



Fixed Narrowband Retail Services Markets

Identification of markets and
determination of market power

Statement

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Section 1

Summary

Introduction

- 1.1 On 19 March 2009, we published a consultation document setting out the initial findings of our review of the state of competition in the retail narrowband telephony markets, which cover analogue and digital (ISDN) telephone lines, and calls for consumers¹ and businesses (the “March Consultation”).²
- 1.2 We have now completed our review. Our conclusions are that most of the UK retail markets, with the exception of Hull, are now effectively competitive and, specifically, BT no longer has significant market power (“SMP”) in the provision of retail fixed narrowband analogue access and retail calls markets in either the residential or business sectors. While we consider that BT still has SMP in the retail ISDN2 market, we consider that it is appropriate to rely solely on wholesale remedies in this market as the existing retail remedies no longer offer additional benefits to the downstream competitive process. We have decided that we need to undertake a further review of the ISDN30 market before we conclude on whether or not this remains an appropriately defined market and, if so, whether it is effectively competitive.
- 1.3 These decisions represent the next stage in a process of deregulation at the retail level, which has been supported by changes to the regulation of BT’s wholesale services. In 2006, we lifted retail price controls, given the improvement in competition in the market.
- 1.4 We consider that this deregulation will lead to a further increase in competition in these retail markets. BT will be able to more freely compete in the supply of bundles of services which include fixed telephony together with other telecommunications service such as mobile communications, broadband and television. This should ensure that competition will continue to lead to enhancement in services and greater value for money for consumers.
- 1.5 Our decisions do not, however, affect BT’s continued universal service obligations under the Universal Service Order (“USO”) to provide basic telephony services (including access) . Equally, Ofcom will continue to regulate the retail activities of BT, on an equal basis with other Communications Providers, through other sector regulations³. We will continue to monitor consumers’ experience of these services and will intervene, if appropriate.

Background

- 1.6 When we last reviewed these market in 2003⁴, we found that BT had SMP in almost all the fixed narrowband markets in the UK (excluding Hull)), while Kingston Communications had SMP in all the fixed narrowband retail services markets in the Hull area⁵. We decided that SMP remedies were essential to ensure that BT and Kingston could not use their SMP to the disadvantage of other Communications Providers,

¹ Throughout the document we will normally use consumers to refer to residential consumers

² http://www.ofcom.org.uk/consult/condocs/retail_markets/fnrsm_condoc.pdf

³ Communications Act general conditions and general consumer protection legislation / regulations,

⁴ Fixed Narrowband Retail Services Market

(http://www.ofcom.org.uk/static/archive/oftel/publications/eu_directives/2003/fix_narrow_retail0803.pdf)

⁵ The exception was BT was not found to have SMP for international business calls

consumers or both. As a result, we set retail controls for BT and Kingston (now KCOM)⁶.

- 1.7 Since the 2003 review, Ofcom has instigated a number of measures to enhance competition in the retail markets. The aim has been to encourage real competition for the benefit of consumers and businesses; and a reduction in BT and KCOM's market power in retail and wholesale services. This has included:
- the development of a set of appropriately priced wholesale narrowband services;
 - agreement with BT of a set of Undertakings⁷ which included the creation of Openreach (the functional separate organisation within BT providing wholesale access services); and
 - the development of equivalence of inputs for the wholesales services for both BT and other Communications Providers, supporting the delivery of services to households and businesses.
- 1.8 As a result of these developments and the improved state of competition they supported, we decided to remove the retail price controls on BT in 2006⁸. The following year, we relaxed retail access remedies for businesses with telecoms spend over £1M pa on the basis other Communications Providers could compete with BT on an equal footing using wholesale line rental ("WLR").⁹

Lack of SMP for BT in the retail analogue access and calls markets

- 1.9 Several of BT's competitors argued against our proposals. In summary, they argued BT continued to have SMP for the following reasons:
- BT maintains high market shares in these markets;
 - BT's competitors face continued barriers to entry and growth;
 - BT's profitability suggests continued significant market power;
 - switching activity has slowed;
 - BT has introduced new automatic roll-over contract terms for their residential customers that could inhibit consumer switching¹⁰ going forward; and
 - potential changes to migration processes currently being discussed could inhibit switching.
- 1.10 We are fully aware of the importance of these matters. Our proposals in the March Consultation took them into account and we have closely looked at them again in light of the responses received. However, we still consider that the empirical evidence demonstrates that ease of competitive entry, lack of barriers to growth, access to wholesale services and customer awareness of choice has substantially changed the nature of retail competition in these markets in the last few years.
- 1.11 Our overall analysis of the economic characteristics of these retail markets is therefore that BT no longer has SMP in any of them. Accordingly, we have concluded that these

⁶ Kingston Communications is now operating as KCOM Ltd, though trades in Hull as Kingston Communications.

⁷ Strategic Review of Telecommunications (http://www.ofcom.org.uk/consult/condocs/statement_tsr/)

⁸ Retail Price Control (<http://www.ofcom.org.uk/consult/condocs/retail/prc.pdf>)

⁹ Wholesale line rental ("WLR") is a regulated wholesale service provided by BT which allows other communications providers to offer telephone line access.

¹⁰ BT have had automatic roll-over contracts for businesses for some time.

markets are effectively competitive already at this stage. In carrying out our regulatory task for these market analyses prospectively, we also consider that on a forward looking basis BT's position in these markets will be further affected by the increased competition that we anticipate will take place, with the result of its market power continuing to decline to a material degree.

- 1.12 We are required under the EU regulatory framework to carry out regulatory tasks, such as market analysis, to achieve the policy objectives set out in Article 8 of the Framework Directive, such as to promote competition. We note that, in addition to an overall assessment of the above-mentioned factors (economically, factually and legally), there is evidence that continued regulation provides little benefit to consumers and may now be constraining competition. BT's competitors may have so far benefited from apparent restrictions in BT's ability to compete in retail markets.
- 1.13 For residential customers these restrictions have stopped BT from being able to freely price product bundles which include both SMP and non SMP services.
- 1.14 For business customers, these restrictions did not allow the development of tailored service packages.
- 1.15 With most¹¹ of these restrictions now removed, competition for customers should intensify.

Competition in Hull

- 1.16 We have concluded that KCOM still has SMP in all the narrowband retail markets in Hull. However, we consider that there are grounds for future further review of the application of the remedies we have imposed on KCOM, for both the residential and business markets.
- 1.17 With respect to the residential markets we are concerned that, in the absence of competition, residents of Hull will not have access to emerging trends in bundled services, allowing both savings through the purchase of multiple products and future innovation in service offerings.
- 1.18 We propose to discuss with KCOM options for the development of new bundled services, subject to controls commensurate with the SMP KCOM continues to hold.
- 1.19 With respect to the business markets, we accept that there is some evidence that the access of larger businesses to narrowband services provided through leased lines may mean that KCOM has market power in this segment of the market has reduced. We propose to undertake further examination of this market segment to determine whether it is appropriate to modify or suspend the application of some of KCOM SMP conditions for a sub-group of their business customers.

Impact assessment

- 1.20 We have undertaken impact and equality assessments in our review, the results of which we set out in the March Consultation. In light of our market power determinations that BT no longer has SMP in most retail markets, we have no option but to withdraw all regulatory SMP obligations applying to BT in those markets. As pointed out in the March Consultation, there should be a net benefit to consumers as a result of the changes we

¹¹ BT will still be subject to universal service obligations and some of the wholesale provision by necessity impact on the retail environment.

are implementing. The only significant risk identified is that BT will discriminate against its less active customers. However, we consider BT would find it difficult to substantially exploit this customer group as such customers are not confined to one specific social, economic or demographic grouping.

- 1.21 Also, changes to BT's SMP status and to the SMP remedies in these markets have no impact on BT's universal service obligations, which ensure universal access and the protection of vulnerable consumers.¹²
- 1.22 As regards to BT's SMP in the retail ISDN2 market and KCOM's SMP in its retail markets, we refer to our impact assessment set out in the March Consultation and updated section 7 of this Statement that takes into account the relevant consultation responses.

Summary of conclusions

- 1.23 We conclude that BT (in the UK (excluding Hull)) no longer has SMP in the supply of:
- retail fixed narrowband analogue telephone lines for businesses and consumers;
 - retail fixed narrowband calls for business and consumers.
- 1.24 We have concluded that BT still has SMP in the supply of ISDN2 lines. However, we consider that the current retail remedies are no longer effective and are potentially counterproductive to the development of downstream competition. We have concluded, therefore, that it is appropriate to rely solely on the wholesale remedies for this market.
- 1.25 We have reviewed the retail markets in Hull and concluded that KCOM retains SMP in all retail narrowband markets and that the existing retail remedies should be retained, that is:
- No undue discrimination in the pricing and provision of services;
 - Price publication for all services.
- 1.26 However, the application of these remedies in Hull may be subject to further review.
- 1.27 We have not included our final determination on the ISDN30 market within this statement as we are still reviewing evidence provided on market definition and the competition for both the retail and wholesale markets. We will be consulting further on both the ISDN30 retail and wholesale markets later this year.

Structure of this document

- 1.28 This Statement should be read in conjunction with the March Consultation for the full reasoning of Ofcom's final decisions on the market definitions, market power determinations and the setting of SMP conditions. This is because our conclusions in this Statement are drawn from the analysis and reasons given in the March Consultation and the further consideration we have afforded to each issue after carefully considering each and every response we received to our consultation. This Statement does not therefore repeat all our reasoning, together with related evidence, data and other

¹² We will shortly reviewing of the current USO. We intend to consider whether changes to it are required. We will include an assessment of the extent to which the USO results in a significant net burden upon BT and KCOM, the universal service providers, and the case for alternative funding and procurement models to ensure that USO provision is both effective and proportionate.

information, but instead focuses on issues arising following the consultation and, where appropriate, it presents updated (or revised) data.

1.29 The rest of the document is structured as follows:

- Section 2 explains the purpose of this market review and its relationship with the related wholesale review and other projects; it also introduces the regulatory framework for undertaking this review;
- Section 3 discusses the market and regulatory developments;
- Section 4 sets out our conclusions on the definition of the relevant markets;
- Section 5 sets out our conclusions on the market power analysis for access markets;
- Section 6 sets out our conclusions on the market power analysis for calls markets;
- Section 7 sets out our conclusions and comments on regulatory remedies and the impact assessment raised by stakeholders in their consultation responses; and
- Section 8 summarises our conclusions on market definitions, market power determinations and remedies in light of our duties and the legal tests.

Section 2

Purpose of the review

Introduction

- 2.1 This review forms part of another round of market reviews to consider the state of competition in narrowband retail markets. The objective of this review has been to:
- define and analyse competition in the retail narrowband markets;
 - assess whether any individual company or, if appropriate, set of companies, hold SMP in any of those markets; and if SMP is found
 - determine what *ex ante* remedies are appropriate to address the market power, enhance competition in the markets and protect consumers from the exploitation of market power.
- 2.2 In particular, this review has reconsidered the set of retail markets defined in the first round of market reviews in 2003 and the impact of changes to the remedies that have been imposed on BT and KCOM since that review.
- 2.3 We were required to undertake this market review as part of our commitment to a regular programme of such reviews. However, several other factors supported undertaking the review at this time:
- changes to the EC recommendations have removed the retail fixed calls market from the list of markets suitable for ex ante regulation, calling into question our continued determination in this market. (However, we are required by the Communication Communications Act 2003 (“the Communications Act”) to re-review any market in which we have previously found SMP.);
 - changes to wholesale regulations undertaken in response to the Telecommunications Strategic Review (“TSR”);
 - indications of increased retail competition to fixed networks from mobile networks; and
 - changes to the nature of competition between fixed providers: e.g., a large number of new market entrants some of which are competing on the basis of new sales strategies such as bundling fixed narrowband services with other products and services.

Relationship with the Fixed Narrowband Wholesale Service Market Review and other Related Projects

- 2.4 There is a clear relationship between any analysis of retail markets and the corresponding wholesale markets. Wholesale markets are defined in terms of the retail markets. However, of equal importance is the fact that forward looking analysis of competition in retail markets depends on assumptions regarding the wholesale remedies available to support competition at the retail level.

- 2.5 In recognition of this relationship, we have simultaneously undertaken reviews of the state of competition in the fixed narrowband retail and wholesale services markets. In forming our proposals and conclusions, each review was informed by the proposals and conclusions of the other. In the case of this retail review, we assumed that the wholesale recommendations, ensuring the continued provision of appropriate wholesale access and call origination remedies, are in place. The review also assumed all other existing regulations from other related markets (for example, the Wholesale Local Access market review and the associated local loop unbundling (“LLU”) remedies) remain in place.
- 2.6 The Fixed Narrowband Wholesale Services Market Review considered:
- wholesale narrowband access;
 - call origination and termination; and
 - conveyance and transit markets.
- 2.7 Other related projects include:
- The Network Charge Control: This considers the charge control remedies - for network conveyance and transit, call origination, and call termination – imposed by the Fixed Narrowband Wholesale Services Market Review. We are publishing our conclusions on this review simultaneously with this Statement.
 - Wholesale Line Rental (“WLR”) Charge Control: This considers the charge controls for WLR and related services and its conclusion is expected to be published in the near future.

The Regulatory Framework

- 2.8 The regulatory framework that applies to the issues covered in this document is set out in detail in the March Consultation. However, in summary, the framework is based upon five EU Communication Directives, four of which were implemented into UK law by the Communications Act.
- 2.9 The Communications Act sets out, at section 3, general duties of Ofcom where we must, in carrying out our functions, further the interests of citizens in relation to communications matters and the interests of consumers in relevant markets, where appropriate by promoting competition.
- 2.10 Section 4 of the Communications Act sets out duties of Ofcom for the purpose of fulfilling Community obligations.
- 2.11 Sections 3 and 4 apply across our decision making in this document as we carry out the function of undertaking a market review.
- 2.12 The framework, as implemented by the Communications Act, sets out the procedure to be followed when undertaking market reviews. In particular section 84 of the Communications Act requires us to carry out further analyses of identified markets at appropriate intervals. For reasons summarised at paragraph 2.3 above, we have considered it appropriate to conduct a review of narrowband retail services at this time.
- 2.13 A market review normally has three stages:
- market definition, i.e. the definition of relevant markets;

- market analysis, i.e. the assessment of competition in each market; in particular whether any undertaking has SMP in a given market; and
- remedies, i.e. the assessment of appropriate regulatory obligations where there has been a finding of SMP.

Market Definition

- 2.14 The legal process set out in the legislation on the market definition stage is considered in detail in Annex 7 to the March Consultation. In considering market definitions, we have had regard to the Commission's 2007 review and revision of its Recommendation on relevant product and service markets (the "Recommendation"). The Recommendation identifies markets that may be susceptible to ex ante regulation. In the last review of the Recommendation in 2007, the Commission identified only one market at the retail level as being susceptible to ex ante regulation: access to the public telephone network at a fixed location. Although the Commission has identified that single retail market in its Recommendation, this does not mean that NRAs are not in a position, after analysis of relevant markets, to impose regulatory remedies on those markets where SMP has been found should national circumstances justify it. Equally, if on analysis of the identified market in the Recommendation, an NRA finds that the market is competitive, based upon national circumstances, it would not be appropriate to impose regulatory remedies.
- 2.15 The Recommendation was discussed in Annex 7 to our March Consultation and, in particular, the use of the "three criteria test" is considered. Where a market outside of the list identified by the Commission is considered by an NRA, the Recommendation states that the three criteria test should be applied cumulatively to determine if the market is susceptible to ex ante regulation. The three criteria are:
- Barriers to entry and the development of competition;
 - Dynamic aspects - no tendency toward competition; and
 - Relative efficiency of competition law and complementary *ex ante* regulation.
- 2.16 We have taken the Recommendation into account when identifying markets in this review.

Market Analysis: the criteria for assessing SMP

- 2.17 The legal process set out in the legislation on the market analysis stage was considered in detail in Annex 7 of the March Consultation. In considering market analysis we have taken into account both the Commission Guidelines (Guidelines for market analysis and the assessment of SMP), and guidance produced by Oftel in relation to the criteria to assess effective competition.
- 2.18 The SMP guidelines require NRAs to assess whether the competition in a market is effective (i.e. no operator 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.
- 2.19 It is stressed in the Guidelines that the existence of a dominant position cannot be established on the sole basis of market shares, and that a thorough overall analysis is required before coming to a conclusion on the existence of SMP. Non-exhaustive criteria are suggested to measure the degree of market power held by an undertaking.

- 2.20 Where a market is found to be competitive then no SMP conditions can be imposed. Section 84(4) of the Communications Act requires that any SMP condition in that market, applying to a person by reference to a market power determination made on the basis of an earlier analysis, must be revoked.

Remedies

- 2.21 The legal process set out in the legislation on the remedies stage was considered in detail in Annex 1 of the March Consultation.
- 2.22 Before considering remedies it is also important to consider whether competition law remedies are sufficient to address the identified problems.
- 2.23 Where remedies are proposed they have to comply with section 47(2) of the Communications Act, in that they have to be objectively justifiable, not unduly discriminatory, proportionate and transparent.
- 2.24 In addition section 91(2) requires that SMP conditions being considered at the retail level may only be imposed where conditions at the wholesale level do not allow us to fully perform our section 4 duties in the relevant market.
- 2.25 When considering appropriate remedies we have also taken account of guidance produced by the European Regulators Group (ERG) remedies; "The Common Position on Remedies".

Section 3

Market and regulatory developments

Introduction

- 3.1 This Section summarizes the developments, since 2003, in the retail and wholesale markets that underpin the analysis and conclusions set out in the later sections. In particular, we consider the impact of the Telecommunications Strategic Review, the improvement in wholesale services and equality of input (“EOI”)¹³, the changes to the market from bundling¹⁴ and increased mobile use. This Section provides a broad introduction to these trends which will be considered in more detail in later sections.
- 3.2 We also summarise the conclusions of our review of the impact of the removal of retail price controls (“RPCs”) in 2006 which was set out in the March Consultation.

Background – Previous reviews and strategic framework

2003 Market Review

- 3.3 In 2003 Oftel completed the first round of market reviews linked to the new European Commission directives. This included our reviews on fixed retail narrowband markets potentially subject to ex ante regulation¹⁵.
- 3.4 The outcome of the latter review was a series of SMP determinations for BT and KCOM, in which SMP was found for:
- Nine out of 10 identified retail calls markets (with the exception of business international calls for BT); and
 - All narrowband retail access markets (residential and business analogue markets, ISDN2 residential and business and ISDN30 business)
- 3.5 This determination in turn led to remedies which included (initially):
- The remedies of no undue discrimination and price publication on all SMP services;
 - RPCs with a proposed review in 2006; and
 - The requirement to produce regulatory account on the services covered by the RPCs.

Telecommunications Strategic Review (“TSR”) and withdrawal of the RPCs

- 3.6 In the TSR, Ofcom set out seven principles for the regulation of telecoms markets, including that Ofcom should:
- focus regulation on the deepest levels of infrastructure where competition will be effective and sustainable;

¹³ Equality of Input is a requirement on BT to provide certain wholesale services on an equal basis to both itself and other Communications Providers.

¹⁴ We define bundling in this paper as retail telecommunications service packages which include more than one service type (e.g. narrowband, broadband, television, mobile) at a charge less than the component services would be sold individually.

¹⁵ Fixed Narrowband Retail Services Market
(http://www.ofcom.org.uk/static/archive/oftel/publications/eu_directives/2003/fix_narrow_retail0803.pdf)

- ensure equality of access at those levels; and
- as soon as competitive conditions allow, withdraw from regulation at other levels.

3.7 The subsequent Undertakings volunteered by BT led to the creation of Openreach and EOI in respect of services provided by Openreach to Communications Providers and BT's downstream businesses. These initiatives, combined with the creation of a commercially viable and fully fit for purpose WLR product by BT, fundamentally altered the basis of retail competition. As a consequence in 2006 and 2007 we reconsidered the extent of retail regulation in the residential and business markets respectively:

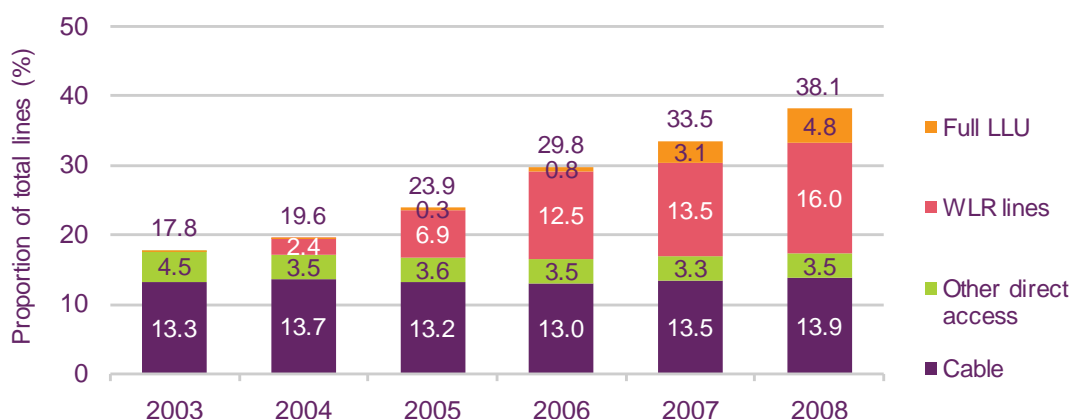
- In 2006 we undertook a review of the RPCs¹⁶. The RPCs were allowed to lapse on the basis that there was now sufficient retail competition, due to the improvement in the wholesale environment, to ensure prices were set at a competitive level. The removal was accompanied by a commitment by Ofcom to a review of the removal of controls which we undertook and set out in Annex 6 to the March Consultation.
- In 2007 following the a review of the replicability of BT's business exchange lines¹⁷, we allowed specified exceptions to SMP retail access remedies for larger businesses (telecoms spend over £1M pa) on the basis that the WLR product was fit for purpose and would allow other Communications Providers to compete fully. The stated intention in this review was that the £1M pa limit was a temporary restriction and that, if it were successful, Ofcom could extend this exemption to cover all business customers. We have had no issues raised by Communications Providers or businesses with respect to these changes. If we were not undertaking this market review at this time, it would in any event be appropriate to consider extending the exceptions to smaller businesses and to the calls market.

Recent market developments

3.8 Since 2003 we have seen a transformation in the competitive environment – for example in the growth in competitive residential and business market retail access providers (using WLR and LLU) – with corresponding impacts on service diversity, price and BT's market share. See Figure 3.1 below.

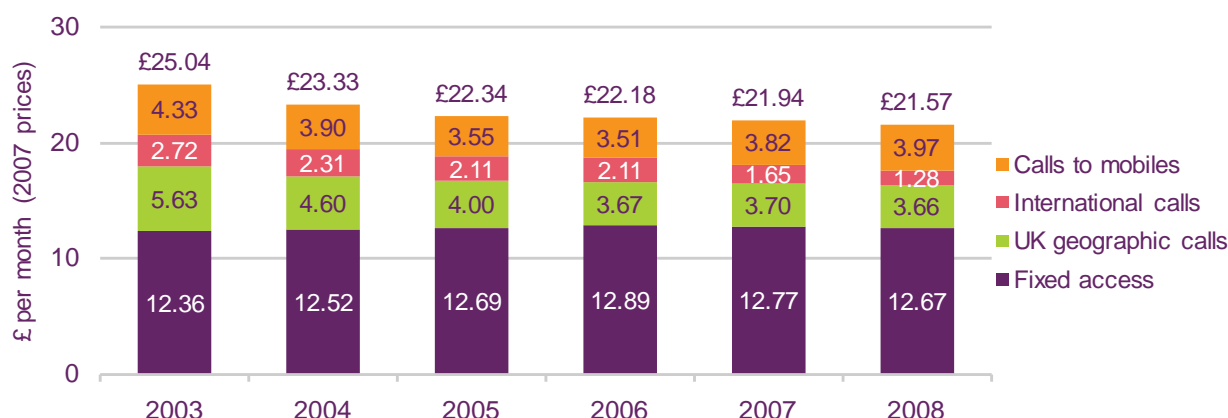
¹⁶ Retail Price Controls (<http://www.ofcom.org.uk/consult/condocs/retail/prc.pdf>)

¹⁷ Consent on business exchange line Replicability, 29 May 2007
(<http://www.ofcom.org.uk/consult/condocs/draftconsent/statement/consent.pdf>)

Figure 3.1**Share of Fixed Lines taking non-BT voice Services**

Source: The Communications Market Report 2009

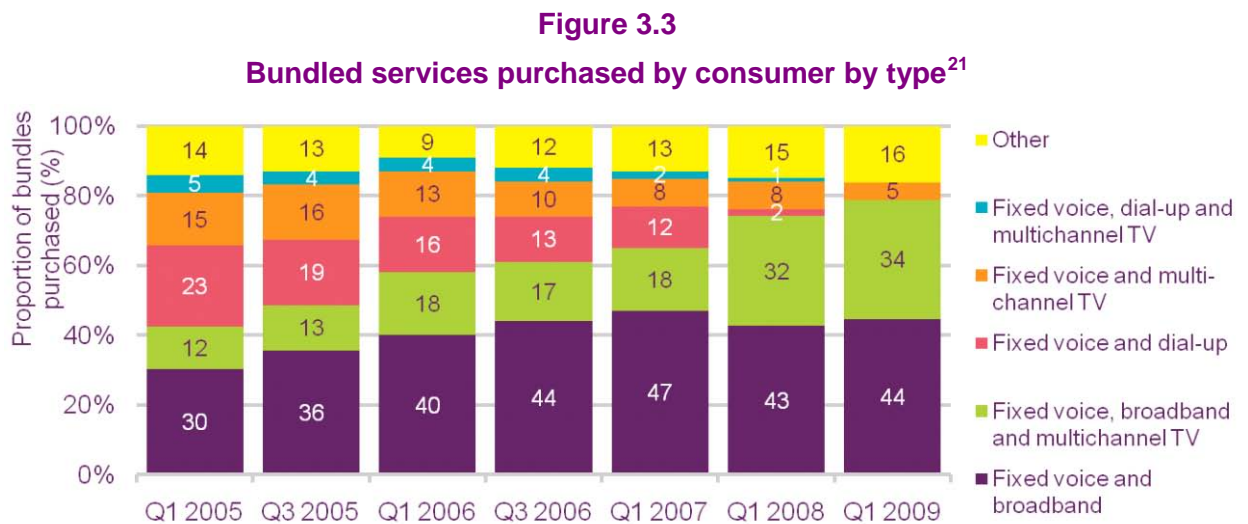
- 3.9 For example, prior to 2004, Carrier Pre-selection (“CPS”) was the only real competitive narrowband option available outside the areas covered by cable. As Figure 3.1 shows there has been a massive increase in access services provided by Communications Providers other than BT, with the trend towards the provision of a complete access package (WLR + CPS¹⁸ or full LLU).
- 3.10 Competition has also led to real savings for consumers. Despite the removal of the retail price controls (discussed below and in Annex 6 to the March Consultation), we have seen a steady decline in the real cost of narrowband services (see Figure 3.2) on a comparable basis.

Figure 3.2**Real cost of a basket of residential fixed narrowband services**

Source: The Communications Market Report 2009

¹⁸ We refer to CPS as a general wholesale service for the provision of calls – in reality Communications Providers can choose between CPS or the alternative BT managed service of BT wholesale calls.

- 3.11 We have also seen a trend towards narrowband services being only one component of a bundle of communications services - including telephony, broadband and pay TV services - with both benefits in terms of convenience and often¹⁹ price to consumers. Approximately 46%²⁰ of individuals now access multiple services from a single supplier, up from 29% in 2005.
- 3.12 As Figure 3.3 shows these single supplier bundles are increasingly being driven by telephony linked to multi-channel TV and/or broadband.
- 3.13 Consumers and businesses are now able to jointly purchase fixed lines and calls services together with broadband access and/or pay television (or even mobile access and calls), at reduced rates (or at times no additional cost). In addition, consumers have seen innovation in packaging of calls and access, with the benefits of predictable monthly budgets and, when chosen appropriately, real cost reductions. We discuss the impact of bundling in more detail in Section 4.



Source: Communications Market Report 2009

- 3.14 We have also seen the continued rise of mobile phone service in terms of mobile's share of call minutes (see Figure 3.4) and, equally, its share of revenue. While we do not yet consider that mobile and fixed narrowband calls are in the same retail market (see Section 4), it is clear that competition from the mobile operators has strongly influenced the nature of the fixed service packages provided.

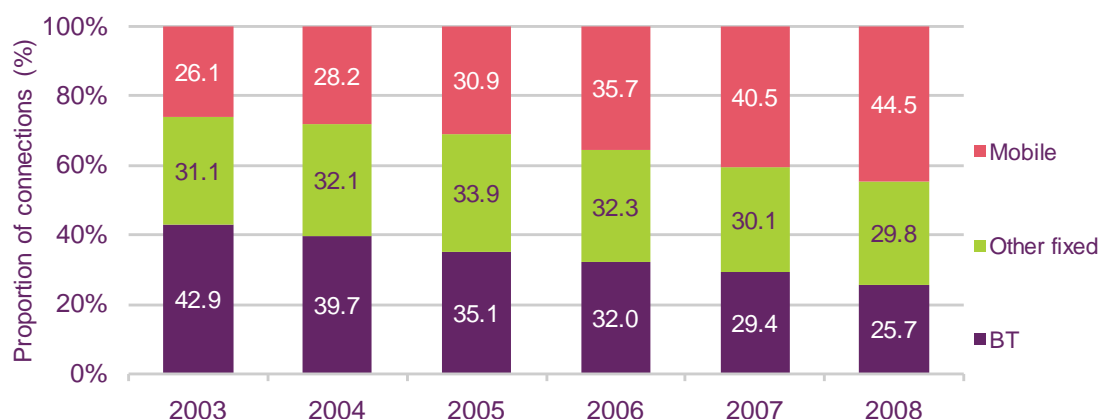
¹⁹ For the purposes of this discussion bundles refers to situations where a consumer takes two or more services from a single supplier, with or without a price discount. In later sections, we sometimes differentiate bundles which include discounts from those that do not.

²⁰ Source: Communications Market Report 2009.

²¹ In this instance a bundled services is taken to be where a consumer takes two or more services from a single supplier, with or without a price discount.

Figure 3.4

Share of total outbound voice call volumes



Source: Communications Market Report 2009

- 3.15 The evidence shows that the narrowband markets have been substantially transformed since the 2003 review. As we will discuss in later Sections, we consider that this transformation has largely eroded BT's market power in the analogue access and calls markets in the UK (excluding Hull).

Impact of removal of the RPCs

- 3.16 In 2003, following the first retail narrowband market reviews, Ofcom confirmed the continuation of RPCs on BT as a remedy for the residential market²². RPCs were weighted such that compliance was judged against the expenditure basket of the bottom eight deciles (by expenditure) of residential customers. In expectation that competition in the market would strengthen, the control included an opportunity to review the remedies in 2006 to determine whether its continuation was required.
- 3.17 The 2006 review concluded that the improvements in the competitive environment for retail services (following the introduction and increased use of WLR in particular) allowed us to deregulate the controls on residential charges, and the RPC was allowed to lapse. However, the review did call for a subsequent analysis of the impact of the removal. This analysis was presented in the March Consultation.
- 3.18 At the time that they were discontinued, the RPCs effectively held average real (volume change excluded) increases in retail prices to zero (i.e. RPI+0%) for consumers in the bottom eight deciles of expenditure. The RPCs did not include the charge for payment by means other than direct debit.
- 3.19 Our analysis, as set out in Annex 6 to the March Consultation, showed that in nominal terms BT prices for the bottom eight deciles has fallen by 0.6%, if the additional charge for non-direct debit is excluded, and risen by 2.2% if the non-direct debit charge is included. This is in a period of inflation of around 4% - thus a reduction in real terms.
- 3.20 Further analysis showed that consumers in the bottom three deciles have experienced greater price reductions with a net reduction of 3.5% (nominal), if the non-direct debit charge is excluded, and an increase of 0.2% if the charge is included. This is a reduction of over 7% in real terms, excluding the non-direct debit charges, and around 3.8% if it was included.

²² This was to be the last in a series of such retail price controls going back to 1984.

- 3.21 On this basis we concluded that that regulatory change has had no negative impact on the market, and consumer outcomes and may have led to the emergence of more flexible pricing structures.

Section 4

Market definitions

Introduction

- 4.1 In this Section we briefly summarise the proposals we made in the March Consultation and stakeholders' comments on our proposals. We then set out our response to those comments and our final decisions.
- 4.2 Stakeholders made a number of substantive comments about our market definition proposals. The key issues raised were:
- the degree of fixed to mobile substitution in the residential markets;
 - fixed to mobile substitution for businesses in Hull;
 - whether a UK (excluding Hull) national market was appropriate given the limits on the LLU roll out and the market conditions in Northern Ireland; and
 - whether our conclusions on the ISDN2 access markets were sound.
- 4.3 Market definition is an important intermediary step in the assessment of whether a firm has SMP. It allows us to consider the competitive constraints imposed by demand and supply-side substitutes, as well as to determine market shares.
- 4.4 As set out in the March Consultation, in defining the relevant markets we followed our standard approach which fully takes into account the relevant guidelines and recommendations published by the Commission. Under this approach relevant product and geographic markets are identified by using the "hypothetical monopolist test". A product is considered to constitute a separate economic market if it would be profitable, for a hypothetical monopoly supplier of the product, to impose a "small but significant non-transitory increase in price" (SSNIP) above the competitive level. If a hypothetical price rise would not be profitable then the market definition should be expanded to include substitute (either demand or supply-side) products.
- 4.5 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 mobile telephones on the fixed market).
- 4.6 Again as set out in the March Consultation, we have chosen to adopt a cautious approach to market definition to support a robust determination of market power. Specifically, where the evidence of substitutability is conclusive, we have amended our previous market definitions, but where the evidence is ambiguous, we retained our previous market definitions while recognising any increased competitive constraint from greater substitutability in our SMP assessment.

Summary of defined markets

- 4.7 In the March Consultation, we defined the following fixed narrowband markets for the UK (excluding Hull):

- Residential Fixed Narrowband Analogue Access;
- Business Fixed Narrowband Analogue Access;
- Residential Fixed Narrowband Calls;
- Business Fixed Narrowband Calls; and
- ISDN2 Access.

(As noted in Section 1, we will be re-consulting on the ISDN30 market for the UK (excluding Hull), later in the year)

For Hull

4.8 In the March Consultation, we defined the following fixed narrowband markets for the Hull area:

- Residential Fixed Narrowband Analogue Access;
- Business Fixed Narrowband Analogue Access;
- Residential Fixed Narrowband Calls;
- Business Fixed Narrowband Calls;
- ISDN2 Access

(As noted in Section 1, we will be re-consulting on the ISDN30 market for the Hull Area, later in the year)

- 4.9 There are clear indications that there is a greater level of mobile competition for calls, and, in addition, bundles of telecommunications products are increasingly being considered as a single purchase. However, we consider that consumers and businesses still make purchasing choices based around the traditional fixed narrowband services.
- 4.10 Equally, while the competitive environment varies throughout the country, for example in Northern Ireland, the evidence suggests that such variations are insufficient to lead us to conclude that there are distinct regional (or sub-regional) geographic market definitions.

The geographic market differentiation

- 4.11 We proposed in the March Consultation that for each individual market the only geographic differentiation was between a UK market (excluding Hull) and a separate Hull market.
- 4.12 Our view was that all major narrowband operators have national uniform pricing policies and national marketing campaigns, so competition on the supply-side of the market has a clear national dimension²³. There is clearly the exception of Hull, where the incumbent provider is KCOM and the main UK based retailers, including BT, do not offer directly competing services at the retail level.
- 4.13 We explained that, while there were some differences in the range of choices available to consumers in different parts of the country (for example whether or not a consumer was able to purchase services provided over cable or from LLU based infrastructure) we considered this did not lead to a substantive difference in the quality or price of the narrowband services.

²³ One caveat is the TalkTalk Group which has certain tariffs which offer lower prices to customers who are able to be served within their LLU footprint.

Consultation responses

- 4.14 One confidential respondent and the Federation of Communications Services (“FCS”) commented on BT’s market share in Northern Ireland and questioned whether it was appropriate to conclude that there was a national market.
- 4.15 FCS noted “the continuing dominance of BT in the retail market in Northern Ireland where BT’s share of, for example, the business market is still over 80%. BT marketing activity in conjunction with the lack of equivalence arising from the decision not to require the introduction of functional separation and specifically the role played by Openreach on mainland UK has led to a curtailment of choice and consequent low levels of customer satisfaction. Ofcom must ensure that this unsatisfactory situation is not compounded by further relaxation of relevant regulation.”
- 4.16 In addition, Sky questioned whether the limitations of the roll out of LLU called into question the existence of a single market.

Ofcom’s response

LLU

- 4.17 Communications Providers use LLU to provide either broadband services (using partial LLU, also known as Shared Metallic Path Facility (“SMPF”)) or bundled voice and broadband services (using full LLU, or Metallic Path Facility (“MPF”)). At the present time Communications Providers are using LLU in c.2,000 of BT’s c.5,600 local exchanges (c.36%). Because Communications Providers have generally elected to use LLU in the larger local exchanges, i.e. those local exchanges that serve the most premises, the circa 2,000 local exchanges where LLU is in use actually covers c.85% of UK premises (this is the LLU footprint).
- 4.18 In the Wholesale Broadband Access market review²⁴ (21 May 2008) we recognised the significant impact LLU roll out has had on broadband competition. However, we consider competition in the narrowband markets does not have the same characteristics as in the broadband markets.
- 4.19 The availability and efficacy of the WLR remedy has been the most significant driver of narrowband competition up to now. It is Communications Providers using WLR who have had the most significant impact on competition in the provision of narrowband services to date. WLR is a national remedy not limited by the technical or financial constraints that apply to LLU.
- 4.20 While we would agree that the addition of LLU and cable supports additional narrowband competition nationally, we do not agree that its absence in some geographic parts of the market means that the characteristics of narrowband competition are fundamentally altered. The characteristics of competition are national – ease of entry, awareness of competition by consumers and common wholesale products.

Northern Ireland

- 4.21 In response to the comments we received about BT’s market share in Northern Ireland we undertook further research into the market for the provision of exchange lines by Communications Providers active in Northern Ireland from January 2008 to May 2009. This research included issuing further formal information requests to key

²⁴ Review of the wholesale access broadband markets (www.ofcom.org.uk/consult/condocs/wbamr07/)

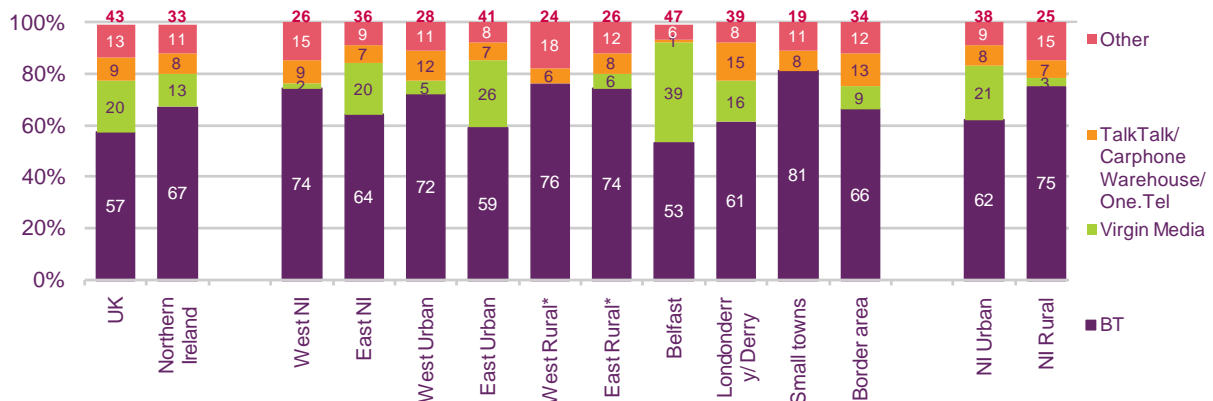
Communications Providers operating in Northern Ireland, information from Openreach on WLR provision in Northern Ireland as well as drawing on market research undertaken for the Communications Market Report 2009²⁵ (and published in that report).

- 4.22 Our research shows there is some difference between the experience in Northern Ireland and the average for the UK as a whole. This to be expected. As the UK is not perfectly uniform, if we were to examine any part of the UK in isolation it would show some differences from the average for the UK as a whole. Specifically Northern Ireland has a greater proportion of rural consumers than the UK, as a whole, and it has a lower proportion of households that can access cable.

Residential markets

- 4.23 BT's market share in Northern Ireland is substantially higher than in the UK as a whole. In the survey reported in the 'Communication Market Report: Northern Ireland'²⁶, 67% of those with a fixed-line phone in Northern Ireland list BT as their supplier. This is 10% higher than the national average in the same survey of 57%.
- 4.24 However, in the Communication Market Report: Northern Ireland in 2008, this proportion was 75%. We have, therefore seen an 8% decline in the last twelve months.
- 4.25 In addition, as Figure 4.1 below shows BT's market share varies significantly between urban and rural consumers (38% and 25% respectively use suppliers other than BT). This split is not inconsistent with England (44%/32%), Scotland (45%/28%) or Wales (34%/23%). For example, in Belfast only around 53% of households take their fixed line services from BT.

Figure 4.1
Fixed-line supplier used



Source: Communications Market Report 2009 (Northern Ireland)

- 4.26 There is also clearly a lag in competing infrastructure roll-out in Northern Ireland. The proportion of homes connected to unbundled exchanges in Northern Ireland was 71% at the end of 2008, compared to the UK average of 84%. However, this was up from 51% at the end of 2007 and the rate of increase is among the highest in the UK.

²⁵ Communications Market Report 2009 (www.ofcom.org.uk/research/cm/cmr09/)

²⁶ Communications Market Report: Northern Ireland 2009 (<http://www.ofcom.org.uk/research/cm/cmnr09/ni/cmnrni.pdf>)

- 4.27 We accept that compared to the UK as a whole BT's market share in Northern Ireland is relatively high. However, over the last year the number of exchange lines provided by other Communications Providers grew by 23%²⁷ (growth from Q1 2008 to Q1 2009). The direction of change in market share indicates that other Communications Providers are actively competing against, and winning market share from, BT in Northern Ireland.
- 4.28 In addition, the basis of competition (and largely pricing) is the same as the rest of the UK. Virgin, and most other national competitors, price on a national basis as does BT.
- 4.29 Overall, residential competition in Northern Ireland may have developed at a slower rate due to geographical factors (e.g. greater proportion of the population living in rural areas) and a slightly slower rate of infrastructure roll out. However, we see limited evidence which suggests that competition is sufficiently different in structure from the rest of the UK to justify Northern Ireland being designated a separate residential market.

Business markets

- 4.30 Our research shows the number of business lines provided by BT in Northern Ireland has fallen, but, up to now, at a slightly lower rate than in the rest of the UK.
- 4.31 The reasons for this appear the same as for residential lines – i.e., differences in the level of urbanisation and slower roll out of infrastructure.
- 4.32 The rate of decline in BT's market share in Northern Ireland is slower than the national average. From January 2008 to May 2009, the number of business exchange lines BT provided in Northern Ireland fell by around 13,000 or 12%, while across the whole of the UK the number of exchange lines provided by BT declined by around 18%. We have information from a sample of Communications Providers who are active in Northern Ireland and the number of exchange lines they provided increased by 17% over the same period.
- 4.33 Based on information from Virgin Media and from BT on external WLR, competing Communications Providers have a market share of 26% at Q1 2009. The direction of change in market share indicates that other Communications Providers are actively competing against, and winning market share from BT in Northern Ireland. Nevertheless it is true that the intensity of competition is somewhat lower than the UK average.
- 4.34 Overall, as with the residential markets, we accept competition in Northern Ireland may have developed at a slower rate due to geographical factors (e.g. greater proportion of the population living in rural areas) and a slightly slower rate of infrastructure roll out. However, again we see only limited evidence which suggests that competition is sufficiently different in structure from the rest of the UK to justify Northern Ireland being designated a separate business market. We also note that other more rural areas of the UK might have witnessed a slower rate of growth for competing Communications Providers.
- 4.35 Given this, we consider it would be inappropriate to undertake a further detailed analysis at a local or regional level in a market characterised by national pricing and national marketing campaigns. Accordingly, with the exception of Hull, we consider that we should define a single geographic market in the UK for all the products in this market review.

²⁷ Based on information from BT on MPF, external WLR lines and Virgin Media.

Fixed and mobile residential access

- 4.36 While there was evidence that there was some substitutability between fixed and mobile access, the greater weight of evidence presented in the March Consultation suggested that consumers predominantly view the two types of access as meeting different needs and have a strong preference to purchase both fixed and mobile access.
- 4.37 We considered that demand for landlines was primarily driven by non-price factors. For example when respondents were asked about their attitudes to having a landline, 62% agreed with the statement “never give up landline – feel secure with one”²⁸, with 44% agreeing with the statement that there is “too much upheaval to get rid of home phone”, 43% stating that “mobile is not reliable enough to drop the landline” and 26% saying that they “only have a landline for internet”.
- 4.38 Our research set out in the March Consultation showed that 78% of the UK adult population chose to have both fixed and mobile access. This has remained broadly constant since 2003 (when it was 79%).
- 4.39 We, therefore, proposed that fixed and mobile access were in separate markets.

Consultation responses

- 4.40 T-mobile agreed with our conclusions with regards to the substitutability between fixed and mobile access. They noted that “It is correct that they should fall into separate markets. Whilst consumers are able to use either device to make voice calls, there are other different aspects of both services which make them very different. In our experience, consumers consider their mobile phone to fulfil different needs to their fixed phone, and vice versa. This is confirmed by the fact that the majority of people purchase both fixed and mobile access as opposed to instead swapping one for another. We do not think that the extent of fixed-mobile substitution is enough to consider them in the same economic market.”
- 4.41 On the other hand, BT noted that they considered that the growth in mobile call minutes has been largely at the expense of fixed call minutes and with “more in-depth analysis, Ofcom would also have been able to disentangle the access and calls relationship in order to be able to identify a similar pattern of substitution in the access markets.”

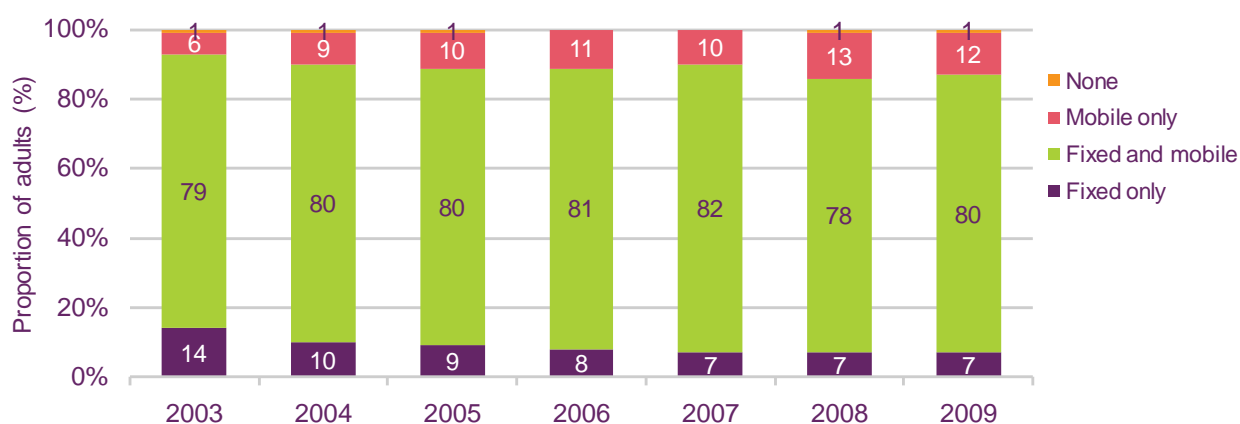
Ofcom’s assessment

- 4.42 We accept, as noted above, that there has been some movement to mobile-only households and that the existence of mobiles does influence the fixed access market.
- 4.43 However, it is clear from our research that consumers currently regard mobile phone and fixed line access as complementary services rather than substitutes. The clearest indicator of this is that the vast majority of consumers buy both fixed and mobile access.
- 4.44 Further evidence that consumers have a preference to purchase both fixed and mobile access can be seen from the fact that the proportion of mobile-only users has experienced a relatively slow rate of growth over the last five years despite a very large fall in the price of mobile services. Between 2003 and 2008 the real price of mobile services declined by an estimated 47% while the price of equivalent fixed line services fell by only 14%. In the same period, mobile-only households grew from around 6% to around 12%, while the proportion of consumers having fixed and mobile access

²⁸ Ranked the statement at 4 or 5 (where 1 means “does not apply” and 5 means “applies a lot”).

remained steady at around 80%. This is consistent with consumers taking advantage of the falling absolute and relative price of mobile phones by increasingly purchasing both mobile as well as fixed access rather than substituting away from fixed lines.

Figure 4.2
Fixed and mobile access



Source: Communications Market Report 2009

- 4.45 We, therefore, consider that it is appropriate to retain a definition of the residential narrowband access market which excludes mobile access.

Mobile and fixed calls markets

- 4.46 In the March Consultation, we acknowledged that the assessment leading to the exclusion of mobile services in the markets under consideration was not clear cut. With 79% of UK consumers having both mobile and fixed line access most customers clearly have a degree of choice as to whether to make a call on their fixed line or mobile. Although there will be circumstances where consumers can either only use a mobile or landline or where they have a strong preference for using one over the other, in general mobile and fixed calls are substitutable for each other.
- 4.47 The situation is made more complex by the different marginal call prices faced by consumers with mobile on the basis of pay-as-you go versus monthly contracts. The latter have far lower marginal costs for calls, within their inclusive bundle, while the former pay-as-you go consumers face quite large marginal costs. In addition, our market research found there was clear differentiation in use of the mobile and fixed lines depending on the call type and the recipient.
- 4.48 Our assessment was that overall, while there is clear evidence of increasing competition from mobile networks for the provision of calls, on balance we did not believe that such competition is sufficiently strong to prevent a hypothetical monopoly supplier of fixed calls raising prices by 5-10%. We, therefore, proposed that fixed calls were likely to remain a relevant economic market and that the market definition should not be extended to include mobile calls. However, we recognised the growing competitive constraint from mobile calls, and took this into account in our SMP assessment.

Consultation responses

- 4.49 Both BT and KCOM were concerned that we had underestimated the extent of fixed mobile substitution. BT pointed to evidence that the recent increase in mobile call

volumes had come partially at the expense of fixed calls. While KCOM noted that they “believe that customers in the Hull area may well demonstrate a greater inclination to substitute fixed calls with mobile calls in the absence of the more extensive choice of fixed line providers available to customers outside of the Hull area. For example, during the period 2005 to 2007, KCOM experienced a 14.5% decrease in volumes of residential geographic, international direct dial and calls to mobile. By comparison annual volumes of the same residential calls for all operators reported in Ofcom’s Telecoms Market Data Tables published in Q4 2006, 2007 and 2008 decreased by only 10%. We believe this is illustrative of an increased tendency by customers in the Hull area to substitute fixed line calls with mobile calls.”

Ofcom’s response

- 4.50 As noted above we accept that there is clear evidence of an increased level of competition from mobiles.
- 4.51 However, it is also clear from the evidence that the degree of substitution between mobile and fixed calls varies considerably depending on the nature of the mobile contract and the nature of the calls made. In addition, pay-as-you-go mobile users, who face higher marginal call costs are likely (on average) to have lower than average incomes, which must suggest caution in extending trends based on usage by those with higher incomes. In addition, average mobile call costs remain substantially higher than the average fixed line cost, although this differential is clearly decreasing, see Figure 4.3.

Figure 4.3
Comparison of mobile and fixed average nominal call costs



Source: Communication Market Report 2009

- 4.52 Given this uncertainty we consider that it is appropriate to take a conservative view of the market boundaries. As discussed in the introduction, the purpose of market definitions is mainly to support analysis of market power. The exclusion of mobile calls from the market sets a higher hurdle, in any analysis, in establishing that that market is effectively competitive. This strengthens the robustness of our finding of no SMP for the UK (excluding Hull).
- 4.53 With respect to Hull, we also accept that in an environment of very limited competition for calls from other fixed providers, there will be greater reliance on mobile. However,

these circumstances would suggest caution in including what may be a second-best substitute as part of a wider calls market.

- 4.54 Accordingly, we consider it is appropriate to retain our proposed narrowband calls market definition, which excludes mobile calls.

Mobile calls and fixed line calls for business users are in different markets in Hull

- 4.55 The March Consultation focused principally on the overall UK business market, rather than specifically at Hull, but there was no evidence to suggest that the attitude of businesses in Hull departed significantly, in this regard, from the UK as a whole. We did, however, use statistical data which was Hull specific.
- 4.56 In the March Consultation we noted that the fall in the volumes of Business fixed calls²⁹ between Q1 2003 and Q2 2008 was substantially in excess of the percentage decline in the number of business analogue exchange lines³⁰. We considered this reflected a number of factors including increased competition from e-mail, voice over broadband, and mobile.
- 4.57 Our survey of SMEs suggested that the fixed mobile substitution element of this fall was limited. For example, of the businesses in our sample, only 68% had mobile phones, and 13% blackberries. Of the total sample, 69% agreed with the statement “we use landline services where possible because they are cheaper than mobile.” In contrast, only 14% of respondents indicated that they generally used mobile phones. Landline calls were also widely perceived to be cheaper than mobile calls apart from calls to mobile phones. For example, 70% believed that landline calls were cheapest for calls to UK landlines, and 82% for international calls.
- 4.58 With calls to mobile numbers often being perceived as being cheaper using a mobile phone, we might expect business calls to mobile to have declined at a faster rate than for calls to geographic numbers as the use of a mobile phone to call other mobile phones is cheaper than fixed to mobile calling. However, fixed calls to mobiles declined at a significantly lower rate than calls to geographic numbers. The most likely explanation for this is that, the call pattern of businesses has changed (for instance email is likely to be a better substitute for a fixed to fixed call than a fixed to mobile call). The data does not, however, provide conclusive evidence that businesses are using mobile phones in place of calling from a landline.

Consultation responses

- 4.59 KCOM stated that “We are also concerned about the extent of the analysis which Ofcom has undertaken in respect of the substitution of fixed calls with mobile by business customers. Ofcom makes the comment that it does not have data of sufficient quality to determine the extent to which business have substituted to mobile while the customer research carried out by Ofcom is largely focused on very small business customers (84% of the SMEs questioned had 1-9 employees). We question how representative Ofcom’s survey sample is in terms of mobile usage by businesses – as Ofcom notes mobile penetration was found to be much higher in the larger companies surveyed with

²⁹ Geographic, international and call to mobile call types.

³⁰ Our recent revision of the statistics suggested that the 58% decline in business fixed calls quoted in the consultation should be increased to a decline of 48%, and the 3% reduction in the number of business analogue exchange lines should be reduced further to 18%. However, the reduction in the volume of calls is still substantially in excess of the decline in lines.

large companies more likely to use a mix of landline and mobile services. As a result we believe that Ofcom's research may well understate the propensity of business customers to substitute mobile calls for fixed line calls."

Ofcom's response

- 4.60 We accept that there are some limits to the extension of our survey data based on SME behaviour to the business markets as a whole. However, while our survey focussed on the SME companies in terms of behaviour, our statistical evidence was based on the totality of business calls.
- 4.61 This statistical evidence suggested that those calls most likely to be made by using mobiles (i.e. calls to other mobiles) were not declining at the same rate as calls overall. While this is not conclusive it suggests that the decline in business call traffic is attributable to a use by businesses of a wide range of a communications tools, such as email, rather than just mobile substitution.
- 4.62 As discussed above, we consider that it is appropriate to be conservative in moving away from a more narrow market definition. For this and the above reasons we therefore believe that the balance of evidence supports the view that fixed business calls is a separate economic market.
- 4.63 However, clearly competition from mobile calls is increasing and we take this into account in our SMP assessment. We are also conscious that there are some other arguments put forward) by KCOM (discussed in the next section that for larger businesses there is an increased level of competition for calls (i.e. using leased lines). We will consider these arguments also in Section 7 in considering the remedies for our SMP findings.

ISDN2 access

- 4.64 In the March Consultation, we reviewed demand and supply side substitution between ISDN2 and either leased lines or analogue access. We also considered ISDN30 but as noted earlier this market will be re-considered in a separate consultation.
- 4.65 We proposed that the market for ISND2 was distinct.

Consultation responses

- 4.66 BT stated that in their view, "ISDN is increasingly in competition with new technologies such as IP-based products. Ofcom's market definition analysis does not sufficiently take into account these forward-looking factors: a proper analysis would show that these new products (broadband and IP based solutions) are growing and are increasingly substitutable for ISDN and, at the very least, are constraining BT's supply and pricing of ISDN products."
- 4.67 BT also stated that the ISDN2 market did not satisfy the EU's three criteria test for ex ante regulation.

Ofcom's response

- 4.68 In the assessment of ISDN2 as a separate and distinct market, we have not ignored the fact that there are some instances where these services are potentially substitutable by alternative technologies.

- 4.69 Broadband has clearly impacted on ISDN2 demand in some areas. Broadband has completely superseded ISDN2 in the residential sector and where internet access is the primary requirement broadband is replacing ISDN2 in the business sector.
- 4.70 However, and as BT has noted in its response to the Wholesale Fixed Narrowband Review, ISDN2 is used for a number of other purposes including point of sale machines, automated teller machines (ATMs) and resilient back-up for other services. Table 4.4 below shows ISDN2 volumes for the past four years, from BT's regulatory accounts:

Table 4.4**ISDN2** ³¹

	2005/6	2006/7	2007/8	2008/9
Total channels	1.515	1.459	1.428	1.299
BT	1.344	1.201	1.081	0.898
Others	0.171	0.258	0.347	0.401

Source: BT Regulatory Accounts

- 4.71 Table 4.4 shows a steady decline in the total number of ISDN2 lines supplied. The total number of ISDN2 channels had decreased by an average of around 4% a year from 2005/6 to 2008/9.
- 4.72 From 2005-2009, the functional differences between broadband and ISDN2 have widened (in terms of speeds available via broadband compared to the maximum 128kb/s available via ISDN2). At the same time, the retail price of broadband has fallen. BT's current retail ISDN2 price is £90.78/qtr versus analogue line plus broadband of £79.80/qtr. If broadband was an effective substitute for most customers, we would expect these trends to have resulted in a much higher rate of substitution.
- 4.73 This suggests broadband does not provide a constraint on the pricing of ISDN2 for all services for which ISDN2 has been used. The advantages of broadband over ISDN2 are likely to be irrelevant for ATMs. Indeed, the key advantage of ISDN2 is that it provides a resilient, secure and high-quality level of service. Users of ISDN2 for this reason may consider that broadband does not provide these features, and as such broadband cannot be considered to be an adequate substitute product. This is supported by a review of recent Openreach documents discussing substitution between ISDN2 and other products.
- 4.74 Another consideration for users is likely to be on-premises equipment. Changing from ISDN2 to an alternative will generally require an investment in alternative transmission equipment. This limits the scope for such alternatives to compete for existing business. So while there may be a relatively greater level of competition for new customers not currently using ISDN2, we consider that there is a large and relatively static set of customers for whom continued use of ISDN2 is the only reasonable approach until such time as their existing equipment needs to be replaced (provided that the alternatives are satisfactory).
- 4.75 We accept that the ISDN2 market is likely to decline steadily over the review period and we accept that there is likely to come a point when alternative technologies will be an effective substitute for ISDN2 for most customers. However, there is no clear evidence that this is likely to be that case for the forward look in this review and as a consequence we consider that our market definition should remain.

³¹ Figures exclude Virgin which we estimate to be around 1% of the total market.

Relationship between the retail market definition and the Commission's Recommendation on relevant product and services markets.

- 4.76 In Section 2 (and, in more detail, in the March Consultation), we have explained what Ofcom must do before making a market determination and that we are required to take due account of the Commission's Recommendations.
- 4.77 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.
- 4.78 As set out above we have defined 6 separate access markets (three for UK (excluding Hull) and three for Hull), which will be narrower than and, therefore, different to the Commission's market definition.
- 4.79 We have also defined 4 separate calls markets (two for UK (excluding Hull) and two for Hull). The Commission have not included a calls market within their recommendation, indicating that this may be a market that is not susceptible to *ex ante* regulation.
- 4.80 Consequently, in determining the requirement for *ex ante* regulation due to market power, in the analysis set out below we will give careful consideration to the three criteria set out in the Explanatory Memorandum to the Recommendation (section 2.3), and discussed at paragraph 2.15 above, namely:
- barriers to entry and the development of competition ("Criterion 1")
 - dynamic aspects – no tendency towards competition ("Criterion 2")
 - relative efficiency of competition law and *ex ante* regulation ("Criterion 3")
- 4.81 As all 10 of the markets we have identified differ from the retail market identified in the Recommendation we have applied the test to each of those markets.
- 4.82 We consider that EC's criteria were addressed in the March Consultation document both in the market definitions section and in the sections that dealt with market power analysis. Whilst the latter sections primarily discussed whether an operator holds SMP for a proposed market, 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 operator in a given market.
- 4.83 However, certain issues are relevant to both the three criteria test and to a consideration of market power. In the March Consultation we sought to keep such discussion in a single section of the document to avoid unnecessary repetition of argument.
- 4.84 We considered that Criterion 1 was covered with the discussion of barriers to entry and expansion. Criterion 2 was covered within the discussions of switching costs and the intensity of competition, market shares and prices and profitability. We addressed Criterion 3 where we identified competitive failure (i.e. in the ISDN2 market for the UK (excluding Hull) and all markets for Hull) within this section of the document.
- 4.85 We received some comments from stakeholders in relation to our assessment of the factors that are relevant to both the three criteria test and to the assessment of SMP, for

example, barriers to entry. Consistent with the approach that we adopted in the March Consultation document, we have addressed these issues in the sections on market power assessment (Sections 5 and 6). Where this additional analysis is relevant to the question of whether the three criteria test is met, we have reviewed our analysis.

- 4.86 In addition to the further arguments set out in Sections 5 and 6, we should note here that:
- 4.87 The nature of the ISDN2 market is such that at present there is limited scope for replacement of the ISDN2 services by alternative technology. As such the review against this criteria is limited to competition for the provision of ISDN2 itself.
- 4.88 As we will discuss in the next Section, there is some evidence of increased market entry. But there are clearly significant barriers to growth in that market as no competitor to BT holds more than 3% of the market. Entry is constrained by BT's existing market presence and a perception that there is limited benefit in substantial investment to increase market presence due to the threat that this market will diminish over time.
- 4.89 As a consequence, we consider that there is an effective barrier to significant market expansion.
- 4.90 The evidence, as set out in the March Consultation, shows that a key characteristic of this market is relatively stable prices. Even as BT has lost market share, prices have remained relatively constant.
- 4.91 The competitive focus appears to be on the next generation of services, leaving those using ISDN2 to purchase the same product for the same price.
- 4.92 The nature of the customer base, cost of ISDN2 as a proportion of business input costs and competing Communications Provider involvement in the market means that it is less likely that abuse by an incumbent would be effectively identified and addressed ex post.
- 4.93 This suggests that there is often insufficient individual harm to warrant the cost of pursuing a competition law complaint. Ex ante regulation, even if, in this case, it is confined only to the statement of SMP, would ensure that the cost of pursuing a complaint is lowered as there would be a greater presumption of incumbent dominance and we would reserve the right to directly intervene if abuse is indicated.

Conclusion on application of the 3 criteria test

- 4.94 We consider that our assessments of how the three criteria test applied to each of our defined markets, as set out in the March Consultation were correct, and we have not changed our position on market definition since the March Consultation (save to exclude ISDN30 access markets from our consideration), having regard to all of the comments received during the consultation process and our further analysis of the evidence.

Section 5

Access Markets - market power analysis

Introduction

- 5.1 This Section sets out our assessment of market power for the access markets. We set out our assessment of market power for the calls markets in Section 6.
- 5.2 Where we have found a market to be effectively competitive, there is no continuing requirement for company specific regulation (see Section 8). However, Ofcom's involvement in the retail market will continue through sector-specific retail regulation, such as the General Conditions on communications providers (see Section 7).
- 5.3 Where we find SMP in a relevant market, we are obliged to consider what remedial regulations may be required to address the competitive failure. Such remedies as are required are set out in Section 7.

Data corrections

- 5.4 Since the March Consultation, Ofcom has re-examined the market share statistics we compile for narrowband markets in the UK. We identified the need for a re-adjustment of the statistics, due to reclassification of exchange lines within the various ISDN and PSTN markets, including a number of non-BT lines which had been incorrectly classified as business rather than residential services. Additionally, we had under-counted some of the non-BT lines. We have also updated the information to take into account more recent data for Q4 2008 and Q1 2009.
- 5.5 The main impact of these changes is to slightly reduce BT's market share in residential lines and to increase BT's market share in business lines.

Summary

- 5.6 Our conclusions with respect to market power remain unchanged from the March Consultation.
- 5.7 In summary, we have concluded that in the UK (excluding Hull):
- no company has SMP in either the residential or business fixed narrowband analogue access markets; and
 - BT has SMP in the market for ISDN2 access.
- 5.8 As discussed previously we are not considering ISDN30 markets for the UK (excluding Hull) or the Hull area at this time.
- 5.9 In the Hull area we have concluded that KCOM holds SMP in the following access markets:
- Residential fixed narrowband analogue access;
 - Business fixed narrowband analogue access; and
 - ISDN2 access.

Our approach

- 5.10 Article 14 of the Framework Directive defines SMP as equivalent to the competition law concept of dominance:

"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."

- 5.11 In assessing whether BT and KCOM have SMP we have taken into account the following factors both with regard to the current and recent experience, and the likely competitive picture during the forward look period covered by this market review:

- Market shares;
- Barriers to entry and expansion;
- Customer switching costs and the intensity of competition in the market;
- Prices and profitability;
- Countervailing buyer power;
- Other competitive constraints; and
- International comparisons.

- 5.12 As noted above, the test for SMP is essentially whether the undertaking is in a position of economic strength affording it the power to behave to an appreciable extent independently of competitors, customers and ultimately consumers. For example, a firm will have SMP where it has an ability to raise prices significantly above the competitive level. Firms are more likely to have SMP where they have a persistently high market share. However, even when market shares are relatively high, a firm may not have SMP where there are low barriers to entry and expansion or where there are other significant competitive constraints on its behaviour. A company's market share is only one of a number of relevant factors that need to be jointly assessed to determine whether that company has SMP in a particular market.

- 5.13 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.

Access markets

- 5.14 In this Section we consider whether any provider is likely to possess SMP in each of the fixed access markets identified in Section 4.

- 5.15 These markets are:

- Residential narrowband fixed analogue access (for UK (excluding Hull) and for Hull)
- Business narrowband fixed analogue access (for UK (excluding Hull) and for Hull)
- ISDN2 access (business only) (for UK (excluding Hull) and for Hull)

Residential Markets for fixed analogue access

UK (excluding Hull)

- 5.16 In the March Consultation, we considered that, despite BT's relatively high market share, the level of competition in the market for the provision of fixed analogue access was such that BT had no SMP for the following reasons:
- The wholesale remedies (e.g. WLR) have led to the development of products which enable competitors to replicate the services offered by BT without making significant infrastructure investments. This has lowered barriers to entry and growth.
 - New firms have entered and expanded in the market resulting in a fall in BT's market share.
 - Some of the main competitors such as Sky are expected to rely increasingly on LLU during the review period to further reduce their costs and increase the competitive pressure on BT.
 - Consumers are willing and able to switch provider (evidenced by the fall in BT's market share).
 - Since RPCs were lifted the overall average increase in the phone bill has continue to fall in real terms.
 - The overall cost of a fixed line access and calls package is comparable to similar OECD countries.
- 5.17 Eleven stakeholders responded to our SMP analysis for the residential access market in the UK (excluding Hull) with a variety of viewpoints which we consider below, these included BT, T-mobile, Scottish & Southern Energy ("SSE"), COLT, TalkTalk Group, Cable & Wireless, FCS, UK Competitive Telecommunication Association ("UKCTA"), Sky and two confidential responses.

Overview of consultation responses

- 5.18 BT agreed with our SMP analysis. They also noted that the market today is subject to significant churn which is principally due to the fact that customers are aware of their ability to switch supplier and the numerous alternatives provided by CPS, LLU, WLR and mobile operators.
- 5.19 BT strongly believed that Ofcom's proposals to deregulate the narrowband market will benefit all end consumers by allowing BT to compete on a more level playing field. Residential consumers are well informed about alternatives (both fixed and mobile) and their ability to switch meaning that concern over any negative consequences of deregulation was unfounded.
- 5.20 BT agreed with Ofcom's assessment that the proposals are not detrimental to residential consumers who are uninterested in changing supplier and that in any event it would be difficult to target such consumers. BT's research that we have reviewed shows that consumers who have never left BT are by and large inactive by choice. The research additionally shows that these consumers are making an informed decision to stay with BT and that they have high levels of satisfaction and trust with BT. BT concurred that there are sufficient measures in place via BT's Universal Service Obligations and other General Conditions to protect any vulnerable consumers.
- 5.21 TalkTalk Group and UKCTA noted that Ofcom's competition policy for fixed narrowband retail markets has been successful to some degree in ensuring sustainable market entry by strong players who have been able to challenge BT's legacy dominance. The

introduction of CPS, WLR and LLU/MPF as wholesale remedies have all contributed to the gradual erosion of BT's market power in the retail markets in the last 7-8 years. However, they believe that the fixed narrowband retail markets have not yet reached a stage where they can be said to be effectively competitive since BT still holds twice the market share of all other operators taken together.

5.22 The other stakeholders disagreed with aspects of the SMP analysis. The main areas of concern related to:

- BT's market share – some stakeholders thought BT's market share was sufficiently high to indicate a presumption of SMP.
- Wholesale narrowband product range – some stakeholders commented that if more wholesale product options were offered (e.g. xMPF) then retail competition in the residential voice access market would be enhanced, and that the current set of wholesale products was constraining retail competition and giving an advantage to BT Retail.

5.23 We discuss these points and other stakeholder comments in further detail below.

BT's market share and related comments

Consultation responses

- 5.24 A number of Communications Providers, the FCS and UKCTA commented that BT still has a relatively high market share which was indicative of SMP and expressed concern that the market was not sufficiently competitive to justify full deregulation. Several stakeholders commented that a market share in excess of 50% was evidence of a dominant position based on current case law.
- 5.25 COLT also commented that competition authorities such as the OFT usually use a benchmark of 40% market share at which it is unlikely that an individual undertaking will be individually dominant. COLT noted that BT's shares of lines and revenues are comfortably above that level.
- 5.26 COLT suggested that if the decline in BT's market share continues at the current rate it will be 2013 before BT's share falls below 50% and 2016 before it falls below the 40% threshold and both these dates are outside the expected time period for this market review. Sky, UKCTA and TalkTalk Group also commented that the evidence presented does not support the contention that BT's market share will continue to decline at a sufficient rate such that, during the forthcoming review period, the presumption of dominance can be rebutted.
- 5.27 Sky commented that, in order to rebut the presumption of dominance, Ofcom should be able to explain the extent to which it expects BT's market shares to decline (i.e. that they will decline to a level where BT no longer enjoys SMP). Such a decline should also not simply be by the end of the forthcoming review period. It is not sufficient for Ofcom merely to highlight a general decline in BT's market shares, based on a number of unsubstantiated prospective competitive trends: as the Commission has indicated, "the fact that an undertaking with a significant position on the market is gradually losing market share may well indicate that the market is becoming more competitive, but it does not preclude a finding of SMP".³² Sky also commented that market shares are a more reliable indicator of market power in markets characterised by a high degree of product homogeneity and where market boundaries are reasonably clear. In the present

³² Paragraph 75 of the EC SMP Guidelines.

case, access and calls are relatively uncontroversial as meaningful spheres in which to assess the degree of competition among firms. Accordingly such a presumption is appropriate in this case.

- 5.28 Sky think that in the present case, it is far from clear, even under the current regulatory framework that the downward trend in BT's market shares will continue. Absent SMP regulation, there is a risk that this trend will cease or even reverse.³³ Without sufficient supporting evidence to show that BT's market share will inevitably decline, an approach based on 'anticipation' runs counter to Ofcom's duties: rather than justify a removal of ex ante regulation, anticipated market share movements simply indicate a continuing need for Ofcom to keep the relevant markets under review.
- 5.29 In addition, COLT commented that the OFT Guidelines state that market power is more likely to exist when competitors have low market shares. Table 5.1 in the March Consultation shows that the next nearest competitor (Virgin) has an 18% share of lines and 17% share of revenues. In both cases, Virgin Media's share is less than 30% of BT's share. As explained at paragraph 5.38 of the March Consultation there are 12 significant providers using WLR, but these providers have 12% market share between them: an average of 1% per provider. COLT regard this as evidence that other operators have low market shares, further undermining Ofcom's analysis that BT has no SMP.

Ofcom's response

- 5.30 We address these concerns in the following order:

- The role of market share in assessing market power;
- Trends in BT's market share; and
- The relative size and share of competitors.

The role of market share in assessing market power

- 5.31 We accept that BT has a relatively high market share. However, as explained above we consider that it does not necessarily follow that BT therefore has SMP.
- 5.32 As noted in paragraphs A7.44-7.45 of the March Consultation, in its guidelines on market analysis and the assessment of SMP, the Commission discusses market shares as being one indicator of market power; however, the Commission also notes that:

"It is important to stress that the existence of a dominant position cannot be established on the sole basis of large market shares. ...the existence of high market shares simply means that the operator concerned might be in a dominant position. Therefore, 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."³⁴

³³ For example, extrapolating over the next 3 years the recent rate of decline of BT's market share for access of around 3-4% per annum, BT can be expected still to have a market share of over 50%. This is also consistent with the forecasts in Table A7.1 of Ofcom's May 2009 Statement on A New Pricing Framework for Openreach, which suggests a similar market share for access for BT in 2011/12.

³⁴ See "Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services", paragraph 78.

- 5.33 Furthermore, the European Court of Justice (ECJ) has stated that dominance can be presumed in the absence of evidence to the contrary if an undertaking has a market share persistently above 50%³⁵ (emphasis added).
- 5.34 In other words, the Commission clearly states high market share alone is **not** sufficient to find dominance and the ECJ states an assessment of dominance should consider market share alongside other evidence.
- 5.35 Therefore, we consider it clear that high market shares alone are not sufficient to find that an undertaking has SMP. In fact, we are obliged to take into account a number of factors, not just market share, in assessing whether an undertaking has SMP (even in a market where products are relatively homogenous). To that end, the Competition Appeal Tribunal has ruled³⁶ in a case involving a 100% market share that, as part of an overall assessment of whether there is SMP:
- “The underlying principle in a case like this is whether there is effective competition. SMP is a tool in determining this question – indeed, it is the central tool...Various factors are relevant in determining whether there is SMP, and one of those is CBP.”
 - “A large market share gives rise to a presumption of dominance...However, the nature of that “presumption” must be properly understood. Normally, in English law, a presumption can be relied on by itself if there is no other evidence which goes to the point; no-one suggested that the position would be different so far as any European principles might be in play. The first sentence of paragraph 78 of the guidelines seems at first sight to detract from that principle. However, we are not satisfied that it does. What paragraph 78 provides is that a regulator is not entitled to find a large market share, rely on that as giving rise to a presumption of dominance and stop there. The regulator is obliged to go on and consider all other such factors as are relevant to a consideration of the point in the market in question. The paragraph then goes on to identify some of them. What is required by the Guidelines is 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.” This approach is demonstrated by various authorities, including *Hoffman-La-Roche* [1979] ECR 461, and we do not consider that anything appearing in *Tetra Laval* contradicts or modifies it.”
- 5.36 We believe that the available evidence shows that barriers to entry and expansion in this market are low because the wholesale remedies in place (in particular WLR) mean that competitors can easily enter the market and replicate the services offered by BT with, in the case of WLR, a relatively low level of infrastructure investments (clearly this is greater for LLU providers but the motivation for LLU is not purely narrowband). This is evidenced by the wide variety of retailers who have entered and successfully expanded within the market. We believe these competitors constrain BT. Additionally, one major provider, TalkTalk Group, is competing with BT on the basis of full LLU; and a further provider, Sky, has announced its intention to provide services based on full LLU. Furthermore, the consumer research we conducted, evidence on actual switching behaviour and the reduction in BT’s market share to date indicate that consumers are willing and able to switch to alternative providers (see paragraphs 5.31-5.42 and 5.44-

³⁵ Case C62/86 AKZO Chemie BV v Commission [1991] ECR 1-3359.

³⁶ See paragraphs 110 and 42, respectively, of the Tribunal’s Judgment in *Hutchison 3G (UK) Limited v Ofcom* [2005] CAT 39.

5.67 of the March Consultation). We discuss a number of other factors which we have taken into account in our SMP assessment in the sections below.

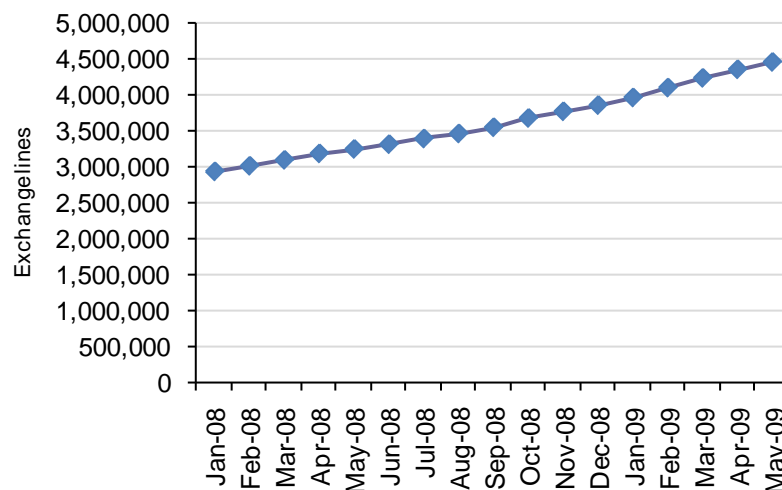
Trends in BT's market share

5.37

Since the publication of the March Consultation we have collected further information on exchange lines from Communications Providers. This information suggests that competition has continued and BT's market share has decreased further. Residential WLR and LLU lines supplied by competing Communications Providers have continued to increase strongly, up by almost 500,000 lines (an increase of 13%) from January 2009 to May 2009. The total number of lines provided by BT has continued to fall – by over 441,000 from January 2009 to March 2009 (more recent data, as yet not fully audited confirms shows this trend continuing from April 2009 to May 2009). We show the growth in the number of LLU and WLR lines provided by BT's competitors in Figure 5.1 below.

Figure 5.1

Number of residential LLU and WLR lines supplied by BT's competitors (excluding Virgin Media)



Source: Ofcom/operators

5.38 Updated information on market share is presented below.

Figure 5.2

Updated market shares of residential fixed narrowband access³⁷

	Exchange Lines			Revenues		
	BT	Virgin Media	Other fixed	BT	Virgin Media	Other fixed
2003	83%	17%	0%	80%	19%	1%
2004	82%	17%	0%	78%	20%	2%
2005	78%	17%	5%	76%	20%	4%
2006	72%	17%	11%	71%	19%	11%
2007	69%	18%	14%	66%	18%	15%
2008	64%	18%	18%	64%	18%	19%

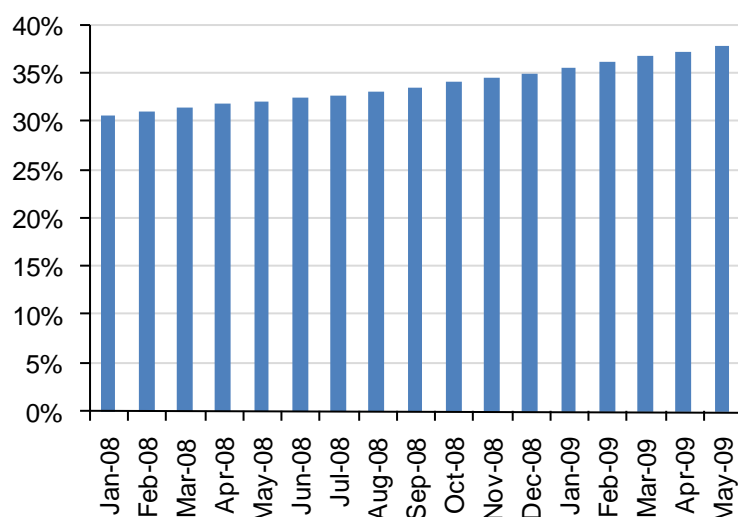
³⁷ Original information was provided in Table 5.1 of the consultation.

2008 Q1	67%	18%	15%	64%	18%	17%
2008 Q2	66%	18%	16%	65%	17%	18%
2008 Q3	65%	18%	17%	63%	17%	19%
2008 Q4	64%	18%	18%	62%	17%	20%
2009 Q1	62%	18%	20%	62%	18%	20%

Source: Ofcom/operators

- 5.39 We have also used the information gathered using formal powers to compile more detailed market share information for BT's competitors up to May 2009. The Figure below shows that the (monthly) market share for BT's competitors (including Virgin Media) has steadily increased since January 2008 and shows no signs of slowing down. BT's market share has continued to decline in the first five months of 2009.

Figure 5.3
BT's competitors market share (including Virgin Media)



Source: Ofcom/operators

- 5.40 In addition, BT has experienced significant levels of churn which provides further evidence that consumers are willing and able to switch provider of residential access lines. In the 12 months to May 2009 BT's churn³⁸ was [X].³⁹ Over the same time period BT gained a substantial number of new lines through a combination of win back and new provision. Overall this suggests that many consumers are highly mobile and willing to seek out the best deals.
- 5.41 The new information on competition, including BT's market share and churn, supports our initial assessment that the wholesale remedies are effective and have led to low barriers to entry and growth.
- 5.42 However, it is important to note that we consider BT's continued loss of market share as just one indicator that they do not have SMP. Our conclusion that BT does not have SMP is not dependent on BT continuing to lose market share as suggested by some stakeholders (who expressed a concern that BT's market share may not fall significantly

³⁸ Churn is defined as lines ceased or transferred over 12 months divided by average lines provided over 12 months. Line transfers includes home moves.

³⁹ The churn statistics are commercially sensitive and have been redacted.

over the review period, in particular, that BT's market share may not fall to a level where it is no longer 'presumed' to be dominant⁴⁰).

- 5.43 We consider the market to be effectively competitive in particular because of the presence of low barriers to entry and growth, thus our assessment does not rest on a further decline in BT's market share over the period covered by the market review (although, as noted above BT's market share has continued to fall since the March Consultation was published). Our assessment is based on the competitive environment remaining broadly similar or increasing in intensity going forward. We will continue to monitor the competitive environment and, if conditions change materially, suggesting that competitive pressures are lessening, we would consider conducting a further review. We consider this in more detail in Section 7.

The relative size of competitors

- 5.44 In relation to COLT's comment that market power is more likely to exist when competitors have low market shares, we note in Table 5.2 above that Communications Providers other than BT or Virgin Media provide 20% of residential access lines, mostly using WLR, but also full LLU. The WLR providers do not have a uniform market share and, in addition, looking at WLR alone is an incomplete and inaccurate picture because a number of providers use both WLR and LLU. For example, TalkTalk Group (including Tiscali) has a market share of around [redacted]⁴¹ of exchange lines as at May 2009. Furthermore, a number of WLR providers have entered the market relatively recently (e.g. since 2007) and we would expect it to take some time for them to build market share. We expect the market shares for this set of providers to increase in the future e.g. as providers such as Sky sell into their existing customer bases. As noted above the number of exchange lines provided by 'other' providers has increased since the March Consultation was published. Also, it is important to note that cable is only available in around half of the UK market, thus Virgin Media's market share is significantly higher within their addressable market. Furthermore, as discussed in the March Consultation, these competing providers offer many services alongside residential access lines (they usually sell voice calls and access lines but they may also provide broadband access, pay TV and/or mobile phone services) so some providers are able to enjoy significant economies of scope.

Impact of LLU

Consultation responses

- 5.45 COLT believes LLU is well advanced in the UK, and BT's recently stated changes to the deployment of some 21CN voice products/services and its intention to continue using the older TDM voice network will cause BT's market share to fall more slowly than predicted meaning rigorous regulation would still be required.
- 5.46 Sky referred to paragraphs 5.39 and 5.40 of the March Consultation which noted that the rate at which exchanges are being unbundled slowed during 2007 and indicated that LLU does require some sunk investment. Sky commented that this implicitly acknowledged there was some form of barrier to entry or expansion. In light of the slowing rate of unbundling, and compounded by the concerns raised about the inadequacies in BT's wholesale products (discussed further below), it is not clear that

⁴⁰ This comment was also made in relation to business analogue access, residential and business calls. Our assessment in these markets is the same.

⁴¹ Redacted as the information was provided in confidence.

BT's market shares will continue to fall, rather than stabilise at a level where it continues to have SMP.

Ofcom's response

- 5.47 We noted in the March Consultation that the rate of exchange unbundling has slowed during 2007 and this might mean that the decline in BT's market share slows in the future. We reiterate that this is probably because the larger and most commercially important exchanges have already been unbundled. The proportion of premises connected to an unbundled exchange increased from 80% in 2007 to 84% in 2008⁴².
- 5.48 Despite the slowdown in exchange unbundling the number of LLU lines provided has continued to increase, from 1.6 million in December 2008 to 1.7 million in March 2009. In addition, Sky has announced its intention to move to MPF during the summer of 2009 and referred to the lower costs it expects to gain from this⁴³. We consider that this is likely to lead to increased incentives being offered to customers to encourage them to purchase both narrowband and broadband services.
- 5.49 We also noted in paragraph 5.39 of the March Consultation that LLU requires some investment in equipment at local exchanges but that it also offers strategic advantages as services can be provided at lower cost. An entrant Communications Provider also has the option of using WLR/CPS to provide services which do not require any investment in infrastructure. The choice between using WLR or LLU thus depends on the preferences and strategy of the Communications Provider in question. The WLR/CPS option means that entry is possible without incurring sunk costs in infrastructure and that Communications Providers are able to purchase the WLR product to complement their on-net LLU-based offer. We believe the current suite of wholesale products allows each Communications Provider sufficient flexibility to compete effectively at the national level with BT in this market.

Risks of removing regulations are asymmetric

Consultation responses

- 5.50 Sky noted that premature removal of ex ante conditions has the clear potential to result in significant harm to consumers – notably in the form of higher prices, and risk to emerging competition to BT. They argued that if the removal of ex ante regulation is based to a significant extent on the continuation of trends considered to undermine BT's SMP, then a high standard should be set for evidence in support of such conclusions. In addition, Sky commented that Ofcom fails to recognise the significant uncertainties associated with the prospective competitive trends identified. They further commented that there is little to be lost from waiting to see whether the trends do actually materialise.

Ofcom's response

- 5.51 We consider that BT does not have SMP due to the competitive environment created by appropriate wholesale regulation and the resulting market entry and expansion. Therefore we do not agree that our conclusions are based on prospective competitive trends as suggested by Sky.

⁴² Page 229 of the Ofcom Communications Market Report 2009.

⁴³ Press release for its results for the twelve months ended 30 June 2009 (http://media.sky.com/documents/pdf/press_releases/FY_0809_Press_Release).

- 5.52 We also disagree that there is little to be lost from waiting to see whether the trends do actually materialise. If our overall assessment shows that there is no SMP (as we have concluded) at this time, as well as prospectively in taking a forward look, we are required to withdraw regulation now. That aside, as already discussed above, we consider that a failure to withdraw regulation now would not achieve the policy objectives in Article 8 of the Framework Directive in promoting competition.
- 5.53 Any prevention on BT from bundling fixed narrowband voice services with other products and offering a discount relative to the sum of the list price of the individual component products may now be constraining competition to the detriment of consumers. Other Communications Providers frequently offer these types of proposition to customers, for example bundling voice services with broadband and/or pay TV. If BT was free to price discriminate and offer bundles at a discount (in a similar manner to other Communications Providers), we consider it is likely that prices would decrease for some consumers (e.g. consumers taking both voice and broadband services from BT might be able to get a better deal). This would, in turn, compel other Communications Providers to react to the change in competition. We believe that the regulatory outcome suggested by Sky and others, while commercially advantageous for them, would result in less intense competition and, therefore, we consider that a delay in deregulation is likely to have a detrimental impact on consumer welfare. The expected outcomes of deregulation are discussed further in Section 7 of the March Consultation.
- 5.54 As part of our Consultation process we considered whether BT would be able to adversely discriminate against its relatively inert customers if the current regulations were lifted. Our analysis concluded that BT would find it hard to target these customers specifically because it is difficult to differentiate them from other customer segments.
- 5.55 We have discussed above the trend in BT's market share and churn (including recent evidence) and, while there will always be a degree of uncertainty, on balance we consider that BT's rivals will continue to expand.

Barriers to entry and expansion

Consultation responses

- 5.56 Sky had concerns that, despite the introduction and successful uptake of regulated wholesale products, Communications Providers still encounter problems in differentiating the quality and/or scope of their own retail services from those offered by BT Retail. They believe that these constraints limit the extent to which Communications Providers can develop and differentiate their offering from that of BT Retail. The consequence of these limitations is that Communications Providers are unable to provide a comprehensive service of universal standard across the whole of the UK, and Communications Providers are limited to differentiating in their on-net areas only. Sky commented that the suite of wholesale products available is inadequate and BT's decision not to develop wholesale NGN products under the 21CN programme means that BT will retain a competitive advantage.
- 5.57 Sky does not believe that WLR and CPS are as effective at enabling effective competition as Ofcom suggests because they only facilitate replication of line access and call origination services. They do not allow Communications Providers to offer a unique set of line features (e.g. call termination, features, tones, voicemail). Sky further commented that the fact that BT has chosen not to introduce wholesale products that would give Communications Providers more control over their services (for example xMPF and wholesale voice connect (WVC)) helps perpetuate retail homogeneity, hindering the development of competition.

- 5.58 Sky also commented that the inability of LLU operators to provide an xMPF voice only service to on-net customers means that LLU operators are disadvantaged relative to BT Retail. Sky considered that LLU operators are placed at a disadvantage because they are reliant on WLR and CPS to supply voice only customers in unbundled areas and all customers outside the unbundled area. The voice services which can be offered to these voice only or 'off net' customers will differ compared with those taking voice and broadband in 'on-net' areas which means that an LLU provider cannot offer the same services to all customers across the UK.
- 5.59 A confidential respondent made similar comments about LLU as a competitive constraint i.e. they thought that LLU MPF is not currently capable of providing an effective supply side constraint in voice markets. They considered two things were required to address this: (i) ensuring that there is sufficient margin between MPF and WLR (at least reflecting the underlying cost difference between the two products), and (ii) requiring Openreach to offer a voice-only MPF (so-called xMPF) product to allow operators to provide network based voice services to all customers and not just to the subset who also take broadband from them.
- 5.60 Sky further commented that BT Wholesale's decision not to offer products such as xMPF and WVC might reflect the commercial incentives of BT group as a whole. They suggest that where BT Retail does not want to consume a particular wholesale product then this is likely to have consequences for the decisions made by BT Wholesale (or Openreach). This could mean that wholesale products which would benefit the market as a whole are not introduced.

Ofcom's response

- 5.61 Sky appears to argue that some asymmetry exists between BT and other Communications Providers at the wholesale level and thus we ought to maintain asymmetric regulation at the retail level. We consider that any asymmetry at the wholesale level is limited once the wholesale regulations have been taken into account, and the wholesale products currently available are adequate to enable Communications Providers to fully compete with BT. The uptake of these products at the retail level over recent years and the significant decline in BT's retail market share supports this assessment. As shown in Figure 5.2 above, other fixed Communication Providers (i.e. those using WLR and LLU) share of the residential exchange line market has increased from negligible in 2004 to 20% in Q1 2009 (representing around 4.6 million exchange lines). We do not consider that LLU operators are at a significant disadvantage relative to BT because they are free to use WLR/CPS to offer voice only services in on-net and off-net areas with no further infrastructure investment.
- 5.62 We accept that there may be other wholesale products that, if provided by Openreach, could offer benefits to Communications Providers which are not available through the current products specifically required as a result of the wholesale remedies. However, an improvement in the wholesale products is not a prerequisite for our assessment that BT does not have SMP, and the significant take up of WLR we have witnessed in recent years indicates that this is an adequate and attractive product.
- 5.63 Given that we do not consider that an enhancement of the current set of wholesale services is required for a determination of no SMP, we do not propose to discuss the pros and cons of such services further in this paper. However, we note that the provision of xMPF is considered as part of the review "Next Generation Networks: Responding to

recent developments to protect consumers, promote effective competition and secure efficient investment”⁴⁴.

- 5.64 It is also appropriate to note that in each wholesale market where BT has been found to have SMP (e.g. Wholesale Local Access, various wholesale narrowband markets), BT has an obligation to provide network access on reasonable request. This allows Communications Providers the flexibility to request products from BT in addition to those specifically mandated by Ofcom. If a Communications Provider thinks BT has not responded appropriately to a reasonable request, Ofcom’s formal complaint or dispute procedures can be used. This issue is considered in the Narrowband Wholesale Market Statement.

Developments in NGN

Consultation responses

- 5.65 Sky commented that BT’s failure to invest in NGN technology has deprived Communications Providers of the opportunity to realise efficiencies through scale and scope economies. This is because interconnecting Communications Providers have lost an opportunity to manage their network footprint more efficiently and, to a large extent, will continue to hand-off voice and broadband traffic to BT at different locations and via differing interconnection technologies at greater expense (because there is a cost to NGN operators for carrying out IP-TDM conversion).
- 5.66 Sky noted that BT’s failure to move to NGN-based voice means that competing Communications Providers are hindered from fully leveraging their investment in their own voice networks, for example by ingressing calls to all their customers themselves. Instead, BT Wholesale will continue to receive wholesale geographic termination revenues for WLR and CPS end users.
- 5.67 TalkTalk Group also commented that Ofcom needs to ensure that BT offers a “better” wholesale line rental product as part of its 21CN product development programme.

Ofcom’s response

- 5.68 As above, we consider that the retail access markets are competitive in the absence of NGN. Therefore the timing for NGN rollout does not affect our SMP assessment. However, we note that competition may be further enhanced when the benefits of BT’s rollout of its NGN are ultimately realised. We consider developments in NGNs further in the Ofcom consultation document, “Next Generation Networks: Responding to recent developments to protect consumers, promote effective competition and secure efficient investment”, referred to above.

Reliance on consumer survey evidence

Consultation responses

- 5.69 COLT commented that Ofcom relies heavily on survey data which asks customers how they are likely to behave in the event of a price rise. COLT noted that such surveys often overstate behaviour and are not supported by the limited empirical evidence reported in the March Consultation.

⁴⁴ <http://www.ofcom.org.uk/consult/condocs/ngndevelopments/main.pdf>.

- 5.70 COLT commented that Table 5.5 of the March Consultation shows BT's line rental prices to be amongst the cheapest which might suggest a lack of market power. However, the March Consultation points out that BT's price will rise by £1.00 (a little under 10%) per month from 1st April 2009 making BT the most expensive in the group. COLT have searched the websites of the other operators listed and found that they have not raised their prices in line with BT. According to Ofcom's research referred to at paragraph 5.51 of the March Consultation, such a rise would lead to 22% of customers switching supplier. However, this estimate is based on what survey respondent's state they will do and not on analysis of empirical data showing how consumers actually respond to price rises. Further, the survey data provides no indication as to the timescale over which customers state they would move to another supplier.
- 5.71 COLT concluded that the ability of BT to raise prices by 10% and the poor evidence of likely consumer response to such a price rise, strongly suggest that it is not possible to conclude that BT does not have SMP.
- 5.72 Sky also commented that Ofcom places too much weight on the consumer survey evidence. Specifically, Sky noted that Ofcom placed different emphasis on survey evidence in the retail narrowband and pay TV reviews. In the narrowband review Ofcom concluded that the evidence "*suggests that customers are relatively price sensitive and would be willing to switch*". Sky contrasts this with Ofcom's approach to the pay TV review, where little or no weight has been placed on similar evidence, ostensibly because of concerns that it would be affected by the Cellophane fallacy, and 'stated preference bias' (normally known as "*hypothetical bias*").

Ofcom's response

- 5.73 Firstly, it is important to note that in both the narrowband and pay TV reviews we used a range of evidence to inform our market definition and market power assessments. We regard the narrowband survey evidence as complementary to the other sources of evidence considered (discussed elsewhere in this Section). For example, the decline in BT's market share is consistent with the survey evidence which found that consumers are willing to switch provider. We have not solely relied on consumer survey evidence in reaching our conclusions.
- 5.74 COLT commented that actual evidence on BT's recent price increases does not support the conclusion that consumers are willing to switch provider. However, this interpretation fails to recognise a number of other changes made to BT's pricing. At around the same time as BT raised its line rental price by £1, it made a number of other changes to its line/calls packages. In January 2009 BT included 0845 and 0870 numbers in the free element of its call plans. In addition BT relaunched the Friends and Family scheme. It is not clear that overall phone bills will rise if these factors are netted out. Indeed, Enders Analysis assessed that, "the direct impact of the changes [is] neutral taking into account the increase in line rental"⁴⁵. Our research has indicated that consumers often tend to view the line and call package together and, therefore, we would not necessarily expect this line rental price change (when accompanied by savings in call prices) to result in significant switching away from BT. Nor would we necessarily expect other Communications Providers to raise their line rental prices unless they are also making changes to calls package.
- 5.75 We do not have the empirical evidence to assess the consumer reaction to a historic (and recent) increase in price (we would need more than a few months data to assess the reaction of consumers). Furthermore, as noted above, changes in the price of line

⁴⁵ Enders Analysis, BT residential telephony prices changes: rebalancing act, 11 February 2009, page 4.

rental may be accompanied by other offsetting package changes so it is difficult to isolate the consumer reaction to the price increase for line rental alone. We would also need to collect detailed information on the price changes implemented by BT's rivals (and other changes to factors affecting demand such as marketing spend). In the absence of empirical evidence we are reliant on survey information but note the limitations of this data.

- 5.76 The purpose of the survey is to prompt those questioned to make a decision. In the real world in response to a price increase consumers who switch will do so at different points in time: e.g. it will depend on individual time constraints, the time it takes to research alternatives and reach a decision. It is difficult to accurately assess this as part of a survey. The point to note is that a significant proportion of survey respondents clearly indicated an intention to switch in response to an increase in price. This is consistent with the evidence presented above which shows that BT has a significant rate of churn and win back (i.e. customers are willing and able to seek out the best deals).
- 5.77 We consider it unlikely that the narrowband survey suffered from cellophane fallacy because BT's prices were regulated via the RPCs until 2006. Furthermore, the evidence presented in Annex 6 to the March Consultation suggests that overall prices have increased by less than RPI since the RPCs were lifted (and, as such, prices are lower than the ceiling that would have been in place had the RPCs been continued in the same form as they had been in July 2006).
- 5.78 We accept that any survey answers could be subject to a degree of hypothetical bias (i.e. a difference between actual willingness to pay and willingness to pay revealed in a survey arising from the fact that in actual markets purchasers face real costs, while in surveys they do not). However, given that a substantial proportion (i.e. around one third) of consumers have actually switched provider (thus have a very good idea of the costs involved) the likelihood of systematically underestimating the costs of switching is likely to be less significant.

BT's pricing

Consultation responses

- 5.79 Sky commented that, despite the entrance of new operators, BT has been able to maintain its prices at a relatively stable level indicating an ability to act without regard to its competitors⁴⁶.

Ofcom's response

- 5.80 Although BT has maintained prices at a relatively stable level they have been losing market share (as illustrated above) i.e. in keeping prices at a stable level BT has lost subscribers as they have moved to competing providers. Competition began to intensify in 2006 with competitors offering discounts relative to BT's prices particularly for bundled offerings. BT has been constrained in its ability to respond flexibly to these offers given the constraints on BT linking SMP and non SMP services in its retail offers. Relaxing the present constraints on BT is likely to increase competition in the delivery of bundled offers and put downward pressure on prices.

⁴⁶ Sky also made this comment in relation to the calls markets. Our assessment for these markets is the same.

- 5.81 Ultimately it is up to individual Communications Providers to decide what pricing strategy to pursue, however, the evidence suggests that consumers are willing and able to seek out the best deals and switch provider.

BT's scale advantages

Consultation responses

- 5.82 FCS commented that BT still enjoys many scale advantages over the rest of the market and Ofcom had identified one of these advantages that "customers that are uninterested in changing providers are most likely to remain with BT".

Ofcom's response

- 5.83 Given that BT is the incumbent operator, it will retain a number of consumers that have limited interest in switching. However, the evidence suggests that (i) a large proportion of consumers are price sensitive and willing to switch (as suggested by the consumer survey – see paragraphs 5.51-5.55 and 6.23-6.28 of the March Consultation); (ii) consumers are actively switching as evidenced by the fall in BT's market share (see Figure 5.2 above); and (iii) it would be difficult for BT to target price increases specifically at inactive customers (see paragraphs 5.56-5.62 of the March Consultation and paragraphs below).

Default supplier status

Consultation responses

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

Ofcom's response

- 5.85 In the example BT is not just a default supplier. In addition to adding CPS to their line, the customer has chosen to continue to take line rental (and possibly some calls using the CPS override code) from BT Retail. Where the customer has cancelled their calls only service it is appropriate that the service is removed from their line. Furthermore, BT retail is the only provider that offers standalone line rental because it is the only provider required to do so as a result of regulation at the wholesale level. BT's competitors are not prevented from offering line rental only services; they choose not to do so because commercially they would rather gain line rental and calls revenues.
- 5.86 Additionally, we do not consider that BT derives SMP from this position. Given that the customer has switched in the past (i.e. to a CPS provider) they would be able to switch away from BT again if so desired.

BT's profitability

Consultation responses

- 5.87 Sky commented that Ofcom's examination of BT's profitability is somewhat limited in relation to that undertaken in the pay TV review. In particular Sky noted that Ofcom employed consultants to undertake a detailed examination of Sky's profitability.

Ofcom's response

- 5.88 We have conducted a proportionate analysis of BT's profitability drawing on various sources of information e.g. BT's regulatory accounts⁴⁷, information collected under our formal powers, revenue per minute and revenue per line information (refer to paragraphs 5.70 to 5.76 of the March Consultation). Also, the existence of the RPCs (up to 2006) and the regulatory financial statements, mean that Ofcom has a strong existing understanding of BT costs, revenues and profits.
- 5.89 We have, nonetheless, undertaken a further detailed analysis of BT costs, revenues and returns for both access and calls as most consumers purchase them jointly (as set out in the March Consultation and below). These set out in detail the basis of changes in returns and their consistency with our assessment of the market.
- 5.90 To provide some further information on profitability we have used BT's 2008/9 regulatory accounts to update the analysis for the residential access and calls⁴⁸ market⁴⁹. The updated numbers are shown below.

⁴⁷ Available at <http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/index.htm>.

⁴⁸ Call types included are local, national, international direct dial category A and call to mobile.

⁴⁹ In light of the 2009 consultation and statement on changes to BT and KCOM's regulatory financial reporting, for 2008/9 BT was not required to report international direct dial category B or operator assisted calls due to the small size of these markets (refer to http://www.ofcom.org.uk/consult/condocs/btkcom09/statement/btkcom_statement.pdf, section 4). These call types have been removed from the previous year's figures to ensure the time series is consistent.

Figure 5.4**Residential access and calls markets – revenues, costs and returns from 2003/4 to 2008/9**

Source: BT's regulatory accounts

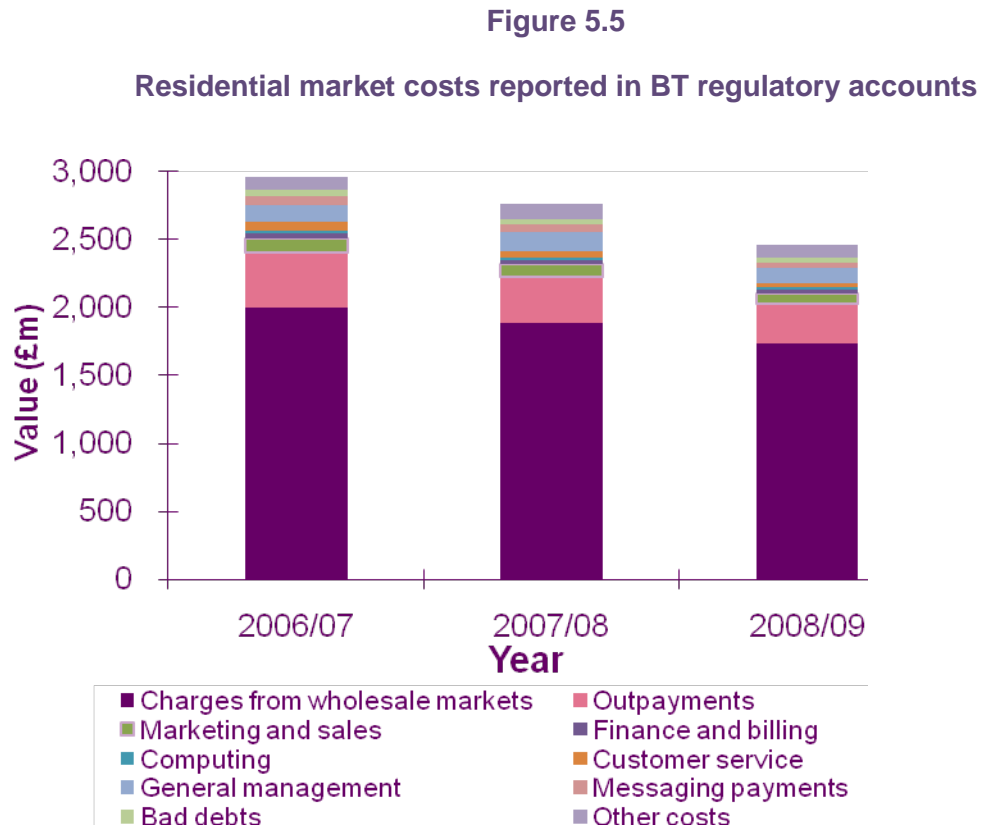
- 5.91 The Figure shows that BT's revenues have continued to decline in 2008/9. However, BT's costs have decreased faster than revenues which means that gross margin and return on sales⁵⁰ for access and calls have increased (the return on sales has increased from 16% in 2007/8 to 21% in 2008/9).
- 5.92 There could be a number of possible reasons for the apparent rise in profitability, for example, it could reflect BT's ability to raise prices (which might suggest an element of market power). Alternatively it could reflect improved efficiency and cost cutting in response to aggressive competition.
- 5.93 There has been some increase in prices since 2005/6 though, as noted in our RPC review in Annex 6 to the March Consultation, the increase in prices from August 2007 to July 2008 was below the ceiling that would have been in place had the RPCs been in effect at the same level as July 2006. We have examined BT's costs as reported in the regulatory accounts in more detail to determine the underlying reasons for the apparent rise in profitability.
- 5.94 Comparing 2007/8 and 2008/9, BT's costs have decreased by £303m across the residential access and calls markets⁵¹. A significant portion of this (around 67%) was due to decreased charges from wholesale markets and reduced out-payments (e.g. to other operators for termination) both of which reflect decreased volumes in the number of lines and calls provided by BT.
- 5.95 However, the third largest contributor is general management. This contributes 13% or £38m to the cost reduction. Then there are 'other costs' which have decreased by £19m,

⁵⁰ Return on sales (%) = Gross margin (i.e. revenues minus costs) / revenue.

⁵¹ Excludes roundings.

messaging payments and marketing and sales which have both decreased by £12m and customer services which has decreased by £11m. The evidence suggests that BT has maintained profitability by reducing costs. Nonetheless it is difficult to draw strong conclusions from these gross margin data as, from an economic point of view, the cost reductions could also reflect a decrease in economic investment (e.g. subscriber acquisition costs) that should be amortised rather than treated as a current costs and fully expensed.

- 5.96 BT's access costs per line have decreased from £127 per year in 2007/8 to £124 per year in 2008/9⁵².



Source: BT's regulatory accounts

- 5.97 A further factor which has improved gross margin is customers migrating to higher value call packages i.e. packages with a higher fixed monthly costs and more inclusive minutes. This would appear to reflect customer choice as to which package offers optimal value (we discussed this in paragraph 6.39 of the March Consultation). The table below shows the proportion of BT's customers on the higher value packages (i.e. the unlimited evening and weekend and anytime plans) has increased in 2008/9.

⁵² To calculate the cost per line we used the total costs for residential analogue exchange line services taken from BT's Current Cost Financial Statements 2009 (pages 78-79) and the number of exchange lines reported in Ofcom Telecommunications Market Data Tables.

Figure 5.6

Residential customers by package

Package	% of customers on package in 2007/08	% of customers on package in 2008/09
Unlimited weekend plan	63%	47%
Unlimited evening and weekend plan	20%	34%
Unlimited anytime plan	7%	11%
Other including LUS ⁵³	9%	8%

Source: BT

- 5.98 We have also provided some additional information on BT's profitability in the business analogue access and ISDN2 sections below.

Ofcom's conclusion on the residential analogue access market

- 5.99 To conclude, taking into account the available evidence (set out in the March Consultation and above) and stakeholder responses, we are of the view that the residential analogue access market is effectively competitive. Over the forward look period we believe competition is likely to increase e.g. as Communication Providers such as Sky sell narrowband services as part of a bundled package into their existing customer base.⁵⁴

Hull

- 5.100 In the March Consultation, we considered that KCOM does have SMP in the residential fixed analogue market for the following reasons:

- There are no significant competitors in the market.
- Threat of entry is somewhat limited.

- 5.101 With respect to the three tests for *ex ante* competition in relation to the Hull area, we are of the view that the market does not tend toward competition due to the presence of barriers to entry and a lack of competition in the market. Therefore the Commission's first two tests are not satisfied.

- 5.102 In addition, we do not think that competition law alone is enough to address the SMP in this market, as the entry barriers are too high, and have proved to be effective in excluding competition. Therefore it is appropriate to impose *ex ante* regulation on the market.

Barriers to entry in Hull**Consultation responses**

- 5.103 One stakeholder (KCOM) responded to the SMP analysis for the Hull area. KCOM do not agree with our conclusion that there remain significant barriers to entry in the Hull

⁵³ LUS is the Light User Scheme – a USO product now being replaced by BT Basic.

⁵⁴ In its press release for its results for the twelve months ended 30 June 2009, Sky stated "We are well positioned to drive increased take-up as customers respond to the value we offer, with still 7.9 million of our customers yet to choose Sky Broadband and Talk."
(http://media.sky.com/documents/pdf/press_releases/FY_0809_Press_Release).

area. Rather than acting as a disincentive to invest, they suggest the relatively small size of the Hull market offers competing providers access for a comparably small investment either in their own infrastructure or through the use of wholesale products offered by KCOM. They suggest this is particularly the case for the larger Communications Providers who have entered the UK market and grown their customer base significantly since Ofcom undertook the last narrowband market review and now benefit from much larger economies of scale and scope than KCOM. KCOM believes that this threat of entry has only intensified given the propensity for competing Communications Providers to offer bundled packages which enable even greater advantage to be taken of their extensive economies of scale and scope.

5.104 KCOM believe the fact that competitive entry remains a very real threat is evidenced by their pricing of retail services which Ofcom has noted is broadly comparable with that offered by BT. Furthermore, KCOM is very aware that its customers have a very clear view of offers available to consumers in the rest of the UK and as such will not hesitate to tell KCOM if their pricing, products or customer service compares negatively with that available through other providers. As such KCOM suggest their own customer base acts as an effective constraint. Despite the lack of significant market entry by competing providers, they state that KCOM is not in a position to act independently of the wider market.

5.105 KCOM have provided some more recent information on residential exchange line numbers which is presented below.

Figure 5.7

Residential lines provided by KCOM

	2003	2004	2005	2006	2007	2008	2009 (May)
Number of exchange lines	157,856	155,666	152,449	150,483	149,106	146,901	[redacted] ⁵⁵
% change over previous year	-1%	-1%	-2%	-1%	-1%	-1%	[redacted]

Source: KCOM

Ofcom's response

5.106 The lack of actual or prospective market entry in the Hull area suggests that significant non-transitory barriers to entry exist. KCOM notes that larger Communications Providers who have entered the UK market and increased their market share may benefit from economies of scale. KCOM seem to infer that these competitors could easily expand into the Hull area. However, it is not simple for competitors in the rest of the UK to roll out their existing arrangements in Hull: products and processes are likely to differ and wholesale arrangements would likely need to be negotiated on a different basis. In particular, Communications Providers would not be able to leverage their systems development unless KCOM used the same processes and systems interfaces as BT. It is much less likely that a Communications Provider could justify developing specific system interfaces to KCOM, given the size of the market in the Hull Area.

⁵⁵ Redacted as not yet audited.

- 5.107 Given the relatively small size of the Hull market the opportunity for achieving sufficient scale to reap scale and scope economies may be limited which is likely to act as a deterrent to entry in the Hull area – especially given the significant investment in marketing and advertising that would be required to attract customers away from the longstanding incumbent. The lack of alternative providers and the presence of barriers to entry create a strong presumption of SMP.
- 5.108 The fact that KCOM's pricing is comparable to BT is not compelling evidence of a competitive constraint as KCOM could change its prices and its customers would currently have no alternative options to obtain fixed line access.
- 5.109 The number of exchange lines provided by KCOM in Hull has declined slowly over time. The more significant decline in early 2009 may well reflect greater substitution to mobile-only access as people economise in response to the economic downturn. However, it is not possible to say whether this trend is permanent or will change when economic conditions improve.

NGA impacts in Hull

Consultation responses

- 5.110 KCOM also believe that the introduction of NGA has the potential to prove an even greater competitive constraint. KCOM see NGA rollout as a key issue over the timeframes for this market review. KCOM suggest that investment in a new geographic area such as Hull would represent a very small increment for an alternative provider and offer the opportunity of access to a new market. They would therefore expect Ofcom to carry out further analysis of the likely impact of NGA developments over the coming 4-5 years.

Ofcom's response

- 5.111 We do not believe that the introduction of NGA will have a significant impact on the Hull area over the period of this Review.
- 5.112 While BT has indicated that it will seek to speed up its NGA roll-out their plans, for the present they will focus on replacement of their own infrastructure and new greenfield sites. BT's focus where existing infrastructure exists is to deliver fibre to the cabinet rather than the home so, even in the event that BT did decide to consider rollout in the Hull area, they would still require access to the KCOM cabinets. Virgin is also looking into developing an NGA product but, again, we are not aware of plans for rollout in the Hull area.
- 5.113 There is also no evidence of other companies proposing large scale NGA roll out at this stage.
- 5.114 We do accept that if/when NGA is rolled-out in Hull, even by KCOM, this is likely to offer a significant opportunity for new wholesale access which may encourage strong retail competition. But we do not consider this is likely to act as a significant constraint on KCOM within the current review horizon.

Business Markets for fixed analogue access

UK (excluding Hull)

5.115 In the March Consultation, we suggested that the business market for fixed analogue access in the UK (excluding Hull) was competitive with no company holding significant market power for the following reasons:

- The wholesale remedies have led to the development of products which enable competitors to replicate the services offered by BT without making significant infrastructure investments. This has lowered barriers to entry and growth.
- New firms have entered and expanded in the market resulting in a fall in BT's market share.
- Relaxation of the SMP regulations in 2007 for large businesses appears to have been successful.
- Recent market research has shown that businesses are aware of alternative providers and appear willing to switch.

Overview of consultation responses

5.116 Ten stakeholders provided comments on the business access SMP assessment for the UK (excluding Hull). Stakeholder views were similar to those presented above for the residential market with a number of stakeholders providing comments for the business and residential markets combined. To avoid repetition, combined comments have been covered in the residential discussions above, although a further discussion is provided below where warranted.

5.117 BT agreed with our assessment that they no longer have SMP in the business access market. They believe that our proposals are fully justified and are a logical progression from the 2007 Replicability decision where Ofcom found that BT's Retail access services are replicable by its competitors.

5.118 The other respondents disagreed with our conclusions. The main issues of concern were BT's market share and apparent ability of BT Retail to charge a price premium. We discuss these points and other stakeholder comments in more detail below.

BT's market share

Consultation responses

5.119 The comments made on BT's market share in the business analogue access market were very similar to those made in relation to the residential market (discussed above). A number of stakeholders, including TalkTalk Group, COLT, SSE, Cable & Wireless, FCS and UKCTA, commented that BT still has a relatively high market share which was indicative of SMP and expressed concern that the market was not sufficiently competitive to justify full deregulation. Some Communications Providers further commented that BT's market share would not decline at a sufficient rate to rebut the presumption of dominance over the forthcoming review period.

Ofcom's response

5.120 As noted in the residential section above, a high market share alone is not enough to conclude that SMP is present. A wide range of factors need to be taken into account in

an overall SMP assessment. In particular, we believe that the available evidence shows that barriers to entry and expansion in this market are low because the wholesale remedies in place (particularly WLR) mean that competitors can easily enter the market and replicate the services offered by BT without making significant infrastructure investments. New firms have entered and expanded in the market resulting in a 19% fall in BT's share of business exchange lines from 85% in 2003 to 66% in 2008.

- 5.121 The information collected formally from Communications Providers since the March Consultation was published suggests that strong competition has continued and BT's market share has fallen further. The number of business analogue lines provided by BT fell by around 5% from January to May 2009. Research we have examined suggests that price is the main reason why customers are moving away from BT.
- 5.122 Updated market share information is presented below. As noted in the introduction to this section, this data has been revised since the March Consultation was published, in particular, the revised estimates suggest BT's share of exchange lines is higher over the period 2006-2008 than previously reported.

Figure 5.8
Updated market shares of business fixed narrowband access⁵⁶

	Exchange Lines		Revenues	
	BT	Others	BT	Others
2003	85%	15%	87%	13%
2004	83%	17%	86%	14%
2005	78%	22%	79%	21%
2006	74%	26%	72%	28%
2007	69%	31%	68%	32%
2008	66%	34%	65%	35%
2008 Q1	68%	32%	66%	34%
2008 Q2	67%	33%	66%	34%
2008 Q3	67%	33%	65%	35%
2008 Q4	66%	34%	63%	37%
2009 Q1	65%	35%	63%	37%

Source: Ofcom/operators

- 5.123 In the 12 months to May 2009 BT's churn⁵⁷ was [3%]. This is partly driven by a decline in market size (e.g. some businesses have ceased trading) but also indicates that BT is losing customers to other Communications Providers. Research also suggests that churn has increased between Q2 2008 and Q4 2008. Over the same time period BT gained a substantial number ([3%]) of new lines. Overall this suggests that businesses are willing and able to seek out the best deals and switch provider.
- 5.124 Churn in business is lower than in residential lines, which may, in part be a factor of longer and stronger contractual commitments and less movement in premises (moves often prompt a review of service providers).

⁵⁶ Original information was provided in Table 5.16 of the consultation.

⁵⁷ Churn is defined as lines ceased or transferred over 12 months divided by average lines provided over 12 months. Line transfers includes change of premises.

- 5.125 The new information on competition including BT's market share and churn supports our assessment that the wholesale remedies are effective which has led to low barriers to entry and growth.

BT's pricing and profitability

Consultation responses

- 5.126 COLT suggested a further reason why Ofcom's analysis does not prove a lack of SMP is that BT is able to retain a price premium evidenced by its share of revenue being greater than its share of volumes. COLT stated that BT's ability to maintain this price differential without losing market share indicates the persistence of market power. COLT further commented that Ofcom's analysis is often one-sided, explaining why it believes BT's ability to charge a price premium does not indicate the presence of SMP, but not exploring why it might indicate the presence of SMP.

Ofcom's response

- 5.127 We have updated BT's market share for lines and revenues since the March Consultation was published. The revised figures show that since 2006 BT's share of lines has been greater than their share of revenues. The evidence therefore suggests that BT is not charging a price premium.
- 5.128 Moreover, it is not necessarily the case that a price premium indicates SMP, as demand for access is linked to the price of calls and other products. This means it is not necessarily possible to conclude that a price premium is being charged without considering access together with the prices of related products.
- 5.129 We also formally requested additional information from BT to further assess profitability in the business market. The Figure below presents BT's revenues, costs and gross margin for the business analogue access combined with local and national business analogue calls^{58 59} for 2005/6 to 2008/9.

Figure 5.9

Business analogue access and local/national calls – revenues, costs and returns 2005/6 and 2008/9⁶⁰

[X]

Source: BT

- 5.130 BT's revenues for calls and access have decreased over time. Revenues decreased by around 9% in 2008/9 relative to 2007/8. The return on sales⁶¹ has varied over the period and decreased by 8 percentage points from 2006/7 to 2007/8 (from [X] to [X]), though increased by 2 percentage points in 2008/9.
- 5.131 BT's regulatory accounts do not contain a more detailed cost breakdown for the business markets so our analysis here is more limited. However, the information

⁵⁸ It is useful to consider lines and calls together as customers tend to buy these services as a package, and a low price for access can increase demand for calls.

⁵⁹ It was not possible to include mobile and international calls because it was not possible to split the data between PSTN and ISDN services.

⁶⁰ Redacted as the information is commercially confidential.

⁶¹ Gross margin / revenue.

obtained from BT shows that BT's costs per business analogue access line decreased £6 between 2007/8 and 2008/9.

BT has advantages of scale

Consultation responses

- 5.132 FCS said that BT has advantages of scale, for example, they thought that the popularity of inclusive business packages (referred to in paragraph 4.91 of the March Consultation) was largely due to BT marketing and the power of the BT brand. They noted that other Communications Providers can use e.g. indirect access, to replicate this type of service offer but do not always have the knowledge or expertise to do so.

Ofcom's response

- 5.133 We are not convinced that the popularity of inclusive business packages is necessarily a reflection of BT marketing and the power of the BT brand. The popularity of inclusive packages is as likely to be demand driven with customers attracted by the convenience of a one stop shop to purchase services. In addition, the wholesale products available (e.g. WLR/CPS and LLU) allow Communications Providers to create offerings similar to BT. We believe that small scale entry in the business market is feasible because business customers are more interested in purchasing bespoke or value added services with a number of small providers offering a package of services to businesses. This is supported by the available evidence showing competing Communications Providers winning sales from BT.

Ofcom's conclusion on the business analogue access market

- 5.134 To conclude, taking into account the available evidence (set out in the March Consultation and above) and stakeholder responses, we are of the view that the business analogue access market is effectively competitive. Over the forward look period we believe competition is likely to increase.

Hull

- 5.135 In the March Consultation we considered that KCOM still held SMP due to the muted prospects for entry and high market share of KCOM.

Consultation responses

- 5.136 Only one stakeholder (KCOM) commented on the SMP analysis for the Hull area. KCOM thought that the impact of leased lines substitution in the business analogue exchange lines and calls markets had been substantially underestimated. In particular, KCOM thought that if traffic using leased lines to bypass the PSTN was taken into account in the business calls market, KCOM's market share is substantially lower than estimated by Ofcom and no longer justifies a finding of SMP and the imposition of regulatory remedies.
- 5.137 KCOM noted that although Ofcom recognises that some Communications Providers offer fixed exchange line services by other means in the Hull area (e.g. leased lines or fixed radio access) no estimate was given for the market share this represents. The only figures given are the number of business exchange lines provided by KCOM during 2006/07 and 2007/08 which Ofcom concludes is a high market share creating a presumption of market power.

- 5.138 KCOM further noted that in its statement on the Business Connectivity Market Review published in December 2008 Ofcom concluded that KCOM no longer had SMP in the retail market for low bandwidth TI leased lines based largely on KCOM's low market share of 25%. KCOM commented that this would suggest rather more extensive use of alternative access methods than suggested by Ofcom and must be taken into account by Ofcom in assessing the constraints which apply to KCOM's provision of business analogue exchange lines.
- 5.139 KCOM has provided some revised information on the number of business exchange provided in the Hull area:

Figure 5.10**Business exchange lines provided by KCOM**

	2003	2004	2005	2006	2007	2008	2009 (May)
Number of exchange lines	41616	41629	44334	44612	45072	44581	[redacted] ⁶²
% change over previous year		0%	6%	1%	1%	-1%	[redacted]

Source: KCOM

Ofcom's response

- 5.140 We note that there are Communications Providers offering fixed line exchange services by other means in the Hull area. However, we lack information to ascertain the number of lines offered by alternative providers specifically in the Hull area. For example, leased lines are not part of the narrowband access market and are assessed as part of a separate market review. While it is possible that leased line calls are exerting some competitive pressure on KCOM PSTN access, this is only likely to be evident for larger businesses where leased lines are a viable alternative. The information provided on the number of business exchange lines suggests the market size is relatively static and substitution to mobile access or other alternatives is limited.
- 5.141 We are nonetheless open to considering whether competition in the calls market for larger businesses is sufficiently developed to warrant a relaxation of the remedies. This is discussed in more detail in Section 7.

ISDN2**UK (excluding Hull)**

- 5.142 In the March Consultation we considered that BT still held SMP due to:

- the absence of significant competitors and apparent barriers to expansion;
- BT's high market share combined with apparently increasing retail margins; and
- lack of evidence of increased competitive intensity.

⁶² Redacted as not yet audited.

Consultation responses

- 5.143 Three stakeholders commented on the SMP assessment for ISDN2 in the UK (excluding Hull).
- 5.144 Two stakeholders agreed with our assessment (COLT and a confidential respondent).
- 5.145 BT disagreed with the SMP assessment. BT commented that we had failed to properly assess whether the ISDN2 market meets the EC three criteria test which we have already discussed in the market definition section above.
- 5.146 BT also stated that ISDN2 is increasingly in competition with new technologies such as IP-based products and there is a strong level of competition from neighbouring products. BT considered that our analysis does not sufficiently take into account these forward looking factors.
- 5.147 BT further commented that the finding of SMP in the ISDN2 market was not justified for the following reasons:
- barriers to customers' switching are low, and this is demonstrated by the very high levels of churn;
 - BT's declining revenue and profit margin;
 - the significant buying power of business customers, their market awareness and their ability to multi-source; and
 - the fact that BT gains no advantage from its vertical integration as a result of the existing wholesale remedies.

Ofcom's response

- 5.148 We recognise that BT and other retail suppliers of ISDN2 are likely to face increased competition from IP based solutions, leading to a progressive decline in the ISDN market (this is noted in paragraphs 5.175 and 5.177 of the March Consultation). Based on information in BT's regulatory accounts we estimate that the number of ISDN2 channels provided by BT and others has decreased by an average of around 4% per year from 2005/6 to 2008/9. We anticipate that the number of channels will continue to decline steadily over the review period.
- 5.149 Nonetheless, there remains a significant number of customers who have invested in equipment specific to ISDN2 technology who are unlikely to switch to alternative technologies until the equipment requires replacement. In the current economic environment it is possible that such capital replacement programmes will be deferred which will slow any decline in the ISDN market, though equally, difficult market circumstances may also lead to investments in new services which give rise to cost savings. However, rivalry from neighbouring products is likely to be strongest when competing for new customers and existing customers are less likely to benefit from this process.
- 5.150 A further barrier to substitution is the need for reliable and resilient services – which is particularly important for business customers. For example, broadband service levels are lower with higher fault rates relative to ISDN services. This means customers requiring high reliability are likely to remain with ISDN until more resilient IP based

services are available. Some businesses who have switched to IP services retain ISDN2 as a secondary back up line.

- 5.151 We have not observed, in any event, that the declining market size has significantly increased the competitive constraints on BT, for example, BT's margin over wholesale access costs has increased over the period (see paragraph 5.168 of the March Consultation).
- 5.152 We explained in the March Consultation (paragraphs 5.150-5.152) why we believe some barriers to entry, expansion and switching remain. We also discussed above why we think competition from neighbouring (e.g. IP based) products has not significantly increased the competitive constraints on BT. In summary, we consider that barriers to entry remain because:
- a. ISDN tends not to be purchased in isolation but as part of a suite of business products/services and to win ISDN market share quickly, firms may well need to offer a whole range of attractive communication products which makes entry and expansion more difficult than for analogue exchange lines.
 - b. It can be difficult and costly to reach ISDN customers because ISDN is purchased by a minority of businesses.
 - c. Although a number of new providers have entered the ISDN market, these resellers are relatively small scale.
 - d. Even if switching costs are small in absolute terms they may well be high relative to the financial benefits of switching (see paragraph 5.157 of the March Consultation).
- 5.153 In support of their position BT noted that they have lost a substantial number ([redacted]⁶³) of ISDN 2 channels over the past 5 years and have a high level of churn. However, this figure includes any movement including location moves and customers who switched to other BT products, so this is not an accurate measure of the competitiveness of the market.
- 5.154 BT noted that their revenues and profit margin are in decline. We would expect ISDN2 revenues to fall over time given that the market is in decline and the number of channels is falling (as noted above). The information submitted by BT shows that return on sales for ISDN2 access fell by 5 percentage points from 2006/7 to 2007/8 but then increased 3 percentage points in 2008/9. The return on sales for ISDN2 access combined with local and national calls via ISDN2 was constant (at [redacted]) in 2007/8 and 2008/9⁶⁴ ⁶⁵. Access costs (i.e. the costs to BT) per ISDN2 channel have increased from 2006/7 to 2008/9. Overall we consider that profit margins are not under significant pressure due to increased competition.
- 5.155 BT considered that the types of customers who purchase ISDN2 (e.g. business customers who multisource) reduced their ability to exert market power. We are not convinced that these customers have sufficient buyer power. ISDN2 customers are likely to multisource to obtain security of supply (e.g. for contingency purposes) and are not

⁶³ Redacted as commercially sensitive.

⁶⁴ It was not possible to include mobile and international calls within this measure because these calls were not split between those made on PSTN, ISDN2 and ISDN30.

⁶⁵ We recognise that ISDN 2 calls are not a separate market (as noted in section 4 we have defined a market for business calls which includes ISDN and PSTN calls), however, it is useful to consider ISDN2 access and calls together as customers tend to buy these services as a package.

likely to switch between these suppliers based on small difference in price. As such, it is not clear that multi-sourcing would drive competition in this market.

- 5.156 The fact that BT does not gain advantage from vertical integration due to wholesale remedies is an important step towards achieving a competitive market. However, it does not necessarily mitigate SMP in markets characterised by barriers to expansion (as discussed above).
- 5.157 We have updated the information on BT's market share in ISDN2 which is presented below:

Figure 5.11
BT Market share for ISDN 2⁶⁶

	2005/6	2006/7	2007/8	2008/9
Total channels	1.515	1.459	1.428	1.299
BT	1.344	1.201	1.081	0.898
Others (WLR resellers)	0.171	0.258	0.347	0.401
BT market share	89%	82%	76%	69%

Source: BT Regulatory Accounts

- 5.158 BT's market share of channels and revenues has continued to fall which reflects the entry of small scale Communications Providers offering WLR services. However, it remains the case that BT's competitors are relatively small and no entrant has a market share above 3%. The evidence still suggests that the market structure is characterised by a single dominant player with a number of competitors with very low individual market shares.
- 5.159 We believe that BT faces little incentive to respond to competition from the fringe of smaller firms by lowering prices to business customers. As noted in paragraph 5.173 of the March Consultation, as the market declines low prices are less likely to result in increased sales, but instead will simply benefit existing customers. In a declining market the incentive to invest in entry and expansion is likely to be limited. In addition, businesses will increasingly use ISDN2 as a backup line which means it is a less attractive proposition for Communications Providers to offer e.g. because there is a limited ability to generate revenues from calls. The significant increase in BT's margin over wholesale access costs (discussed in paragraphs 5.168 and 5.169 of the March Consultation) indicates the lack of incentive to compete on price.
- 5.160 Overall we consider that the ISDN2 market has certainly become significantly more competitive since the last review due to the wholesale remedies which have reduced barriers to entry. However, we consider that on balance an SMP finding is still appropriate because:
- Although the number of players in the market has increased, this does not appear to have increased the intensity of competition to a sufficient degree to support a no SMP finding. Prices have remained relatively static and BT's margin over wholesale access costs has increased since the last review.

⁶⁶ Figures exclude Virgin media which we estimate to be around 1% of the total market.

- BT's competitors are relatively small and the market is characterised by a single dominant player, a fringe of competitors and a constant set of products. BT faces little incentive to respond to competition by a fringe of competitors by lowering prices.
- BT's profitability (as indicated by the return on sales figure) shows little sign of consistent material decline.

5.161 However, as discussed in Section 7, we consider that the existing remedies for SMP are not effectively promoting competition. We consider that there is a value in encouraging more active price competition between BT and other Communications Providers through removal of some of the pricing transparency provided by these remedies. This is also consistent with our view that while at the margin we find SMP for BT, we observe that competition is increasing since the wholesale remedies seem to be working.

5.162 While we find a number of similarities in the way competition takes place in the supply of analogue lines and ISDN2 to businesses, we believe that at the margin BT does not have SMP in the supply of analogue lines while it has SMP in the supply of ISDN2 for the following reasons:

- The ISDN2 market is less attractive for BT's rivals to invest in going forward as it is in decline;
- The ISDN2 market is smaller in size and more expensive to reach in terms of marketing and sale costs as only a small share of businesses are interested in it; and
- The increased use of ISDN2 as a back-up line going forward means expected future revenues (from access and calls) when winning a new customer are lower for ISDN2 than for analogue exchange lines.

Hull area

5.163 In the March Consultation, we considered that KCOM had SMP in the ISDN2 market due to the lack of competitors and KCOM's high market share.

Consultation responses

5.164 One stakeholder (KCOM) commented on the ISDN2 SMP assessment for Hull. KCOM stated that Ofcom had concluded that the prospect of significant entry in the ISDN market appears muted, 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 believe that the continued application of regulatory remedies is no longer justified.

5.165 KCOM also provided some updated information on ISDN2 channels as follows:

Figure 5.10

KCOM ISDN2 channels and revenues

	Number of ISDN2 channels	% change over previous year	ISDN2 revenues (£000's)	% change over previous year
2005	10490	-6%	1452	Not available
2006	9840	-6%	1540	6%
2007	9676	-2%	1610	5%

Source: KCOM

Ofcom's response

- 5.166 KCOM faces no actual competition in the supply of ISDN 2 in Hull. The fact that ISDN products are nearing the end of their lifecycle as customers move to alternative technologies does not necessarily imply that the competitive constraints in the ISDN 2 market have increased. In particular, we note that KCOM's ISDN2 revenues have increased in recent years despite a fall in the number of ISDN2 channels provided. We do not have any compelling evidence to suggest that the competitive constraints will increase significantly over the forward looking review period. Accordingly, in our overall assessment, we remain of the view set out in the March Consultation that this market is not effectively competitive.

Section 6

Calls Markets – market power analysis

Introduction

- 6.1 The purpose of this assessment is to determine the effectiveness of competition in the various fixed narrowband calls markets, both currently and in the foreseeable future. This assessment will inform our decision as to whether retail fixed calls markets are effectively competitive.
- 6.2 Where we find a market to be effectively competitive, the SMP obligations previously imposed must be withdrawn (see Section 8). However, our involvement in the retail market will continue through sector level retail regulation, such as the General Conditions on communications companies (see Section 7).
- 6.3 Where SMP is found, we are obliged to consider what remedial regulations may be required to address the competitive failure.

Summary

- 6.4 We have concluded that in the UK (excluding Hull) no company has SMP in either the residential or business fixed narrowband calls markets.
- 6.5 We have concluded that in the Hull area KCOM holds SMP in both the residential and business fixed narrowband calls markets, though as set out in Section 7 we are open to further consideration on how remedies should be imposed.

Our Approach

- 6.6 Our approach was the same as set out in Section 5. Many of the features of the calls market are common with the access market. In the analysis that follows, rather than repeat our access analysis we instead focus on supplemental evidence.
- 6.7 As noted in Section 5, because access and calls are closely linked in a number of cases the evidence we present relates to both products combined. Where this is the case the evidence is presented once in the access section to avoid repetition. For each calls market we consider separately the UK (excluding Hull) and the Hull area.

Residential Market for calls

UK (excluding Hull)

- 6.8 In the March Consultation we set out our view that BT does not have SMP in the fixed calls market for the following reasons:
- The wholesale remedies (e.g. WLR and CPS) have led to the development of products which enable competitors to replicate the services offered by BT without making significant infrastructure investments. This has lowered barriers to entry and growth.
 - New firms have entered and expanded in the market resulting in a fall in BT's market share.

- Some of the main competitors such as Sky are expected to rely increasingly on LLU during the review period to further reduce their costs and increase the competitive pressure on BT.
- Consumers are willing and able to switch provider (evidenced by the fall in BT's market share).
- Since RPCs were lifted the overall average increase in the phone bill has continue to fall in real terms.
- The overall cost of a fixed line access and calls package is comparable to similar OECD countries.
- Mobile calls represent a significant constraint for at least some types of calls and some consumers.

Overview of consultation responses

- 6.9 A number of stakeholders made overarching comments in relation to the SMP assessment for the markets where we are proposing to deregulate – particularly relating to BT's market share. To avoid repetition, where these comments have been discussed in the sections above they are not covered again unless further discussion is warranted. Comments specific to the residential calls SMP assessment are covered below.
- 6.10 BT agreed with our SMP assessment. They commented that the wholesale remedies are sufficient which has resulted in plenty of choice for consumers and led to considerable levels of switching. They commented that prices have significantly declined since 2003.
- 6.11 Other stakeholders did not agree with our assessment – largely for the reasons set out in the residential analogue access section above. The main comment made was that BT's market share was indicative of SMP and stakeholders expressed concern that the market was not sufficiently competitive to justify full deregulation.

BT's market share

Ofcom's response

- 6.12 As noted above, BT's market share is only one factor in the SMP assessment and a high market share alone not sufficient to conclude that SMP is present. When set against the other factors considered as part of the SMP assessment we believe that the evidence points to BT no longer having SMP – for further discussion see paragraphs 5.31-5.44 above.
- 6.13 Since the March Consultation was published we have updated the market share information, which is shown below.

Figure 6.1

Updated market shares of residential fixed narrowband calls (geographic, international and call to mobile)⁶⁷

	Volumes BT	Virgin Media	Other fixed	Revenues BT	Virgin Media	Other fixed
2003	71%	18%	11%	69%	19%	12%
2004	65%	19%	17%	63%	20%	17%
2005	59%	19%	22%	56%	20%	24%

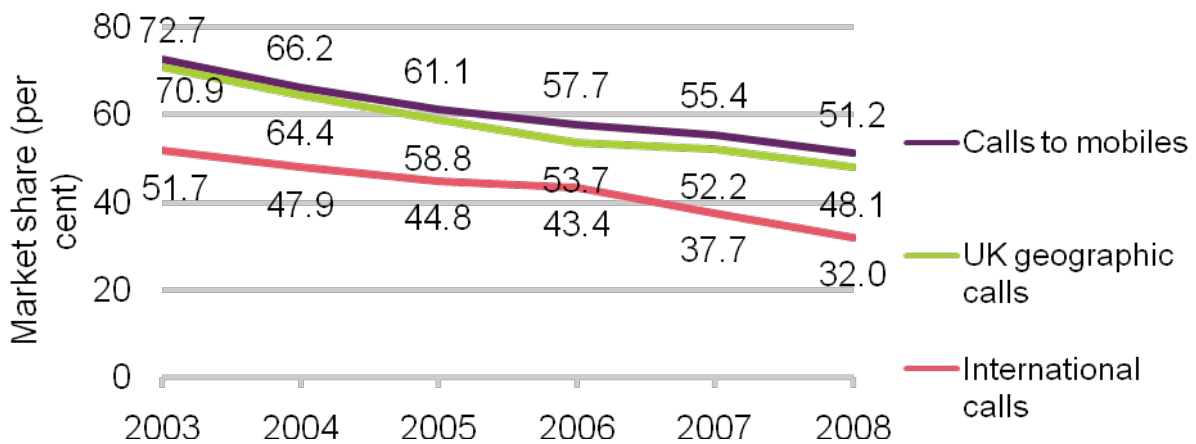
⁶⁷ Original information was provided in Table 6.1 of the consultation.

2006	54%	20%	26%	54%	19%	27%
2007	52%	18%	30%	55%	17%	27%
2008	48%	18%	35%	52%	17%	31%
2008 Q1	49%	18%	32%	51%	18%	31%
2008 Q2	47%	17%	36%	52%	17%	31%
2008 Q3	48%	17%	35%	52%	17%	31%
2008 Q4	47%	17%	35%	52%	17%	31%
2009 Q1	46%	17%	37%	51%	17%	32%

Source: Ofcom/operators

- 6.14 The information shows that BT's market share of volumes and revenues has decreased over 2008 relative to 2007. We noted in the residential access section above that BT has continued to lose market share in exchange lines through 2009 (e.g. as competitors like Sky sell into their existing customer base), and we would expect the market share in calls to follow this trend (as customers who move their line to an alternative Communications Provider will in virtually all cases also move their calls).
- 6.15 The Figure below shows that BT's market share for all residential call types has fallen since 2003.

Figure 6.2
BT share of residential retail voice call volumes, by type



Source: Ofcom/operators

BT's profitability

Consultation responses

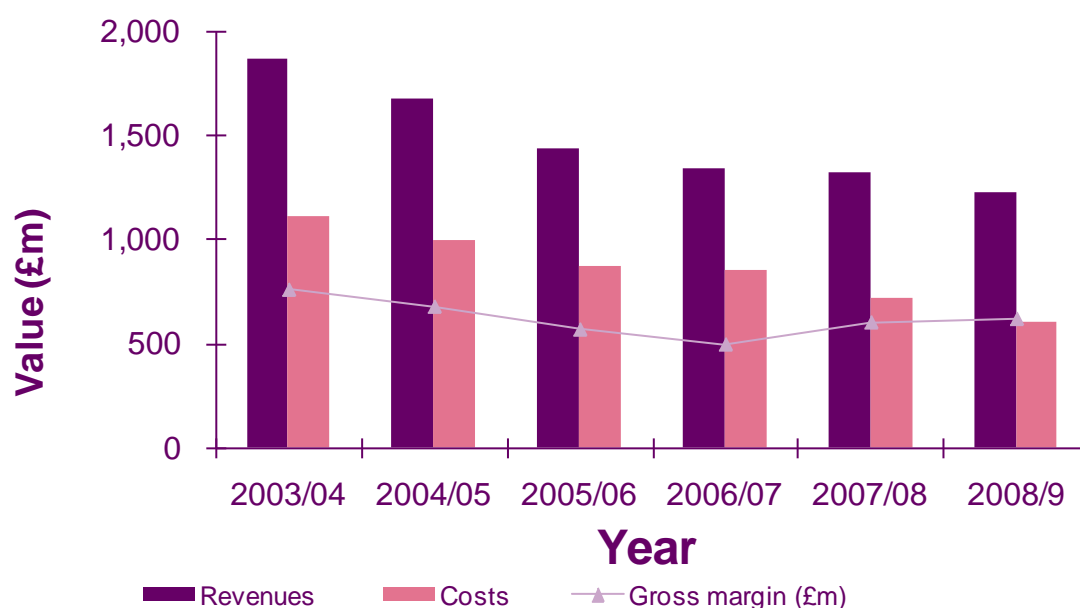
- 6.16 COLT commented that Figure 6.3 in the March Consultation (which shows BT's gross margin through time) shows an upturn in the final year (2007/8). COLT commented that this increase could be a one off or a result of BT's ability to profitably raise prices above the market level.

Ofcom's response

- 6.17 An examination of the gross margin information shows that BT's total revenue from SMP call markets has been falling since 2003/4. BT's gross margin increased in 2007/8 because costs decreased by more than revenues (total costs decreased by £128m and revenues decreased by £23m⁶⁸).
- 6.18 We have updated gross margin data from BT for 2008/9 which we present below⁶⁹.

Figure 6.3

Residential call markets – revenues, costs and returns from 2003/4 to 2008/9



Source: BT regulatory accounts

- 6.19 The Figure shows that BT's revenues have continued to fall and gross margin has increased only slightly in 2008/9. Again, it appears that BT's ability to maintain gross margin is driven by a proportionately larger decrease in costs rather than rising revenues.
- 6.20 We have examined the costs reported in BT's regulatory accounts in more detail. Across the residential local, national, IDD category A and call to mobile call categories in aggregate there was a £116m decrease in total costs in 2008/9 versus 2007/8⁷⁰. £72m of this arose from reduced wholesale charges and out-payments (62% of the total). This will reflect a decrease in the volume of calls provided by BT. The decrease in out-payments for call to mobile will also reflect reduced mobile termination rates. The third

⁶⁸ Figures exclude IDD category B and operator assisted calls.

⁶⁹ In light of the 2009 consultation and statement on changes to BT and KCOM's regulatory financial reporting, for 2008/9 BT was not required to report international direct dial category B or operator assisted calls due to the small size of these markets (refer to http://www.ofcom.org.uk/consult/condocs/btkcom09/statement/btkcom_statement.pdf, section 4). These call types have been removed from the previous year's Figures to ensure the time series is consistent.

⁷⁰ Excludes roundings.

largest contributor was general management which contributed £14m (or 12%) to the cost reduction. Messaging, other costs and marketing and sales contributed £28m combined to the reduction. This evidence suggests that BT has maintained profitability by reducing costs. Nonetheless it is difficult to draw strong conclusions from these gross margin data as, from an economic point of view, the cost reductions could reflect a decrease in economic investment (e.g. subscriber acquisition costs) that should be amortised rather than treated as a current costs and fully expensed.

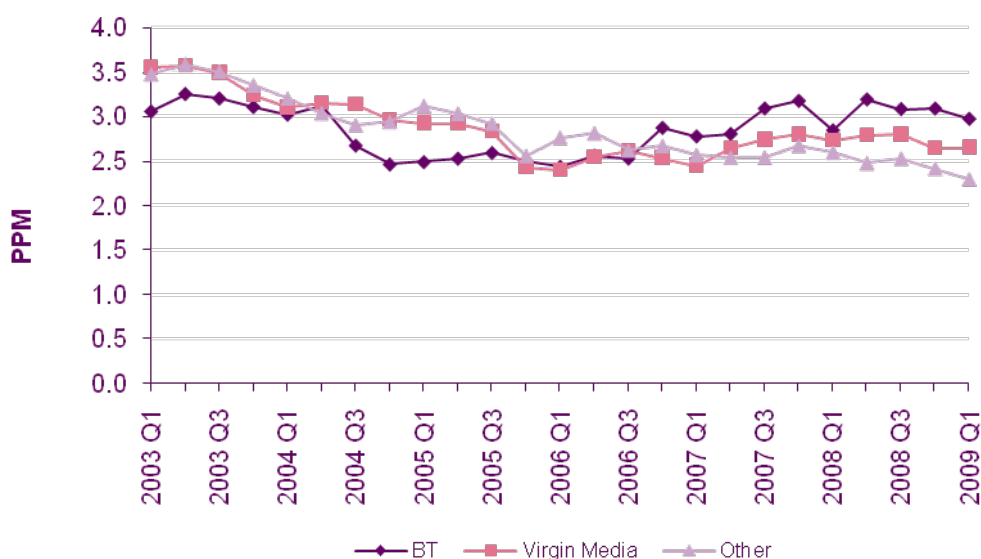
- 6.21 BT's revenue per minute (as shown in Figure 6.4 below) has declined over 2008/9 which, again, suggests that the ability to maintain gross margin is due more to cost reductions than increased prices.
- 6.22 As noted in the residential access section above, a further factor which has helped BT to maintain gross margin in the face of falling call volumes is that customers have tended to migrate to higher value call packages i.e. packages with a higher fixed monthly costs and more inclusive minutes. This would appear to reflect customer choice as to which package offers optimal value.

BT's pricing

Consultation responses

- 6.23 COLT commented that since 2007 BT's share of revenues has been higher than their share of volumes which indicates that BT is able to charge a price premium. They noted that until 2006 the reverse was true and BT's share of volumes was higher than their share of revenues. COLT contended that the ability of BT to charge a price premium despite falling market share countered the assumption that BT does not have market power.
- 6.24 In Figure 6.4 of the March Consultation (updated and shown below) we presented BT's revenue per minute (RPM) for residential calls. COLT commented that we do not discuss SMP as an explanation of BT's ability to raise prices above the market level. Also in relation to Figure 6.4, Sky commented that despite the entry of new operators BT has been able to maintain its prices at a relatively stable level, indicating an ability to act without regard to its competitors.

Figure 6.4
Revenue per minute – geographic, international and call to mobile



Source: Ofcom/operators

Ofcom's response

- 6.25 We explained in paragraphs 6.34-6.49 of the March Consultation a number of reasons to explain why BT's RPM could have risen since 2006 including that we would expect BT to have a first mover advantage in the market and that BT has an established brand. 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 subscribers for a relatively homogenous product⁷¹. In addition, the RPM on calls cannot be considered in isolation from pricing strategies for the products they are sold with. For example, Communications Providers might strategically charge a lower price for calls to drive demand for related products meaning it is difficult to draw comparisons of RPM across different providers.
- 6.26 In addition, the analysis of BT's pricing changes since the RPCs were lifted shows that the total phone bill has increased by less than RPI (paragraph 6.46 of the March Consultation).

Use of survey data

Consultation responses

- 6.27 COLT commented that Ofcom's analysis of sensitivity to price changes (paragraphs 6.23-6.28 of the March Consultation) was based entirely on survey data where customers were asked how they would respond to a price change. COLT noted that such surveys are always likely to overstate customers' willingness to switch/reduce calls and it would be better for Ofcom to use statistically valid research data of consumer behaviour in response to a price change. Sky also commented that we placed a different

⁷¹ This assessment is also relevant for the business calls market below.

emphasis on survey evidence presented in the pay TV review due to concerns that it might be affected by cellophane fallacy and hypothetical bias (we have discussed this in the access section above).

- 6.28 COLT commented that the March Consultation showed that BT lost 17% market share when its prices were below the average (i.e. from 2003-2006) but only 7% since its prices moved above the average (Figure 6.1). COLT considered that this did not support the results of the market survey and calls into question our reliance on survey data to assess market power.
- 6.29 COLT further commented on paragraph 6.25 of the March Consultation which reported that the survey evidence showed BT customers to be slightly more price sensitive than those of their rivals. COLT asked whether this result was statistically significant and also commented that the information on market share appeared to contradict this finding by showing that BT's customers are prepared to pay a premium over the average price.

Ofcom's response

- 6.30 We have commented on the use of survey data in the residential access section above and addressed Sky's points regarding the different emphasis placed on survey data in the pay TV and retail narrowband reviews in paragraphs 5.73--5.78. To reiterate, we have used the consumer survey evidence as complementary evidence to inform our conclusions on SMP rather than relying on this information to draw conclusions.
- 6.31 COLT commented that the survey evidence was contradictory because it appears that BT's customers are prepared to pay a price premium and at the same time are more price sensitive. In fact the evidence may reflect the heterogeneity of BT's customers. There is likely to be a subgroup of customers who have a strong preference for BT and are willing to pay a price premium. In addition, there is also likely to be a segment that is highly price sensitive. The churn figures presented above suggest that a significant portion of BT's customers are willing and able to switch.
- 6.32 Our comment in paragraph 6.25 of the March Consultation which discussed the price sensitivity of BT's customers relative to their rivals was intended to be a descriptive comment to which we do not attach statistical significance.

Porting charges

Consultation responses

- 6.33 Sky commented that the current porting charges favour BT. Under the current fixed number portability arrangements calls to ported numbers are typically routed by the originating Communications Provider to the original number range holder (donor network) who will then onward route the calls to the network to which the number was ported (the recipient network). The donor network is entitled to charge the recipient network for the cost of onward routing. Because an LLU operator will typically port their customer's telephone number from BT's network to their own, this means that an LLU operator effectively returns a proportion of their wholesale geographic termination revenues for calls to these customers back to BT as compensation for the routing of ported calls over BT's network.
- 6.34 Sky argues that as BT is a net exporter of numbers to other operators it is in a better position than other operators. They suggest that lower call margins for non-BT terminating networks can feed through to have adverse consequences for retail competition.

Ofcom's response

- 6.35 Number portability is an important feature to encourage switching and competition in this market. New entrant Communications Providers, in particular, benefit from number portability because it reduces the barriers to switching and makes it easier to 'win' new customers with attractive deals.
- 6.36 Onward routing of ported numbers results in additional conveyance and transmission costs for the donor network and under the current mechanism the recipient operator is charged to cover these costs. It is beyond the scope of this review to consider the policy underlying this decision⁷². We recognise that the cost recovery mechanism reduces the revenues earned by the recipient network for calls to customers with ported numbers. However, we do not consider that BT derives SMP from this. Even under the current arrangement BT has lost substantial market share (as discussed above) which indicates that the cost of number portability is not a substantial impediment to competition. The main LLU operator (TalkTalk) has grown substantially since the last review and is one of BT's largest competitors.

Calls to mobile and pass through of changes in the mobile termination rate

Consultation responses

- 6.37 T-mobile commented specifically on the calls to mobiles sub segment of the calls market. They noted that the price of calls to mobiles increased after 2007 when the new mobile call termination price control came into place. They commented that this is counter-intuitive and implies that the reductions in mobile termination rates have only lead to an increase in BT's margins on these calls, as opposed to any direct consumer benefit. They thought that Ofcom should investigate this area and ensure that the price of calls from fixed to mobile is linked directly to the regulated mobile termination rate.
- 6.38 The respondent argued that there is no competitive pressure on BT or other fixed operators to bring down the price of fixed to mobile calls and that more prescriptive regulation on BT was necessary.

Ofcom's response

- 6.39 As discussed in the March Consultation in the definition of the calls market, customers now tend to buy a calls package which includes some inclusive minutes. Up to the present time, competition has focussed on bundles of inclusive minutes to fixed locations, with mobile, some NTS and international calls outside those bundles. Accordingly, fixed providers will structure their rates for out of bundle call types to ensure that their headline offering is attractive⁷³. This structure and practice is following the lead of mobile offerings (although mobile companies are also able to include mobile calls in the bundles). This means margins are lower for calls types that represent the focal point of competition and higher for calls that are not included in the headline bundles. This means that while margins differ across different call types it is meaningful only to look at margins across all call types as we discuss above.
- 6.40 More recently competition has started to focus more strongly on the price of mobile calls with BT offering a 'mobile add on' which gives unlimited calls to mobile at 7ppm⁷⁴ in

⁷² The case for direct routing of calls to ported numbers is being considered as part of a separate project see http://www.ofcom.org.uk/consult/condocs/gc18_routing/routing.pdf.

⁷³ By headline offering we mean the offer that is routinely advertised in the national marketing campaigns.

⁷⁴ An 8p call set up fee applies.

return for a £1.50 per month flat fee. Virgin media offer a 'talk mobile' package for £1.50 a month which provides a 25% discount on standard mobile rates⁷⁵, and TalkTalk also offer a 'mobile boost' package which offers a discount on mobile calls in return for a flat monthly fee.

- 6.41 For BT's customers the overall phone bill has in fact increased by less than inflation since the RPCs were lifted (see Annex 6 of the March Consultation) and the reduction in mobile termination costs has contributed to this outcome. As shown in Figure A5.8 of the March Consultation BT's revenue per minute for residential calls to mobiles is lower than that of Virgin Media and those charged by other fixed providers, which suggests that, on average, BT's prices are lower than other providers.

Hull area

- 6.42 In the March Consultation we set out our view that KCOM does have SMP in the fixed calls due to the muted prospects for entry and high market share of KCOM.
- 6.43 With respect to the three tests for *ex ante* competition in relation to the Hull area, we are of the view that the market does not tend toward competition due to the presence of barriers to entry and a lack of competition in the market. Therefore the Commission's first two tests are not satisfied.
- 6.44 In addition, we consider that competition law alone is not enough to address the SMP in this market as the entry barriers are too high and have proved to be effective in excluding competition. Therefore it is appropriate to impose *ex ante* regulation on KCOM in this market.

Fixed-mobile substitution in Hull

Consultation responses

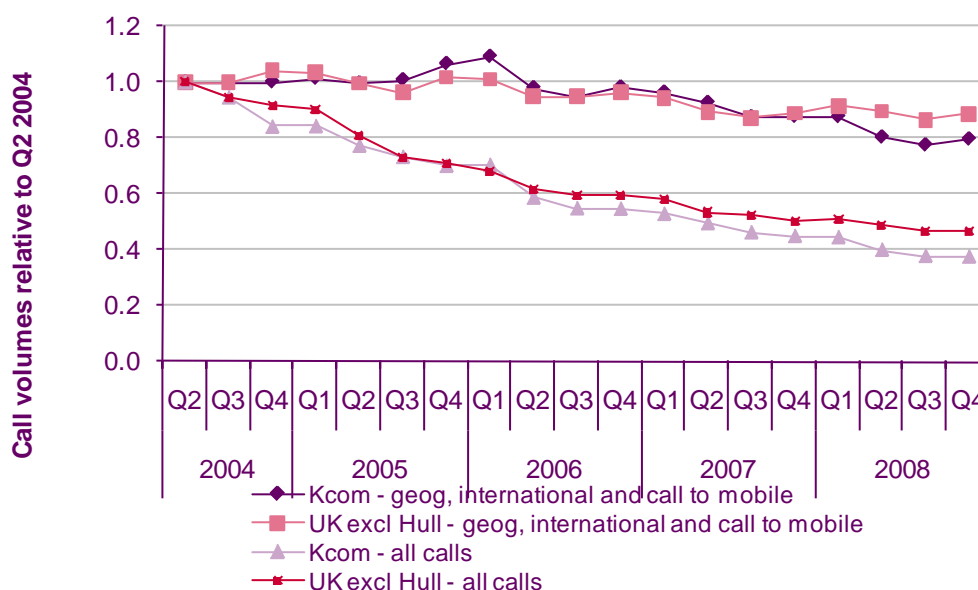
- 6.45 Only KCOM commented on the SMP analysis in Hull. KCOM disagreed with our conclusion on the basis that mobile substitution in the Hull area was likely to be more pronounced than the rest of the UK. KCOM considered that Ofcom had not fully explored the real extent of this substitution, particularly in light of the limited range of fixed alternatives actively marketed to Hull customers. As a result KCOM believe that the degree of fixed to mobile substitution in the Hull market may well be higher and more constraining than is the case in the rest of the UK. KCOM noted that at paragraph 6.29 of the March Consultation we stated that "most consumers want the same provider for both lines and calls", however, there appears there was no specific research carried out on consumer preferences or the reaction to a rise in call prices in the Hull market. KCOM suggested that there is a likelihood that an increase in call prices would result in further mobile substitution.

Ofcom's response

- 6.46 In paragraph 6.17 of the March Consultation we noted that call volumes have fallen at a slightly faster rate in the Hull area than in the rest of the UK in 2008. This is shown in the Figure below.

⁷⁵ An 8.8p call set up fee applies.

Figure 6.5
KCOM versus rest of UK – residential call volumes over time



Source: KCOM/Ofcom/Operators

- 6.47 We accept that there is possibly a higher level of mobile substitution in Hull relative to the rest of the UK. The volume of geographic, international and calls to mobiles has declined by 20% in Hull between Q2 2004 and Q4 2008 and by 11% across the rest of the UK. However, the gap between the rest of the UK and Hull has opened up over 2008 and it is difficult to draw definitive conclusions based on a few quarters of data. We do not believe the level of substitution is substantial enough to 1) include mobile calls within the fixed calls market in Hull (refer to the section 4 of the March Consultation for our analysis on mobile substitution) or 2) mitigate KCOM's SMP in the fixed calls market. The reasons why we believe KCOM has SMP are set out in section 6 of the March Consultation.
- 6.48 We accept that the situation in Hull is somewhat different from the rest of the UK due to the absence of alternative fixed line providers. However, as discussed in Section 4, we do not think consumer preferences are significantly different relative to the rest of the UK. We agree that, as in the rest of the UK, there is a degree of substitution from fixed to mobile calls for some call types and this would be influenced in the event of increases in price of fixed calls. However, there is not sufficient evidence that this movement in Hull would be substantially higher than the rest of the UK.

Barriers to entry in Hull

Consultation responses

- 6.49 KCOM noted that wholesale remedies are in place in Hull should other Communications Providers wish to offer services to customers. KCOM does not agree with any suggestion that there remain significant barriers to entry. KCOM stated that the relatively small size of the Hull market offers competing providers access to the market for a comparably small investment, particularly where they can utilise wholesale products to provide call services. KCOM concluded that the threat of competitive entry is a very real constraint on their behaviour in the pricing of its retail call services. They do not believe

that the current regulatory remedies are justified or proportionate and, may act to place Hull customers at a disadvantage in terms of the choice of service packages which can be offered.

Ofcom's response

- 6.50 The lack of actual market entry in the Hull area (e.g. no WLR/CPS providers) suggests that barriers to entry exist. For the reasons set out in paragraphs 5.106-5.109 above we believe this supports our SMP finding.
- 6.51 However, we are mindful that Hull customers should not be at a disadvantage in terms of the service packages which can be offered. We consider this in more detail in Section 7 below.

Business market for calls

UK (excluding Hull)

- 6.52 In the March Consultation we set out our view that BT does not have SMP in the fixed calls market for the following reasons:
- The wholesale remedies have led to the development of products which enable competitors to replicate the services offered by BT without making significant infrastructure investments. This has lowered barriers to entry and growth.
 - New firms have entered and expanded in the market resulting in a fall in BT's market share.
 - Relaxation of the SMP regulations in 2007 for large businesses appears to have been successful.
 - Recent market research has shown that businesses are aware of alternative providers and appear willing to switch.
 - Mobile calls represent a significant constraint for at least some types of calls and/or at least some business customers.

Overview of Consultation responses

- 6.53 A number of stakeholders made overarching comments in relation to the SMP assessment for the markets where we are proposing to deregulate – particularly relating to BT's market share. To avoid repetition, where these comments have been discussed in the sections above they are not covered again unless further discussion is warranted. Comments specific to the business calls SMP assessment are covered below.
- 6.54 BT agreed with our analysis that it does not have SMP in the business calls market. BT believes that all sizes and sectors of the UK business market are fully and intensely competitive, which has resulted in BT's falling market share, and the trend is expected to continue. In addition, BT supported our analysis that there are sufficient wholesale remedies in place giving businesses plenty of options to choose from in terms of CPS, WLR, LLU and mobile operators. They further commented that customers are fully aware of competing Communications Providers and their ability to switch suppliers.
- 6.55 Other stakeholders disagreed with our assessment – largely for the reasons set out in the residential/business analogue access and residential calls sections above. The main comment made was that BT's market share was indicative of SMP and stakeholders expressed concern that the market was not sufficiently competitive to justify full deregulation

BT's market share

Ofcom's response

6.56 We have discussed why BT's market share is not indicative of SMP in length above. In any case, BT's market share (both volumes and revenues) is lower than 50% in the business calls market. Since the March Consultation was published we have updated the information on market share, which is shown below.

Figure 6.6

Updated market shares of business fixed narrowband calls (geographic, international and call to mobile)⁷⁶

	Volumes BT	Virgin Media	Other fixed	Revenues BT	Virgin Media	Other fixed
2003	42%	7%	51%	50%	7%	43%
2004	41%	7%	53%	48%	7%	46%
2005	40%	7%	53%	45%	6%	49%
2006	39%	7%	54%	45%	6%	49%
2007	39%	6%	55%	45%	5%	49%
2008	38%	6%	56%	44%	5%	51%
2008 Q1	39%	6%	55%	45%	5%	50%
2008 Q2	39%	6%	55%	45%	5%	50%
2008 Q3	38%	6%	56%	44%	5%	51%
2008 Q4	38%	6%	56%	44%	5%	51%
2009 Q1	36%	6%	57%	43%	5%	52%

Source: Ofcom/operators

6.57 The information shows that BT's market share of volumes has remained at less than 40% over 2008 while the share of revenues has stayed at around 44%.

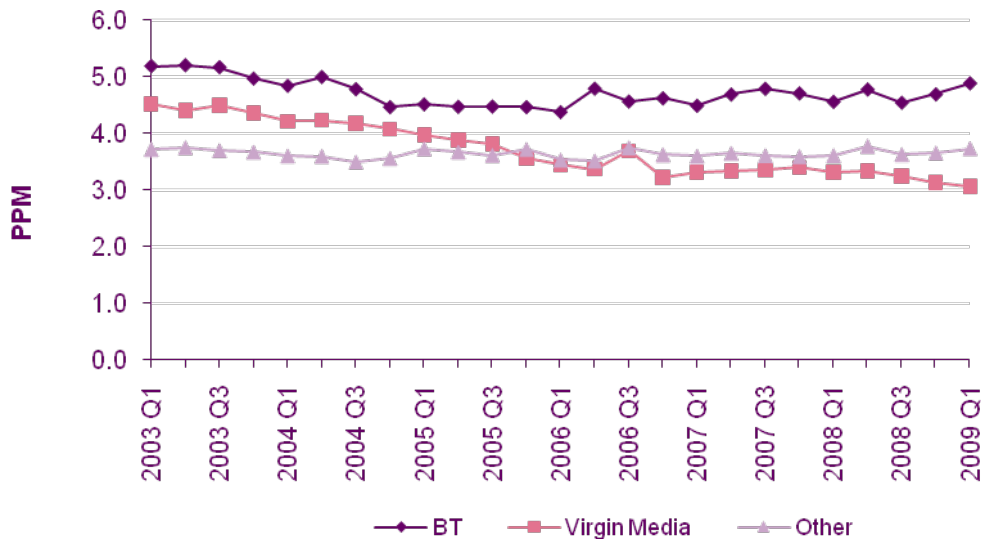
BT's pricing

Consultation responses

- 6.58 COLT commented that BT is able to sustain a price premium because their share of revenues is greater than their share of volumes. They consider that ability to command such a premium for an undifferentiated product should be taken as evidence of SMP.
- 6.59 COLT commented that in the discussion of Figure 6.10 of the March Consultation (updated and shown below) we do not discuss SMP as an explanation for BT's ability to achieve a higher RPM.

⁷⁶ Original information was provided in table 6.7 of the consultation.

Figure 6.7
Revenue per minute – business geographic, international and call to mobile



Source: Ofcom/operators

Ofcom's response

- 6.60 We noted in the residential calls discussion above that a price premium is not necessarily evidence of market power. Even if the products supplied by different Communications Providers are similar, rival providers have different business models which can lead to different pricing strategies in a competitive market.
- 6.61 We discussed in paragraphs 6.76-6.79 of the March Consultation a number of reasons why BT might be able to charge a price premium relative to other providers. A particular feature of the business market is that some organisations have multiple suppliers and may retain a few lines with BT for contingency/resilience reasons. BT might be able to charge a premium for the perceived reliability of its services but actually earns limited revenues from these organisations.
- 6.62 Furthermore, as discussed in the residential calls section above we would expect BT to have a first mover advantage in this market. BT's brand presence might allow it to charge a premium over less well established rivals. This would be expected to diminish to some degree over time but does not itself indicate SMP or act as a substantial barrier to competition.
- 6.63 We note above that BT's revenues for business calls have fallen since the last review and BT has a relatively low market share (i.e. less than 50%), these factors do not suggest that BT is able to exploit a dominant position.

Information on switching

Consultation responses

- 6.64 COLT commented that Ofcom had presented little quantitative evidence on the switching behaviour of SMEs.

Ofcom's response

- 6.65 We focused our switching evidence on the behaviour of residential consumers because businesses are likely to be more sophisticated and thus be aware of alternative providers. In addition, it would be a significant exercise to collect sufficiently reliable data from SMEs to undertake a detailed switching analysis.
- 6.66 We noted in the business analogue access section above that BT's churn in exchange lines was ([REDACTED]) in the 12 months to May 2009. While this will be partly driven by a decline in market size, it does indicate that businesses are switching from BT to other providers.

BT's profitability

Consultation responses

- 6.67 COLT commented that information on gross margin data was not presented so they cannot tell from the March Consultation document whether BT's margins on business calls are increasing.

Ofcom's response

- 6.68 For the residential markets we used information in BT's regulatory accounts to assess gross margin. BT is not obliged to report on business market profitability in its regulatory accounts. However, since the March Consultation we have formally requested information on revenues and return on sales from BT for the business calls⁷⁷ market, which is presented below.

Figure 6.8

Business calls – revenues, costs and returns from 2004/05 to 2008/09⁷⁸

[REDACTED]

Source: BT

- 6.69 The Figure shows that call revenues have declined over time. This reflects the general decline in the volume of business calls and the decline in BT's market share. Since 2004/5 BT's revenues have fallen by [REDACTED] and their costs by [REDACTED], resulting in a significant reduction in gross margin of [REDACTED].

⁷⁷ Includes local, national, international and inland calls BT to mobile for business PSTN, ISDN2 and ISDN30.

⁷⁸ Redacted as the information is commercially confidential.

Hull area

- 6.70 We consider that KCOM has SMP in the business fixed calls market for the same reasons set out for the residential calls market (see paragraphs 6.42 to 6.44).

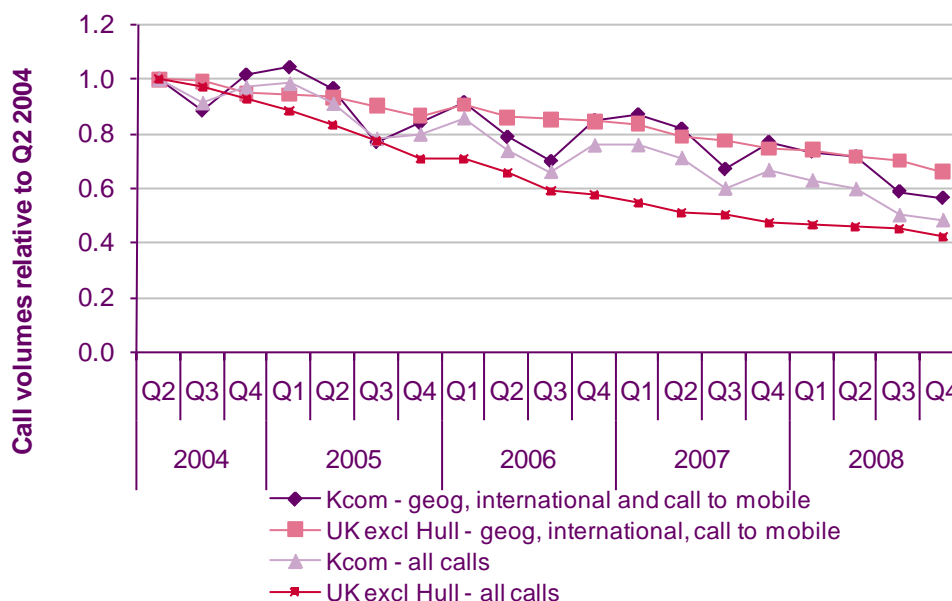
Consultation responses

- 6.71 Only KCOM commented on the SMP assessment for the business calls market in the Hull area. KCOM did not agree with our analysis.
- 6.72 KCOM noted that by Q3 2008 there had been a decrease of approximately 40% in the volume of geographic, international and calls to mobile in the Hull area relative to Q2 2004. KCOM commented that this represented a significant decrease and clearly points to a degree of substitution by business call users. Furthermore, during 2008 KCOM's business call volumes have shown a marked decrease compared to the rest of the UK with a differential of close to 10%. KCOM believes this differential requires further investigation.
- 6.73 KCOM thought that we had substantially underestimated the overall size of the business calls market in Hull. Our analysis had concluded that fixed calls to business customers via indirect access and alternative means, such as leased lines, accounted for a small proportion of the market. This assessment had been reached on the basis that information provided by KCOM on average monthly minutes from February 2008 to January 2009 shows that indirect access minutes (both residential and business) were 10% of total outbound revenue. However, KCOM noted in their response that their assessment was that, for the same period, business indirect access minutes accounted for 26% of total outbound business minutes (excluding local).
- 6.74 Furthermore, KCOM noted that this did not take account of business calls which are carried over leased lines supplied to customers by either KCOM or an alternative provider. In the statement on the Business Connectivity Market Review published in December 2008 Ofcom concluded that KCOM no longer had SMP in the retail market for low bandwidth TI leased lines based largely on KCOM's low market share of 25%. KCOM believe that this finding also has a knock-on effect in the context of the market for narrowband business calls.
- 6.75 KCOM have provided further information which suggests that, after accounting for indirect access providers and leased lines which enable calls to bypass the KCOM PSTN in the Hull area, their market share of calls originating in Hull is actually around 57%.

Ofcom's response

- 6.76 We agree that there has been substitution away from business calls since 2004 e.g. to mobile calls and email. This trend is apparent both in Hull and across the rest of the UK as shown in the Figure below.

Figure 6.9
KCOM versus rest of UK – business call volumes over time



Source: KCOM/Ofcom/Operators

- 6.77 Over the latter part of 2008 KCOM appears to have lost call volumes (geographic, international and calls to mobile) at a higher rate than the rest of the UK. However, it is difficult to form definitive conclusions based on two quarters of data.
- 6.78 We note that there are Communications Providers offering business calls via leased lines in the Hull area. While it is possible that leased line calls are exerting some competitive pressure on KCOM business calls, in any case, this is only likely to be evident for larger businesses where leased lines are a viable alternative.
- 6.79 KCOM have also identified a high use of indirect access (“IA”) call services for non local calls. We accept that this does offer a competitive alternative to KCOM calls, but its high use is itself likely to be a reflection of the lack of full competition. Also the IA market is constrained by KCOM packages which have inclusive calls within the base rental. It is not at all clear that IA would be an effective future competitive constraint.
- 6.80 We are open to considering whether competition in the market for larger businesses is sufficiently developed to warrant deregulation. However, we do not have sufficient information currently to decide whether deregulation is appropriate at this time and what form it should take. However, we are minded to assess this as part of a further review, see Section 7.

Section 7

Market Remedies and Impact Assessment

Introduction

- 7.1 We set out our proposals on market remedies along with a full impact assessment in Section 7 of the March Consultation Document. In this section we consider stakeholder responses on the remedies, impact assessment and concerns around potential risks to competition from current and proposed contract terms and migration processes.
- 7.2 We also set out our conclusions on the remedies that we will establish for the SMP findings in Sections 5 and 6.

Summary

- 7.3 BT's SMP in ISDN2 market: We have decided to rely solely on the wholesale remedies imposed in the Wholesale Market Review.
- 7.4 KCOM's SMP in all narrowband markets (excluding ISDN30): we have decided to continue the existing remedies:
- No undue discrimination; and
 - Price publication.
- 7.5 We may need to further review these remedies in the Hull area to consider:
- Options to allow the introduction of bundles of residential services which would include SMP narrowband market services; and
 - Modifications of the application of SMP remedies for segments of the business calls markets, should evidence be presented of higher levels of competition for those segments.
- 7.6 In addition, we confirm the need to review the impact of automatic rolling contracts and alternative migration processes on competition in the narrowband market. We note that should such contracts or processes be found to have an impact on competition then either measures will need be taken to address this impact or we may need to reconsider our SMP findings set out in this statement.

Remedies for BT's SMP in ISDN2

- A1.1 In the March Consultation we considered the effectiveness of the current retail remedies on ISDN2. We considered that the existing remedies may in effect be counterproductive as the conditions within this, largely static, market are conducive to price following. We were concerned that the price publication and non-discrimination requirements would likely dull the incentive for BT to compete strongly as any price cuts only ensure that the total revenue in the market would reduce without delivering BT any competitive advantage or attracting new customers into the market.
- 7.7 The March Consultation considered the option of more intrusive remedies (i.e. price controls) but we consider that this would risk discouraging innovation in the markets. Instead, we recommended the removal of all specific retail controls, relying on wholesale

remedies alone for the reasons set out in paragraph 7.33 of the March Consultation ie that the existing remedies did not appear to be continuing to contribute to improvement in competition in the market and, instead, appeared to be inhibiting full price competition. This approach was consistent with Article 17 of the Universal Service Directive and section 91 of the Communications Act, which both restrict the imposition of regulatory controls on retail services to situations where obligations that could be imposed under the Access Directive or Framework Directive would not, in themselves, be sufficient to achieve the objectives set out under Article 8 of the Framework Directive.

Consultation responses

- 7.8 Some stakeholders were concerned about the removal of retail remedies. The particular concerns were around the fitness for purpose of the existing wholesale remedies and the risk of margin squeeze.
- 7.9 The FCS said “continuing delays in delivery of fully fit-for purpose services via WLR3 mean that there is still no true equivalence in this area with consequences for effective competition. There is also a replicability issue with regard to e.g. site offices.” COLT noted that “Although BT has been able to raise prices and margins on ISDN2 ..., COLT would be concerned that the removal of all retail regulation could allow BT to effect an anti-competitive margin squeeze by reducing its retail prices whilst maintaining wholesale prices. We therefore prefer to maintain the existing obligations, or at least the continued obligation of price publication which allows competitors to monitor, at least prima facie, whether a margin squeeze is taking place”.

Ofcom's response

- 7.10 While we accept there will continue to be a need to improve the ISDN2 WLR product, we consider that the product is sufficiently fit-for-purpose to allow competitors to compete with BT equally at the retail level (we understand that the next WLR3 release, R1100, on 29th September should address most of the current concerns). We, therefore, consider that there is equivalence in access to ISDN2 at the wholesale level, which is an important consideration in our reliance on wholesale remedies.
- 7.11 Communications Providers can provide to site offices using WLR3 (not available on WLR2) though each order requires a full survey and the construction costs are treated differently from permanent lines. This is the same for BT Retail as they will now be using WLR3 not BT Classic.
- 7.12 With respect to the risk of price squeeze, as discussed in the March Consultation, our current concern is that, despite the entry of new competitors and a decline in fixed wholesale costs in 2004, there is little indication of improved prices to end customers. BT has had price flexibility yet not chosen to exercise this.
- 7.13 We think that the removal of the existing remedies will open the prospect of greater price competition. In particular, the current price publication remedy supports the maintenance of existing margins for BT Retail and other Communications Providers rather than encouraging competition for the benefit of customers. We remain conscious of the possibility of price squeezing as we are with all products BT sells both at the retail and wholesale level.
- 7.14 Our SMP finding indicates that BT retains a dominant market position in the supply of these services and allows us to intervene in the event of concerns over potentially abusive conduct.

- 7.15 We, therefore, consider it appropriate to rely solely on the wholesale remedies for the ISDN2 market.

Remedies for KCOM SMP markets

- 7.16 KCOM's SMP operations in Hull are all subject to two SMP remedies:

- No undue discrimination; and
- Price publication.

- 7.17 In the March Consultation we observed, that while these remedies have not led to a significant entry by retail competitors in the access markets, there has been some market entry in the calls markets.

- 7.18 We discussed the encouragement of competitor entry through wholesale products in more detail in the Wholesale Narrowband Services Market Review. In the March Consultation we considered the following options in respect of retail remedies:

- Option 1 – Remove existing remedies and rely on wholesale remedies;
- Option 2 – Maintain the existing remedies; or
- Option 3 – Introduce more direct intervention on pricing.

- 7.19 Our assessment was that, given the lack of competitive entry, the case for reliance on wholesale remedies would not be appropriate. Wholesale remedies have clearly, so far, not enabled or encouraged sufficient competitive entry. Accordingly we consider that the wholesale remedies do not allow us to fully perform our duties under Section 4 of the Communications Act. In particular, the protection against abuse of its SMP position as provided by the price publication and non-discrimination remedies (which ensure that KCOM's actions are transparent) remains essential.

- 7.20 The argument for price controls rested on a consideration of whether the Hull markets are ever likely to see new competitor entry. Any price controls on the incumbent also constrains the viable prices for a rival entrant and thus would necessarily increase the barrier to entry.

- 7.21 At present, KCOM charges are not noticeably out of alignment with national charges. This is possibly due to the potential threat of price controls, the risk of encouraging market entry by exposing high profits and/or the reaction of its customer base/shareholders (an overlapping group). There is no reason to expect this to change (except with respect to bundles of products which we discuss separately below). Equally, it is not clear that price controls would lead to controls substantially below that which is currently being charged.

- 7.22 Given the lack of clear benefit from increased intervention, the costs of such an intervention and the continuing prospect of new market entry, price controls would not appear justified at this time.

- 7.23 We concluded that it was appropriate to continue with the existing remedies for all markets.

- 7.24 We did note, however, that there was potential complication with the retention of current remedies. We observed that our proposed deregulation of BT should encourage

competition in bundled offerings (i.e. narrowband and other services with pricing below the sum of the component service charges) in the UK (excluding Hull).

- 7.25 Such bundles are already offered by many Communications Providers in the UK (excluding Hull) and we can foresee the situation where the only consumers/business customers unable to benefit from such an arrangement would be Hull residents, unless new market entrants were to provide this.
- 7.26 We set out the following options to address this in the March Consultation, though we did not recommend any specific option. The options were:
- Option 1 – Allow the situation to evolve and restrict KCOM from bundling, thus encouraging entry by bundlers (including now BT);
 - Option 2 – Allow KCOM to offer a bundled product without specific further conditions;
 - Option 3 – Allow KCOM to offer bundled products but require referral of that product to Ofcom for consideration – with the aim of minimising the increase in barriers to entry.
- 7.27 Ultimately, each option would need to be assessed against our general duties to further the interests of consumers and citizens, having regard to choice, price and value for money for customers.
- 7.28 We have considered to what extent the current conditions prohibit bundling. While this is not explicit in the regulations, as noted in earlier reviews (most recently the Consent on Business Exchange Line Replicability, published 29 May 2007⁷⁹ (see Section 3)) Ofcom's current stated interpretation of the no undue discrimination SMP services condition, is that we assume that bundles of SMP and non-SMP products would be likely to be unduly discriminatory. Were we to allow KCOM to offer bundles without further regulations, we would need to re-examine how we applied this condition to these markets.
- 7.29 ERG common position on remedies is that specific requirements can be imposed under A17(2) USD to not unreasonably bundle services. This would be beyond the current conditions (it seems as though the non discrimination is being taken (currently by BT and KCOM) as a restriction on bundling). The Common position then goes on to suggest that where such a restriction could rule out "welfare enhancing bundles", an alternate condition could be imposed that an undertaking be obliged to report proposed new bundles to the NRA who would then judge whether they were anti-competitive.⁸⁰
- 7.30 Clearly, as discussed by the ERG, NRAs should take into account the danger of prohibiting bundles which may increase welfare and that a blanket prohibition of bundles may rule out welfare enhancing bundles, balancing that against the welfare gains in preventing dominant undertakings from distorting competition in horizontally related markets. This consideration is also consistent with S4 of the USD which considers the need to balance promotion of competition and promotion of citizens' interests.
- 7.31 While this approach appears to allow the acceptance of bundles in principle, the difficulty is in setting criteria for their review which do balance consumer interest and competition effectively.

⁷⁹ <http://www.ofcom.org.uk/consult/condocs/draftconsent/statement/consent.pdf>.

⁸⁰ http://www.erg.eu.int/doc/meeting/erg_06_33_remedies_common_position_june_06.pdf.

- 7.32 It may also be appropriate to link any development in this area to KCOM improvement in systems supporting retail competition.

Consultation responses

- 7.33 Only KCOM responded in any detail on this discussion.
- 7.34 With respect to the analogue markets they suggested “there is the potential for a lighter touch regime to be imposed in the residential calls and access markets, particularly in the light of the effects noted above. Certainly, there has been no evidence of issues arising in terms of compliance with the current obligations or of any consumer harm.” They also noted that they “fully agree with Ofcom’s view that there is a need to ensure that Hull residents are not unduly disadvantaged compared to residents in the rest of the UK. However, we believe that they are being unduly disadvantaged as a result of Ofcom’s current interpretation of the undue discrimination obligation which assumes that bundles of SMP and non-SMP products would be likely to be unduly discriminatory.” They suggested that any potential future broadband USO would make the current situation untenable.
- 7.35 KCOM offered as an alternative approach to formal remedies “to explore the possibility of voluntary undertakings primarily designed to provide both consumers and other Communications Providers with an appropriate level of visibility and certainty regarding Kingston’s retail offerings:
- An undertaking to publish prices as currently required by the SMP conditions.
 - An undertaking to benchmark prices against an identified BT entry level package and
 - Not to increase prices above those benchmarks.
 - An undertaking that taken together the elements of any package will not fall below cost. “
- 7.36 With respect to the ISDN Markets, because the prospect of significant entry in the ISDN market appears muted as this is a product nearing the end of its lifecycle and customers are moving towards alternative technologies, KCOM did not think that the continued application of regulatory remedies was justified.
- 7.37 As discussed in Section 6, KCOM have also highlighted differences in competition for business calls for companies of sufficient size to justify the use of leased lines for the provision of services.

Ofcom’s response

- 7.38 As discussed in Sections 5 and 6 we do not consider that KCOM have put forward sufficiently strong arguments to justify a movement away from our SMP finding.
- 7.39 Equally given the lack of substantial change in the level of direct competition we consider that there is no evidence to support general deregulation or reliance on voluntary commitments.
- 7.40 That being said, as we noted in the March Consultation, we consider that in the interest of Hull consumers and businesses we should explore how the range of services offered to Hull customers could be expanded, to help ensure that those customers do not miss out on developments available to the rest of the country.

- 7.41 Similarly, we accept that there may be some merit in the argument KCOM have advanced that there are different competitive conditions for business calls for those companies of whose size and usage levels merit the leasing of dedicated communications lines.
- 7.42 There is an inherent difficulty in setting market regulations linked to business sizes because it is difficult to determine how to set the boundary. The current Replicability regulations for BT set a £1M communications spend level to ensure that the boundary was safely drawn. We propose, therefore, to continue our discussions with KCOM and other relevant stakeholders on this issue. If a clear case for some relaxation or modifications of the SMP conditions with respect to a subset of companies becomes apparent we would re-consult on this matter.

Potential threats to future competition – UK (excluding Hull)

- 7.43 In the March Consultation we noted that even with the removal of SMP-related regulation, BT is and will remain bound by the General Conditions and Universal Service Conditions, in addition to non sector-specific consumer protection legislation which covers all providers.
- 7.44 In particular, we noted that Ofcom needs to monitor developments in contract terms and migration processes which could have a deleterious impact on competition. We specifically identified the introduction of automatic roll-over contract terms and any changes to regulations that would allow BT to discriminate between active and inactive customers, such as losing provider-led switching processes as potential areas for concern. For example, we may need to consider the implications of any proposals that would allow BT to target discounts to customers indicating an intention to leave.⁸¹
- 7.45 With respect to automatic roll-over contracts, we noted that we had set out some general guidelines on contract terms which apply to all Communications Providers based in the Unfair Terms in Consumer Contracts Regulations ("UTCCR")⁸².

Overview of consultation responses

- 7.46 There was a considerable degree of concern expressed by stakeholders over the issues of contract terms and changes to migration procedures.

Automatic roll-over contracts

Consultation responses

- 7.47 With respect to contract terms a number of stakeholders argued that restrictive contract terms allow incumbents to leverage their market share and would act as a barrier to continued competition.
- 7.48 Cable & Wireless noted that "BT seem to be entrenching their market position and protecting their market share by requiring customers to sign up to extended rolling contract terms in order to receive 'standard' benefits and discounts. If customers don't

⁸¹ For example 'losing provider led' migration is the process by which the customer must contact the provider to notify them of his/her intention to move. In order to complete this move, as is the case for broadband, the customer must seek a Migration Authority Code (MAC). For those customers requesting a MAC, BT could identify those with an intention to switch and offer them bespoke rates.

⁸² Ofcom Review of Additional Charges Statement Annex 1 sets out the guidelines (<http://www.ofcom.org.uk/consult/condocs/addcharges/statement/>).

accept BT's extended contract terms they face the prospect of paying higher charges and /or finding another supplier at short notice. If they do accept the extended contract term and later decide to switch supplier they face paying a high early termination charge."

7.49 A confidential respondent noted that rolling contracts were a market anomaly.

7.50 Sky said that:

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

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

Ofcom's response

7.51 In February 2008 BT began offering automatic roll-overs contracts to residential customers for their Free Evening and Weekend Calls package. We requested further information on customer behaviour with respect to those with automatic rollover contracts.

7.52 We do not consider that the existence of automatic roll-over contracts *per se* directly impacts on our assessment of the competitive state of the market which as discussed in earlier sections appears robust based on current evidence. In this context it is appropriate to note that BT has also begun to introduce similar rolling contracts in broadband (since February 2009) – i.e., in a market that was already found not to have an operator with SMP.

7.53 Our assessment of the level of competition is premised on an assumption that the terms and conditions in BT's contract would not have a strong detrimental impact on the competitive process. Clearly, if it is proven that such contracts do have a detrimental competition impact, then we may need to re-assess our view of BT's position in the retail markets. This is likely to depend on the extent to which such impacts are material and could not be mitigated by other actions (for example changes to General Conditions relating to the provision of narrowband services).

7.54 Given the short time since the introduction of these contracts for residential customers by BT, there is limited evidence so far of its impact on customer behaviour. BT has continued to lose market share with no immediately apparent impact on the rate of loss since the introduction of automatic roll-over contracts. BT's competitors have continued to grow.

- 7.55 BT signed up a significant proportion of their residential customers on automatic roll-over contracts in the second half of 2008. It is likely that we would only see the impact (if any) on aggregate churn rates feeding through over the next few months. It is worth noting that there are some small providers other than BT that offer rollover contracts to residential consumers including AdEPT and Axis, though given their small size the impact on overall competition is likely to be low.
- 7.56 Information provided by BT suggests that a significant majority of residential customers on a roll-over contract are being rolled over without change to the contract. However, given the information currently available it is difficult to draw any firm conclusions on the impact on customers' willingness to consider alternative providers or the potential long term impact on switching behaviour.
- 7.57 There is also a concern that the opt out process for rollovers also offers an opportunity for BT to influence consumers that may be thinking about switching and targeting those intending to leave – this risk of consumer differentiation was one of the main concerns highlighted in the impact assessment.
- 7.58 Our view is that this issue warrants further review. We will, therefore, undertake a more detailed examination of the issue, which is likely to include :
- direct contact with customers signed up to automatic rollover contracts;
 - consideration of the use of automatic rollover contracts in other countries and industries; and
 - other detailed data analysis as required.
- 7.59 A key focus of our analysis will be on the impact on competition as well as on the fairness of the terms of the contracts. If a material impact on competition is found, it would be appropriate for us to intervene.

Switching processes

Consultation responses

- 7.60 Stakeholders raised concerns that any movement to loser provider led processes for narrowband services might risk allowing BT to differentiate customers e.g. by offering those who expressed an interest in leaving a more attractive deal and allow BT to build on their market share to the detriment of competition.
- 7.61 TalkTalk Group stated that they “believe that Ofcom must reach a conclusion in its single migration programme sooner rather than later to avoid prolong the debate and uncertainty among providers. Ofcom has already made pronounced statements in support of a gaining provider led switching process. We believe that it would be inappropriate to remove the SMP designation on BT without first making clear that a new single switching process must be gaining-provider led (whilst being robust enough to allay any concerns Ofcom may have around mis-selling).”
- 7.62 Cable & Wireless also noted “BT’s ability to bundle voice services with broadband, which has a losing provider-initiated switching process also allows BT to protect its dominance by creating a barrier to customers switching. BT’s tactics lock in a large proportion of customers, making it prohibitively expensive to seek a new supplier and results in a significantly reduced addressable market available to BT’s competitors.”

Ofcom's response

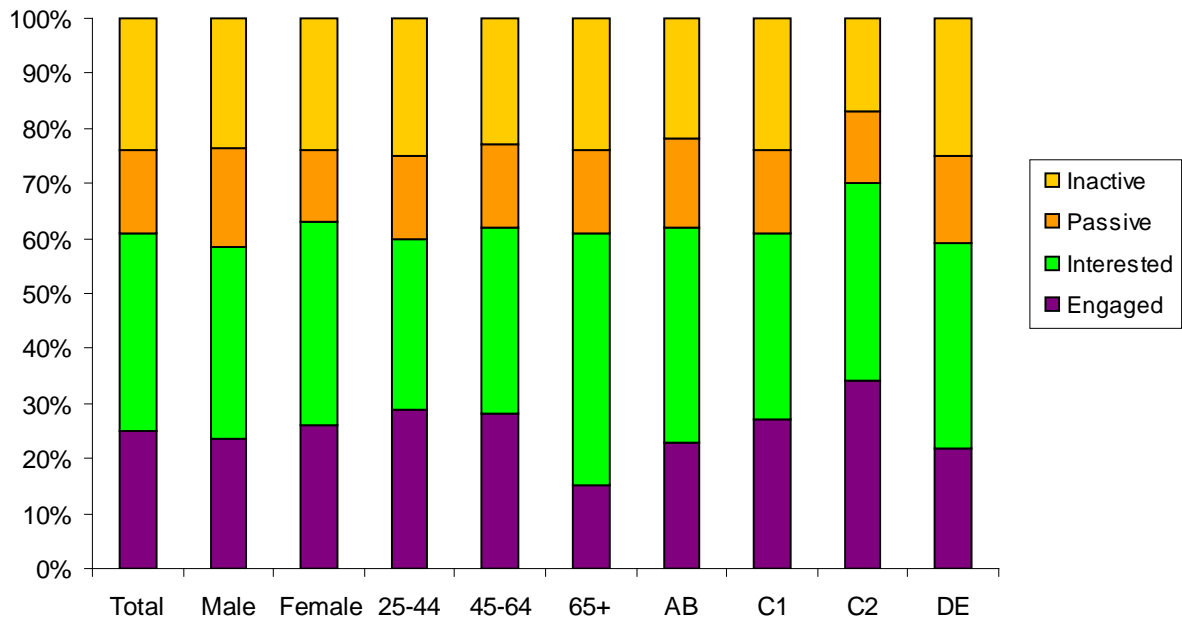
- 7.63 Switching is a vital part of the competitive process, and Ofcom remains committed to ensuring that there are no obstacles in the way of consumers who choose to move between different companies and products. For consumers to benefit from competition, they must be able to shop around and, once they have found a good deal, to switch providers without undue effort, disruption or anxiety. A good customer experience is vital to the competitive process, as competition can only work where customers are confident in the switching and transfer process.
- 7.64 Given the trend towards convergence and, in particular, an increase in retail bundling, switching is already becoming more complex for customers. For example, at present, a consumer who switches landline and broadband at the same time (sometimes as a bundle) will have to go through one of two processes:
- if the customer's existing or new services are provided at the network level using local loop unbundling, then the process follows the 'Notification of Transfer' process and is 'gaining provider'-led;
 - if the customer is moving to or from a landline-broadband combination which does not involve local loop unbundling at the network level, then the customer needs to use a combination of MAC and 'notification of transfer' processes and requires contact with both the losing and gaining providers.
- 7.65 The choice of underlying network technology is something that will be invisible to the consumer, so we recognise that it is likely to be confusing from an end user perspective that the process used varies. In addition, such differences in switching processes may not be competitively neutral in terms of impact between Communications Providers. As such, we can see the merit in establishing processes for switching which are the same for particular types of switches regardless of the underlying network choice. A single process for any switch in which more than one service is involved would be easier to communicate to consumers, and is likely to be simpler to execute, than the current situation in which the choice of switching mechanism varies for reasons that the consumer cannot observe.
- 7.66 Ofcom is currently undertaking a separate project as part of its migrations work which is looking to determine how we can ensure that regulations and processes are in place that do not inhibit consumers' ability to switch, both in a world of single and bundled product offerings. This work is assessing the extent to which there is a need for harmonisation of switching processes across different services. We plan to publish a consultation document on this issue in the first half of 2010.
- 7.67 In making this determination on migrations we will be informed by the analysis set out in the March Consultation and this Statement around the risk of allowing BT to discriminate among its customers in a manner detrimental to consumer welfare (this is discussed further in the impact assessment).

Equality impact assessment

- 7.68 We are required to have due regard to any potential impacts our decisions in this statement may have on race, disability and gender equality – an Equality Impact Assessment (EIA) is our way of fulfilling this obligation. We have accordingly undertaken a full EIA. In particular, we have examined what impact our decisions will have on different demographic groups.

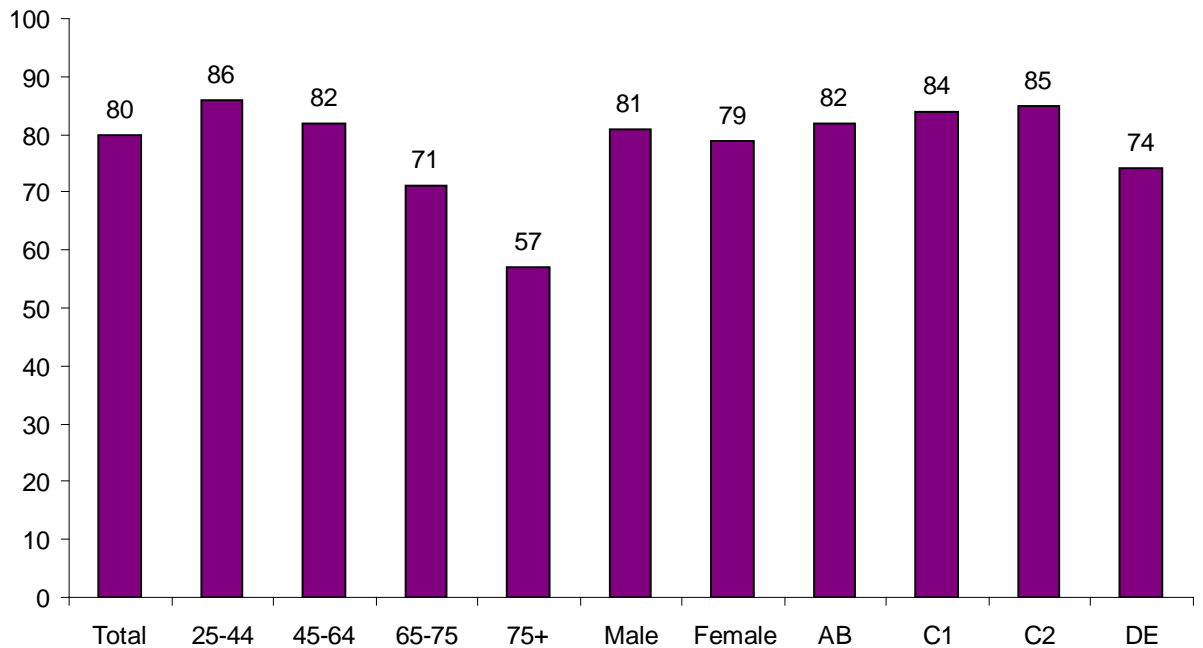
- 7.69 One clear characteristic of this market is a relatively high percentage of inactive customers in terms of fixed line telephone market participation. Given this, it is to be expected that the default position for customers not making a choice is almost always to remain with BT. As discussed in Sections 5 and 6, we do not consider that the continuing relatively high market share of BT is itself an indicator of competition failure. As the incumbent, BT will, for the foreseeable future, retain a relatively high market share.
- 7.70 We would be concerned if BT were able to exploit the existence of this group, say through targeted packages which advantaged consumers who were more likely to be market active.
- 7.71 Our analysis suggests that this would be difficult for BT. According to Ofcom's Consumer Experience (2008) report, this inactivity is spread fairly evenly across age, gender and socio-economic groups (see Figure 7.1).

Figure 7.1
Demographic differences in participation in fixed line markets



- 7.72 Inactivity does not seem to be simply a factor of awareness of competition. As Figure 7.2 shows, levels of awareness are higher than levels of activity. This suggests that a significant proportion is inactive through choice.

Figure 7.2
Awareness of competition



- 7.73 The absence of a clearly defined social grouping for lack of activity suggests that BT would have difficulty targeting such groups. Equally, the fact that for at least some of the customers this lack of activity is a factor of choice suggests that, if the price differential between providers increased, activity might also increase.
- 7.74 We are already seeing the growth of retail providers who are specifically targeting narrowband customers on price alone and who have a wide and effective distribution and marketing presence (e.g. the Post Office and Tesco). The availability of attractive alternative products means BT would be less likely to find a discriminatory strategy profitable (because customers could easily switch away to other providers).
- 7.75 The above notwithstanding, we consider that it is important to avoid changes to regulations that would allow greater customer segmentation to the detriment of inactive customers. For example, we may need to be careful about any proposals that would allow BT to target discounts to customers indicating an intention to leave.
- 7.76 Based on the above analysis we consider that we have taken into account any equality issues in making our decisions in this review.

Section 8

Conclusions

Introduction

8.1 In this Section we set out a summary of the decisions of the market review. We also demonstrate how our remedies, for the remaining SMP markets, satisfy the legal tests for their imposition (or removal).

Summary of conclusions

8.2 Tables 8.1 set out a summary of the market structure and SMP determinations and how they differ from the 2003 review.

Table 8.1

Summary of conclusions on market definition and market power

2003 Markets	SMP BT	SMP KCOM	2009 Proposed Markets	SMP BT	SMP KCOM
Residential fixed narrowband access	Yes	Yes	Residential fixed narrowband access	No	Yes
Business fixed narrowband access	Yes	Yes	Business fixed narrowband access	No	Yes
Residential ISDN2 access	Yes	Yes	N/A	N/A	N/A
Business ISDN2 access	Yes	Yes	Business ISDN2 access	Yes	Yes
Residential fixed local calls	Yes	Yes	Residential fixed calls Single market for all calls	No	Yes
Residential fixed national calls	Yes	Yes			
Residential fixed international calls	Yes	Yes			
Residential fixed calls to mobile	Yes	Yes			
Residential fixed operator assisted calls	Yes	Yes			
Business fixed local calls	Yes	Yes	Business fixed calls Single market for all calls	No	Yes
Business fixed national calls	Yes	Yes			
Business fixed international calls	No	Yes			
Business fixed calls to mobile	Yes	Yes			
Business fixed operator assisted calls	Yes	Yes			

- 8.3 As shown our determinations are largely deregulatory. We have found that BT no longer holds an SMP position in the analogue access markets or calls markets.
- 8.4 We have found that BT retains an SMP position in the ISDN2 market, but we consider that it is appropriate to rely on wholesale remedies alone to promote consumers' interests in those markets. As noted in Section 5, the SMP finding represents a binary assessment of a number of complex evidentiary sources.
- 8.5 For Hull, we do not consider that the market conditions have altered substantially. While KCOM is experiencing some increased competition it still holds SMP in the relevant markets and we consider the continuation of the existing SMP remedies is appropriate. As discussed in Section 7, however, we are open to further review of the application of the remedies subject to further discussion with KCOM and other stakeholders.

Legal tests

Tests for setting of SMP conditions and directions from the Communications Act

- 8.6 As noted, in Section 2 we need to satisfy a number of tests set out under the Communications Act where we decide to impose SMP conditions. We consider that our decisions meet the tests set out in the Communications Act. Our reasoning is set out below for each of the conditions set out in Annex 1.
- 8.7 We also consider that it is appropriate to consider the legal test in respect to the removal of the SMP retail remedies (and reliance solely on wholesale remedies) for the SMP determination on BT for the ISDN2 market, in that we are obliged to impose appropriate regulation on markets in which a finding of SMP is made. In assessing what remedies are "appropriate" we believe that it is important to assess the existing remedies, in light of our assessment of the market.
- 8.8 We have concluded that BT no longer holds SMP in a number of markets. Section 84(4) of the Communications Act requires that, where such a finding is made we, "must revoke every SMP services condition applied to that person by reference to the market power determination made on the basis of the earlier analysis". Where we make a finding of no SMP in a market, we will revoke all existing SMP conditions in accordance with the requirement in section 84(4).

BT ISDN2

- 8.9 Section 3 of the Communications Act imposes general duties on Ofcom, in carrying out its functions, to further the interests of citizens in relation to communications matters and of consumers in relevant markets, where appropriate by promoting competition. The Section also requires us to consider the interests of consumers in respect of choice, price, quality of service and value for money
- 8.10 We consider that our removal of retail remedies fulfil these general duties under section 3 of the Communications Act as we consider that there is insufficient price and service competition in this mature market and that the existing remedies discourage such competition, by allowing price following of the SMP provider and discouraging BT from cutting prices and innovation in service.
- 8.11 Section 4 of the Communications Act sets out the Community requirements on Ofcom which flow from Article 8 of the Framework Directive. In considering which, if any, SMP services conditions to propose, Ofcom has taken account of all of these requirements. In

particular, Ofcom has considered the requirement to promote competition and to secure efficient and sustainable competition for the benefit of consumers.

- 8.12 We have placed particular emphasis on the promotion of competition, which we consider is likely to be the most effective way of furthering citizen and consumer interests in the markets under review.
- 8.13 We will always seek the least intrusive regulatory measures to achieve our policy objectives, in accordance to its duty under section 6 of the Communications Act to minimise the burden of regulation. Given this approach and the requirement to promote competition we consider that the removal of retail remedies is appropriate and justifiable.
- 8.14 In addition to the overarching objective referred to above, we have taken into account a number of secondary objectives, including
- Prices:* to ensure that services are available at prices that are reasonably related to the efficient costs of supply, preferably as a result of effective competition; and
- Investment and innovation:* to promote efficient investment in the development of new and innovative service.
- 8.15 We carried out a full regulatory impact assessment in relation to the proposals for ISDN2 as required by section 7 of the Communications Act.

Section 91 test

- 8.16 Section 91 requires that retail level remedies authorised by that section shall only be applied where “Ofcom are unable, by the setting of conditions of the sorts specified in subsection (3) to perform, or fully perform, their duties under section 4 in relation to the market situation in the relevant market.” (section 91(2))
- 8.17 The conditions specified in subsection (3) are access related conditions and SMP conditions authorised or required by sections 87 to 90. Such conditions include the conditions imposed in the related wholesale review.
- 8.18 We consider that those proposed conditions are sufficient for us to fully perform our section 4 duties. Further we have considered whether additional remedies would add to or assist us in our compliance with section 4. We do not consider this to be the case. In particular we have reviewed the current remedies imposed.
- 8.19 The nature of the ISDN2 market, which is characterised by a slowly declining customer base and price following by other providers, are such that the requirements on BT to publish price and non-discriminate no longer are appropriate. We consider that the regulations lead to reluctance by BT to actively compete on price, in case the value of the market falls for BT and other Communications Providers (e.g. as any price cuts only ensure that the total revenue in the market would reduce without delivering BT any competitive advantage or attracting new customers into the market.) A removal of the remedies and a reliance on wholesale remedies should introduce the opportunity for BT and other Communications Providers to actively compete on a contract by contract basis with a long term benefit for all customers. The section 4 duty to promote competition is, therefore, better served by not imposing additional retail remedies.
- 8.20 We, therefore, consider that, whilst we have found SMP in the ISDN2 retail market, the test in section 91(2) is not satisfied and we should not set additional conditions at the retail level.

EC Guidelines

- 8.21 The Commission's SMP Guidelines state, at paragraphs 21 and 114, that NRAs must impose one or more SMP conditions on a dominant provider. This reflects Article 16(4) of the Framework Directive which states that NRAs "shall on such undertakings [with SMP] impose appropriate specific regulatory obligations". We consider that the appropriate SMP remedies for the identified markets are at the wholesale level and we are compliant with the principles of the Framework Directive and the SMP Guidelines. This is consistent with Article 17 of the Universal Service Directive which restricts the imposition of specific retail remedies to situations where wholesale remedies are not effective (the same test is essentially repeated in section 91 of the Communications Act, as described above).
- 8.22 In removing of retail remedies for ISDN2, set out above, Ofcom is, therefore, satisfied that it has considered all of the relevant requirements of the Communications Act.

KCOM Markets

- 8.23 We consider below the SMP remedies for the markets where KCOM has SMP. We consider that the justification for individual remedies applies equally to each of the markets. For that reason, we will set out the tests for each remedy and then confirm to which markets the remedy applies.
- 8.24 Given the discussion above, we would also wish to confirm that we consider that, in the case of KCOM, we do not consider that it is sufficient to rely on wholesale remedies, as the level of competition in the Hull market is so limited that retail remedies are still required to encourage competitive entry.

SMP Condition no undue discrimination condition

- 8.25 Given KCOM's SMP position our view is that KCOM should be required not to discriminate unduly between retail customers in the following markets in Hull:
- Residential analogue exchange line services;
 - Business analogue exchange line services;
 - Business ISDN2 exchange line services;
 - Residential calls;
 - Business calls;
- 8.26 In the 2003 review, we considered how we should treat undue discrimination in its implementation. We consider that this remedy does not mean that there should not be any differences in treatment between undertakings, rather that any differences should be objectively justifiable and/or not have a material adverse effect on competition for example, by differences in underlying costs of supplying different undertakings.

Section 3 test

- 8.27 As noted above, Section 3 of the Communications Act imposes general duties on Ofcom, in carrying out its functions, to further the interests of citizens in relation to communications matters and of consumers in relevant markets, where appropriate by promoting competition. The Section also requires us to consider the interests of consumers in respect of choice, price, quality of service and value for money
- 8.28 We consider that our proposed condition on non undue discrimination fulfils these general duties under section 3 of the Communications Act as there is a risk that a

provider with SMP may exercise undue discrimination against a particular person or persons. In general, a provider can be said to be discriminating when it applies dissimilar conditions to equivalent transactions.

- 8.29 Such discrimination may be in various forms including price offers, terms and conditions or information. Such behaviour would represent undue discrimination if it has no objective justification e.g., if it has a material adverse effect on competition.
- 8.30 We consider that this condition is appropriate given the level of competition in the markets where KCOM has SMP. Competition law alone cannot be relied upon to prevent certain pricing strategies that could restrict the development of competition. The condition will enable Ofcom to carry out its duties to promote competition and the interests of citizens by prohibiting such undue discrimination.

Section 4 tests

- 8.31 In setting this SMP condition we have considered those requirements set out in section 4 of the Communications Act to act in accordance with the Commission requirements.
- 8.32 By preventing undue discrimination, it meets the first requirement to promote competition and the third requirement to protect the interests of EU citizens.

Section 47 tests

- 8.33 We consider that the setting of this condition meets the tests set out in section 47 of the Communications Act.
- 8.34 It is justifiable, in that it is required to ensure that KCOM does not exploit its market power by discriminating unduly in the retail markets in which it has SMP.
- 8.35 It does not discriminate unduly against KCOM because, although it only applies to them, they have SMP and it is justified to impose the condition only on them. Where providers have SMP, discrimination can be effectively applied by the provider in question. Without market power, discrimination can be undermined by competitors or customers and attempted discrimination would not be considered undue.
- 8.36 It is proportionate in that it does not prevent the application of dissimilar conditions to different transactions where there are objective reasons for doing so. It is therefore the least burdensome means of achieving its aim.
- 8.37 We consider we have met the requirement of transparency set out in the Communications Act by setting out the proposed requirements on KCOM and the justification for the condition.

Section 91(2)

- 8.38 We also consider that the condition meets the test set out in Section 91(2) of the Communications Act. We do not consider that the current state of competition in the Hull markets would allow us to rely on wholesale remedies alone. Those remedies have, so far, not enabled or encouraged sufficient competitive entry. Accordingly, we consider that we continue to require retail remedies to address the concerns set out above.

SMP condition to notify charges terms and conditions

- 8.39 Ofcom has wide powers to seek specific information needed to assess allegations of anti-competitive behaviour. Some general and reliable visibility of a dominant operator's prices is needed, however, to enable both us and competitors to monitor those prices for possible anti competitive behaviour.
- 8.40 We, therefore, propose to require KCOM to publish charges, terms and conditions, including bundled services and to publish amendments and new charges, terms and conditions within 24 hours of the time that those amendments or new charges, terms and conditions come into force including notification to Ofcom.
- 8.41 The requirement would apply to KCOM in respect of the following markets in the Hull area:
- Residential analogue exchange line services;
 - Business analogue exchange line services;
 - Business ISDN2 exchange line services;
 - Residential calls;
 - Business calls;

Section 3 test

- 8.42 As noted above, section 3 of the Communications Act imposes general duties on Ofcom, in carrying out its functions, to further the interests of citizens in relation to communications matters and of consumers in relevant markets, where appropriate by promoting competition. Section 3 also requires us to consider the interests of consumers in respect of choice, price, quality of service and value for money
- 8.43 We consider that the setting of conditions on price notification fulfil these general duties under section 3 of the Communications Act. This option provides certainty that charges, terms and conditions will be published and offers the benefits of notification for monitoring purposes without facilitating price following in accordance with our duties to promote competition and the interests of citizens.
- 8.44 We consider that this condition is appropriate given the level of competition in the markets where KCOM has SMP.

Section 4 tests

- 8.45 In setting this condition we have considered those requirements set out in section 4 of the Communications Act to act in accordance with the Commission requirements.
- 8.46 Ensuring price visibility meets the first requirement to promote competition and the third requirement to protect the interests of EU citizens.

Section 47 tests

- 8.47 We consider that the condition meets the tests set out in section 47 of the Communications Act. The justification for imposing the condition is that general and reliable visibility of a dominant operator's prices enables Ofcom and competitors to monitor the dominant operator's prices for possible anti competitive behaviour.
- 8.48 Imposition of this condition does not discriminate unduly against KCOM as they are the only operator in the market with SMP; the behaviour of other operators is not capable of

having a materially adverse effect on competition as these operators do not have market power.

8.49 The remedy is proportionate, as it is the least burdensome means of achieving the objective, and the requirement is made fully transparent in the condition which is published at Annex 1 to this document.

8.50 We also consider that the condition meets the tests set out in Section 91(2) of the Communications Act as we set out above.

Revocation of existing SMP conditions

8.51 In changing our market definitions from those that we set in 2003, we have decided that it would be appropriate to revoke all of the SMP conditions imposed in 2003 on markets where we have reached a conclusion in this Statement. The only market from 2003 where we have not yet reached a conclusion are the ISDN30 exchange line services markets. It would not be appropriate, therefore, to revoke the SMP conditions applying in these markets prior to our conclusions on these markets. The Notification attached to this document confirm that, in relation to all other markets defined in 2003 all SMP conditions should be revoked.

8.52 In setting new SMP conditions for relevant markets in the Hull area, we have retained the basic numbering of the 2003 SMP conditions, but differentiated the two sets of conditions by replacing the prefix for each condition, moving from a “DA” to “DAA” prefix. It is important to maintain a distinction between these conditions, as, although they are similar in content, the 2003 conditions will continue to apply (as imposed) to the ISDN30 market, whereas the 2009 conditions will only apply to the Hull markets set out at paragraph 8.41 above.

Annex 1

Legal Instruments

NOTIFICATION UNDER SECTIONS 48(1) AND 80 OF THE COMMUNICATIONS ACT 2003

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 the *Fixed Narrowband Retail Services Markets explanatory statement and notification*⁸³ (‘the 2003 statement’).
2. On 29 December 2003, Ofcom took over the functions and responsibilities under the Communications Act 2003 relating to the EC Communications directives from the Director.
3. On 12 April 2006, Ofcom published *The Replicability of BT’s regulated retail business services and the regulation of business retail markets statement*⁸⁴.
4. On 19 July 2006, Ofcom published the *Retail Price Controls explanatory statement*⁸⁵ allowing retail price controls confirmed in the 2003 statement to lapse.
5. On 19 March 2009 Ofcom published a consultation document *Review of the fixed narrowband services wholesale markets*⁸⁶ consulting on proposals made in relation to fixed narrowband markets identified at the wholesale level.
6. Following a period of consultation and having carefully considered the responses received during the consultation, this Notification now sets market definitions, market power analysis and SMP service conditions.
7. Ofcom is not, in this Notification, making decisions in relation to the previously defined ISDN30 access markets⁸⁷. Ofcom will further consult on proposals for these markets and existing market definitions, market power determinations will, in the interim, remain extant for these markets. SMP service conditions for these markets will remain in force unless specifically revoked.

Decisions

8. Ofcom hereby makes, in accordance with sections 48(1) and 80 of the Act, the following decisions for identifying markets, making market power determinations and the setting of SMP services conditions by reference to such determinations.

⁸³ http://www.ofcom.org.uk/static/archive/oftel/publications/eu_directives/2003/fix_narrow_retail0803.pdf.

⁸⁴ <http://www.ofcom.org.uk/consult/condocs/busretail/statement/statement.pdf>.

⁸⁵ <http://www.ofcom.org.uk/consult/condocs/retail/statement/rpcstatement.pdf>.

⁸⁶ http://www.ofcom.org.uk/consult/condocs/retail_markets/fnrsm_condoc.pdf.

⁸⁷ Business ISDN30 exchange line services market for UK excluding Hull and Business ISDN30 exchange line services market for the Hull area, as defined in Notification to the 2003 statement.

Market Definitions

9. Ofcom has decided to identify the following markets for the purpose of considering market power determinations:

(a) for the United Kingdom, except the Hull Area:

- (i) Residential Fixed Narrowband Analogue Access;
- (ii) Business Fixed Narrowband Analogue Access;
- (iii) Residential Fixed Narrowband Calls;
- (iv) Business Fixed Narrowband Calls; and
- (v) ISDN2 Access.

(b) for the Hull Area:

- (i) Residential Fixed Narrowband Analogue Access;
- (ii) Business Fixed Narrowband Analogue Access;
- (iii) Residential Fixed Narrowband Calls;
- (iv) Business Fixed Narrowband Calls; and
- (v) ISDN2 Access.

Market Analysis

10. Ofcom has decided to make market power determinations that the following persons have significant market power:

- (a) in relation to the market set out at paragraph 9(a)(v) above, BT;
- (b) in relation to each of the markets set out at paragraph 9(b) above, KCOM.

11. Ofcom has decided that each of the markets set out in 9(a)(i) to 9(a)(iv) are effectively competitive and, therefore, has determined that BT is no longer a person with SMP in those markets.

Setting and revocation of SMP Conditions

12. Ofcom has decided to set SMP conditions on the person referred to in paragraph 10(b) above as set out in Schedule 1 to this Notification.

13. The effect of, and Ofcom's reasons for making, the decisions to identify markets set out in paragraph 8 above and to make the market power determinations set out in paragraphs 9 and 10 above are contained in, in the case of the markets set out in:

- (a) paragraphs 9(a)(i), 9(a)(ii), 9(a)(v), and 9(b)(i), 9(b)(ii), 9(b)(v), in Section 5 of the explanatory document accompanying this Notification;
- (b) paragraphs 9(a)(iii), 9(a)(iv) and 9(b)(iii), 9(b)(iv) in Section 6 of the explanatory document accompanying this Notification;

14. The effect of, and Ofcom's reasons for making, the decisions to set the SMP conditions set out in Schedule 1 to this Notification, and for not setting retail SMP conditions as set out at paragraph 11 above are contained in Sections 7 and 8 of the explanatory document accompanying this Notification.

15. Ofcom has decided that the SMP conditions set out at Annex H of the 2003 statement be revoked for the following markets only⁸⁸ (as defined in the 2003 statement);

(a) for the United Kingdom, except the Hull Area:

- (i) Residential analogue exchange line services;
- (ii) Residential ISDN2 exchange line services;
- (iii) Business exchange line services;
- (iv) Business ISDN2 exchange line services;
- (v) Residential local calls;
- (vi) Residential national calls;
- (vii) Residential calls to mobiles;
- (viii) Residential operator assisted calls;
- (ix) Residential IDD category A calls;
- (x) Residential IDD category B calls (on a route by route basis);
- (xi) Business local calls;
- (xii) Business national calls;
- (xiii) Business calls to mobiles; and
- (xiv) Business operator assisted calls.

(b) for the Hull area;

- (i) Residential analogue exchange line services;
- (ii) Residential ISDN2 exchange line services;
- (iii) Business exchange line services;
- (iv) Business ISDN2 exchange line services;
- (v) Residential local calls;
- (vi) Residential national calls originating in the Hull area;
- (vii) Residential calls to mobiles originating in the Hull area;
- (viii) Residential operator assisted calls originating in the Hull area;
- (ix) Residential IDD category A calls originating in the Hull area;
- (x) Residential IDD category B calls (on a route by route basis) originating in the Hull area;
- (xi) Business local calls;
- (xii) Business national calls originating in the Hull area;
- (xiii) Business calls to mobiles originating in the Hull area;
- (xiv) Business operator assisted calls originating in the Hull area;
- (xv) Business IDD category A calls originating in the Hull area; and
- (xvi) Business IDD category B calls (on a route by route basis) originating in the Hull area.

Amendment of associated regulation

16. Ofcom has further decided that the conditions set out at Annex 2 of *The regulatory financial reporting obligations on BT and Kingston Communications Final statement and notification* dated 22 July 2004 (as amended) ("the financial reporting Notification"), shall be revoked only in so far as they apply to the markets number 18 to 24, as identified in the table at Part 2 of Schedule 1 to the Annex to the financial reporting Notification.

17. The revocations, set out in paragraphs 15 and 16 above, will take effect on the publication of this Notification.

⁸⁸ Specifically excluding ISDN30 markets.

18. Ofcom proposes to further amend Annex 2 to the financial reporting Notification, by amending the table, “Part 2: Retail Markets” of Schedule 1 to the Annex by removing references to markets 18 to 24 inclusive; the amended table to read as follows:

Part 2: Retail Markets

Market identified and in which BT found to have SMP in previous Notification pursuant to section 79 of the Communications Act	Date
25. Provision of traditional interface retail leased lines up to and including a bandwidth capacity of eight megabits per second within the UK but not including the Hull Area	24.06.04

19. For the avoidance of doubt, the SMP conditions set under the financial reporting Notification shall continue and not otherwise be affected by the Notification, save to the extent set out in paragraphs 16 and 18 above.

Ofcom’s duties and legal tests

20. In identifying and analysing the markets referred to above, 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.

21. Ofcom considers that the SMP conditions referred to in paragraph 12 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.

22. In making all of the decisions referred to in paragraphs 8 to 19 of this Notification, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act and the six Community requirements in section 4 of the Act.

23. 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(2) and 81 of the Act.

Interpretation

24. Save for the purposes of paragraph 9 of this Notification and except as otherwise defined in paragraph 25 of this Notification, words or expressions used shall have the same meaning as they have been ascribed in the Act.

25. In this Notification:

(a) “the 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 Communication (Hull) plc.

(d) “**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 736 of the Companies Act 1985 as amended by the Companies Act 1989;

Gareth Davies
Competition Policy Director

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

15 September 2009

Schedule 1

The Conditions imposed on KCOM under Sections 45 and 91 of the Communications Act 2003 as a result of the analysis of the markets set out in paragraph 9(b) of this Notification in which KCOM has been found to have significant market power

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

1. Conditions DAA1 and DAA2 shall apply to the markets set out in paragraph 9(b) of this Notification.
2. In this Schedule 1:

 "the Act" means the Communications Act 2003 (c. 21);

 "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 736 of the Companies Act 1985 as amended by the Companies Act 1989;
3. 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.
4. The Interpretation Act 1978 shall apply as if each of the conditions were an Act of Parliament.
5. Headings and titles shall be disregarded.

Part 2: The conditions

Condition DAA1 – Requirement not to unduly discriminate

DAA1.1 The Dominant Provider shall not unduly discriminate against particular persons or a particular description of persons in relation to services offered.

DAA1.2 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 DAA2 – Requirement to publish charges

DAA2.1 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.

DAA2.2 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).

DAA2.3 The Dominant Provider shall publish any amendments to the charges, terms and conditions published under paragraph DAA2.2, including charges, terms and conditions for any new services, within 24 hours of the time that the amendment comes into effect.

DAA2.4 Publication referred to in paragraphs DAA2.2 and DAA2.3 shall be effected by placing a copy of the information on any relevant website operated or controlled by the Dominant Provider.

DAA2.5 The Dominant Provider shall send to Ofcom a written notice of any amendment to the charges, terms and conditions published under paragraph DAA2.2 (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.

DAA2.6 Where it would be impractical for the Dominant Provider to publish under paragraphs DAA2.2, DAA2.3 or DAA2.5 any charge or amended charge, the Dominant Provider shall instead publish the method to be adopted for determining that charge or amended charge.

DAA2.7 The Dominant Provider shall provide services at the charges, terms and conditions published under this Condition, and shall not depart therefrom either directly or indirectly.