, is the market in relation to which it is appropriate to consider making such a determination and to analyse that market.
- A7.9 The Framework Directive requires that NRAs shall, taking the utmost account of the Recommendation on Relevant Product and Service Markets⁸³ and SMP Guidelines⁸⁴ published by the European Commission, define the relevant markets appropriate to national circumstances, in particular relevant geographic markets within their territory, in accordance with the principles of competition law.
- A7.10 The Recommendation identifies a set of product and service markets within the electronic communications sector in which *ex ante* regulation may be warranted. Its purpose is twofold. First, seeking to achieve harmonisation across the single market by ensuring that the same markets will be subject to a market analysis in all Member States. Secondly, providing legal certainty by making market players aware in advance of the markets to be analysed. However, NRAs are able to regulate markets that differ from those identified in the Recommendation where this is justified by national circumstances taking account of the three cumulative criteria referred to in the Recommendation⁸⁵ (the “three-criteria test”) and where the European Commission does not raise any objections.
- A7.11 The fact that an NRA identifies the product and service markets listed in the Recommendation or, where they differ, meets the three-criteria test does not mean that regulation is warranted. Market definition is not an end in itself but is a means of assessing effective competition. The three-criteria test is also different from the SMP assessment because the test’s focus is on the general structure and market characteristics.

⁸² The market power determination concept is used in the Act to refer to a determination that a person has SMP in an identified services market.

⁸³ Commission Recommendation of 17 December 2007 on relevant product and service markets within the electronic communications sector susceptible to *ex ante* regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communication networks and services.

⁸⁴ Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services (2002/C 165/03).

⁸⁵ The Recommendation states that, “[w]hen identifying markets other than those set out in the Annex, national regulatory authorities should ensure that the following three criteria are cumulatively met: (a) the presence of high and non-transitory barriers to entry. These may be of a structural, legal or regulatory nature; (b) a market structure which does not tend towards effective competition within the relevant time horizon. The application of this criterion involves examining the state of competition behind the barriers to entry; (c) the insufficiency of competition law alone to adequately address the market failure(s) concerned.”

- A7.12 The relationship between the market definitions identified in this review and those listed in the Recommendation is discussed in Sections 4 and 6 of this document.
- A7.13 The SMP Guidelines make clear that market definition is not a mechanical or abstract process. It requires an analysis of any available evidence of past market behaviour and an overall understanding of the mechanics of a given sector. As market analyses have to be forward-looking, the Guidelines state that NRAs should determine whether the market is prospectively competitive, and thus whether any lack of effective competition is durable, by taking into account expected or foreseeable market developments over the course of a reasonable period. They clarify that NRAs enjoy discretionary powers which reflect the complexity of all the relevant factors that must be assessed (economic, factual and legal) when identifying the relevant market and assessing whether an undertaking has SMP.
- A7.14 The SMP Guidelines also describe how competition law methodologies may be used by NRAs in their analyses. In particular, there are two dimensions to the definition of a relevant market: the relevant products to be included in the same market and the geographic extent of the market. Ofcom's approach to market definition follows that used by the UK competition authorities, which is in line with the approaches adopted by the European Commission.
- A7.15 While such methodologies are being used in identifying the *ex ante* markets, they will not necessarily be identical to markets defined in individual competition law cases. This may be the case, especially as the former is based on an overall forward-looking assessment of the structure and the functioning of the market under examination. Accordingly, the economic analysis carried out for the purpose of this review, including the identified markets, is without prejudice to any analysis that may be carried out in relation to any investigation pursuant to the Competition Act 1998 (relating to the application of the Chapter I or II prohibitions or Article 81 or 82 of the EC Treaty) or the Enterprise Act 2002.

Market analysis procedure

Effective competition

- A7.16 The Act requires that, at such intervals as we consider appropriate, we carry out market analyses of identified markets for the purpose of making or reviewing market power determinations. In any event, such analyses are to be carried out as soon as reasonably practicable after recommendations are made by the European Commission that affect matters that were taken into account, or could have been taken into account, in the case of our last analysis of that market.
- A7.17 In carrying out a market analysis, the key issue for an NRA is to determine whether the market in question is *effectively competitive*. The 27th recital to the Framework Directive clarifies the meaning of that concept. Namely, “[it] is essential that *ex ante* regulatory obligations should only be imposed where there is not effective competition, i.e. in markets where there are one or more undertakings with significant market power, and where national and Community competition law remedies are not sufficient to address the problem”.
- A7.18 The definition of SMP is equivalent to the concept of dominance as defined in competition law. The Framework Directive requires, however, that NRAs must carry out market analysis taking the utmost account of the SMP Guidelines. The latter emphasise that NRAs should undertake a thorough and overall analysis of the

economic characteristics of the relevant market before coming to a conclusion as to the existence of significant market power.

- A7.19 In that regard, the SMP Guidelines set out, additionally to market shares, a number of criteria that can be used by NRAs to measure the power of an undertaking to behave to an appreciable extent independently of its competitors, customers and consumers, including (a) overall size of the undertaking; (b) control of infrastructure not easily duplicated; (c) technological advantages or superiority; (d) absence of or low countervailing buying power; (e) easy or privileged access to capital markets/financial; (f) resources; (g) product/services diversification (e.g. bundled products or services); (h) economies of scale; (i) economies of scope; (j) vertical integration; (k) highly developed distribution and sales network; (l) absence of potential competition; and (m) barriers to expansion. A dominant position can derive from a combination of these criteria, which taken separately may not necessarily be determinative.

Sufficiency of competition law

- A7.20 As part of our overall forward-looking analysis, we also assess whether competition law by itself (without *ex ante* regulation) is sufficient to address the competition problems identified. Aside from the need to address this issue as part of the three-criteria test, we normally also conclude on this matter in dealing with the appropriate remedies which, as explained below, are based on the nature of the problems we identify. We always consider the option of no *ex ante* regulation, while noting that the SMP Guidelines clarify that, if NRAs designate undertakings as having SMP, they must impose on them one or more regulatory obligations.
- A7.21 In considering this matter, we bear in mind the specific characteristics of communications markets. Generally, the case for *ex-ante* regulation in communications markets is based on the existence of market failures, which, by themselves or in combination, mean that competition might not be able to become established, if the regulator relied solely on its *ex-post* competition law powers that are established for dealing with more conventional sectors of the economy. Therefore, it is appropriate for *ex-ante* regulation to be used to address these market failures and any entry barriers that might otherwise prevent effective competition from becoming established. By imposing *ex-ante* regulation that promotes competition, it may be possible to reduce such regulation, as markets become more competitive, and place greater reliance on *ex-post* competition law.
- A7.22 *Ex-post* competition law is also unlikely in itself to bring about effective competition, as it prohibits the abuse of dominance rather than the holding of a dominant position. In contrast, *ex-ante* regulation is normally needed to promote actively the development of competition. *Ex ante* regulation attempts to reduce the level of market power in a market, thereby encouraging effective competition to become established. This is particularly the case when addressing the effects of network externalities, because the network externality effect generally re-enforces a dominant position and, as noted above, under general competition law there is no prohibition on the holding of a position of dominance in itself. Therefore, it is more appropriate to address the impact of network externality through *ex-ante* obligations.
- A7.23 Additionally, unless we consider otherwise in relation to a specific obligation in this review, we generally take the view that *ex ante* regulation is needed to create legal certainty for the markets under review. Linked to that certainty is the fact that the SMP obligations we have identified are required to enable us to intervene in a

timely manner. For some other specific obligations, we generally consider that they are needed as competition law would not remedy the particular market failure or specific clarity and detail of the obligation is required to achieve a particular result.

Remedies procedure

Powers and legal tests

- A7.24 The Framework Directive prescribes what regulatory action NRAs must take depending upon whether or not the market in question has been found effectively competitive. Where a market has been found effectively competitive, NRAs are not allowed to impose SMP obligations and must withdraw such obligations where they already exist. On the other hand, where the market is found not effectively competitive, the NRAs must identify the undertakings with SMP on that market and then impose appropriate obligations.
- A7.25 NRAs have a suite of regulatory tools at their disposal, as reflected in the Act. Specifically, the Access Directive specifies a number of SMP obligations, including transparency, non-discrimination, accounting separation, access to and use of specific network elements and facilities, price control and cost accounting. When imposing a specific obligation, the NRA will need to demonstrate that the obligation in question is based on the nature of the problem identified, proportionate and justified in the light of the policy objectives as set out in Article 8 of the Framework Directive.
- A7.26 Additional requirements may also apply depending on the SMP obligation in question, such as for price controls where the NRA's market analysis must indicate that the lack of effective competition means that the operator concerned might sustain prices at an excessively high level, or apply a price squeeze, to the detriment of end-users. In that instance, NRAs must take into account the investment made by the operator and allow him a reasonable rate of return on adequate capital employed, taking into account the risks involved, as well as ensure that any cost recovery mechanism or pricing methodology that is mandated serves to promote efficiency and sustainable competition and maximise consumer benefits.
- A7.27 To the extent relevant to this review, we demonstrate the application of these requirements to the SMP obligations in question at Section 8, 9 and 10 of this document. As part of that application, we also show for each and every SMP obligation why it satisfies the test that the obligation is: (a) *objectively justifiable* in relation to the networks, services, facilities, apparatus or directories to which it relates; (b) *not such as to discriminate unduly* against particular persons or against a particular description of persons; (c) *proportionate* to what the condition or modification is intended to achieve; and (d) in relation to what it is intended to achieve, *transparent*.
- A7.28 In so doing, we also set our assessment of how, in our opinion, the performance of our general duties under section 3 of the Act is secured or further by our regulatory intervention, and acted in accordance with the six Community requirements in section 4 of the Act. This assessment is also relevant to our assessment of the likely impact of implementing our proposals. A number of specific points should be noted in this regard.

Section 3 – Ofcom’s general duties

- A7.29 Under the Act, our principal duty in carrying out functions is to further the interests of citizens in relation to communications matters and to further the interests of consumers in relevant markets, where appropriate by promoting competition.
- A7.30 In so doing, we are required to secure a number of specific objectives and to have regard to a number of matters set out in section 3 of the Act. As to the prescribed specific statutory objectives in section 3(2), we consider that the objective of securing the availability throughout the UK of a wide range of electronic communications services is particularly relevant to this review.
- A7.31 In performing our duties, we are also required to have regard to a range of other considerations, as appear to us to be relevant in the circumstances. In this context, we consider that a number of such considerations are relevant, namely:
- the desirability of promoting competition in relevant markets; and
 - the desirability of encouraging investment and innovation in relevant markets.
- A7.32 We have also had regard to the principles under which regulatory activities should be transparent, accountable, proportionate, consistent, and targeted only at cases in which action is needed, as well as the interest of consumers in respect of choice, price, quality of service and value for money.
- A7.33 Ofcom has, however, a wide measure of discretion in balancing its statutory duties and objectives. In so doing, we have taken account of all relevant considerations, including responses received during our consultation process, in reaching our conclusions.

Section 4 – European Community requirements for regulation

- A7.34 As noted above, our functions exercised in this review fall under the CRF. As such, section 4 of the Act requires us to act in accordance with the six European Community requirements for regulation.
- A7.35 In summary, these six requirements are:
- to promote competition in the provision of electronic communications networks and services, associated facilities and the supply of directories;
 - to contribute to the development of the European internal market;
 - to promote the interests of all persons who are citizens of the European Union;
 - to take account of the desirability of Ofcom’s carrying out of its functions in a manner which, so far as practicable, does not favour one form of or means of providing electronic communications networks, services or associated facilities over another, i.e. to be technologically neutral;
 - to encourage, to such extent as Ofcom considers appropriate for certain prescribed purposes, the provision of network access and service interoperability, namely securing efficient and sustainable competition and the maximum benefit for customers of communications providers;

- to encourage compliance with certain standards in order to facilitate service interoperability and secure freedom of choice for the customers of communications providers.

A7.36 We considered that the first and fifth of those requirements are of particular relevance to the matters under review and that no conflict arises in this regard with those specific objectives in section 3 that we consider are particularly relevant in this context.

Section 7 – Impact assessment

- A7.37 The analysis presented in the whole of this document represents an impact assessment, as defined in section 7 of the Act.
- A7.38 Impact assessments provide a valuable way of assessing different options for regulation and showing why the preferred option was chosen. They form part of best practice policy-making. This is reflected in section 7 of the Act, which means that generally Ofcom has to carry out impact assessments where its proposals would be likely to have a significant effect on businesses or the general public, or when there is a major change in Ofcom's activities. However, as a matter of policy Ofcom is committed to carrying out and publishing impact assessments in relation to the great majority of its policy decisions. For further information about Ofcom's approach to impact assessments, see the guidelines, Better policy-making: Ofcom's approach to impact assessment, which are on the Ofcom website:
http://www.ofcom.org.uk/consult/policy_making/guidelines.pdf
- A7.39 Specifically, pursuant to section 7, an impact assessment must set out how, in our opinion, the performance of our general duties (within the meaning of section 3 of the Act) is secured or furthered by or in relation to what we propose.
- A7.40 Ofcom is separately required by statute to assess the potential impact of all our functions, policies, projects and practices on race, disability and gender equality. Equality impact assessments (EIAs) also assist us in making sure that we are meeting our principal duty of furthering the interests of citizens and consumers regardless of their background or identity. Unless we otherwise state in this document, it is not apparent to us that the outcome of our review is likely to have any particular impact on race, disability and gender equality. Specifically, we do not envisage the impact of any outcome to be to the detriment of any group of society.
- A7.41 Nor are we envisaging any need to carry out separate EIAs in relation to race or gender equality or equality schemes under the Northern Ireland and Disability Equality Schemes. This is because we anticipate that our regulatory intervention will affect all industry stakeholders equally and therefore not have a differential impact in relation to people of different gender or ethnicity, on consumers in Northern Ireland or on disabled consumers compared to consumers in general. Similarly, we are not envisaging making a distinction between consumers in different parts of the UK or between consumers on low incomes. Again, we believe that our intervention will not have a particular effect on one group of consumers over another.

Regulated entity

- A7.42 The power in the Act to impose an SMP obligation by means of an SMP services condition provides that it is to be applied only to a 'person' whom we have determined to be a 'person' having SMP in a specific market for electronic

communications networks, electronic communications services or associated facilities (i.e. the ‘services market’).

- A7.43 The Framework Directive requires that, where an NRA determines that a relevant market is not effectively competitive, it shall identify ‘undertakings’ with SMP on that market and impose appropriate specific regulatory obligations. For the purposes of EC competition law, ‘undertaking’ includes companies within the same corporate group (*Viho v Commission Case C-73/95 P [1996] ECR I-5447*), for example, where a company within that group is not independent in its decision making.
- A7.44 We consider it appropriate to prevent a dominant provider to whom a SMP service condition is applied, which is part of a group of companies, exploiting the principle of corporate separation. The dominant provider should not use another member of its group to carry out activities or to fail to comply with a condition, which would otherwise render the dominant provider in breach of its obligations.
- A7.45 Accordingly, we are seeking to apply the SMP conditions as relevant to BT and KCOM and we have defined each company as including any of its subsidiaries or holding companies, or any subsidiary of such holding companies (as defined by section of 1159 of the Companies Act 2006).