



Brussels,
C(2014)
Office of Communications (Ofcom)
Riverside House - 2a Southwark
Bridge Road
SE1 9HA London
United Kingdom
For the attention of:
Mr Ed Richards
Chief Executive Officer
Fax: +44 20 7981 3504

Dear Mr Richards,

Subject: Commission Decision concerning Case UK/2014/1606: Wholesale local access market
Commission Decision concerning Case UK/2014/1608: Wholesale broadband access market
Comments pursuant to Article 7(3) of Directive 2002/21/EC

I. PROCEDURE

On 19 May 2014, the Commission registered two notifications from the United Kingdom national regulatory authority Office of Communications (Ofcom)¹, one concerning the third review of the market for wholesale local access (WLA) services², and the other the fourth review of the market for wholesale broadband access³ (WBA) in the UK.

Ofcom conducted a series of national consultations.⁴ With regard to the WLA market the consultations were published on 3 and 11 July 2013 (fixed access market review, “FAMR consultation” and LLU charge control consultation), on 19 December 2013 (on Openreach quality of service), on 20 December 2013 (on regulatory financial reporting), and on 16 January 2014 (on notification periods and VULA margin). With regard to the WBA market the consultations were published on 11 July 2013 (2013 WBA

¹ Under Article 7 of Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services (Framework Directive), OJ L 108, 24.4.2002, p. 33, as amended by Directive 2009/140/EC, OJ L 337, 18.12.2009, p. 37, and Regulation (EC) No 544/2009, OJ L 167, 29.6.2009, p. 12.

² This market corresponds to market 4 in Commission Recommendation 2007/879/EC of 17 December 2007 on relevant product and services markets within the electronic communications sector susceptible to *ex ante* regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services (‘the Recommendation’), OJ L 344, 28.12.2007, p. 65.

³ This market corresponds to market 5 in the Recommendation.

⁴ In accordance with Article 6 of the Framework Directive.

Consultation), 20 December 2013 (on regulatory financial reporting) and on 27 January 2014 (on the impact of the fibre roll-out and further consultation on the proposed charge control).

On 27 May 2014, a request for information⁵ was sent to Ofcom and a response was received on 2 June 2014.

Pursuant to Article 7(3) of the Framework Directive, national regulatory authorities (NRAs), the Body of European Regulators for Electronic Communications (BEREC) and the Commission may make comments on notified draft measures to the NRA concerned.

II. DESCRIPTION OF THE DRAFT MEASURE

II.1. Background

II.1.1. The wholesale local access market

Under case number UK/2010/1064, Ofcom notified to the Commission its second review of the market for wholesale unbundled access (including shared access) to metallic loops and sub-loops for the purpose of providing broadband and voice services in the United Kingdom, comprising traditional copper loops, cable connections⁶ and fibre-based local access. Furthermore, on the basis of the substitution analysis and the need to secure adequate competition on the retail broadband markets, Ofcom included in the market a virtual unbundled local access (VULA) product. Ofcom concluded that the VULA product offers features similar to physical unbundling⁷.

Ofcom defined two separate geographic markets and designated BT as the operator having significant market power (SMP) in the UK excluding the Hull area, and Kingston Communications (KCOM) as the operator with SMP (in the Hull area).

Consequently, Ofcom imposed the following regulatory obligations on both operators: (i) general network access; (ii) requirement not to discriminate unduly; (iii) price control based on an LRIC+ method; (iv) transparency requirements; and (v) cost accounting and accounting separation. In addition, Ofcom imposed on BT the requirement to provide local loop unbundling (LLU) services (including shared access) and, in the case of the NGA networks, the requirements to provide (i) virtual unbundled local access (VULA); (ii) sub-loop unbundling (SLU); and (iii) physical infrastructure access (PIA) consisting of duct and pole access. With regard to LLU Ofcom proposed to maintain the previously imposed charge control obligation. For VULA it allowed pricing flexibility (including geographic variations, volume discounts and tiered pricing), while ensuring that VULA is provided on an equivalence of input basis (EoI).

The Commission commented on the inclusion of the VULA product in the relevant wholesale market, as well as on the inclusion of cable on the basis of indirect constraints. With regard to the latter, the Commission was concerned that Ofcom did not provide sufficient evidence on the pass-through of the wholesale price increase to the retail customers and that there was sufficient demand substitution at the retail level to render

⁵ In accordance with Article 5(2) of the Framework Directive.

⁶ Ofcom proposes to include cable-based services within the relevant market on the basis of indirect constraints, relying on the evidence available from previous reviews.

⁷ The key characteristics for VULA are: Local (interconnection should occur locally); Service-agnostic (should be able to support a multitude of services); Uncontended (dedicated capacity should be available to the end-user); Control of access (sufficient control of the access connection should be available); and Control of customer premises equipment (CPE) (sufficient control of CPE should be available).

the wholesale price increase unprofitable. The Commission considered that the inclusion of cable and hence the broader market definition had no impact on the regulatory outcome, as BT was found to have SMP even on such broadly defined market. The Commission commented also on the lack of price control remedy for VULA, while acknowledging that it will be provided on fair and non-discriminatory terms under the equivalence of input requirements.

II.1.2. The wholesale broadband access market

In March 2010, Ofcom notified the Commission its third review of the market for wholesale broadband access under case number UK/2010/1065⁸. On the basis of indirect constraints Ofcom included in the relevant market fibre-based, cable-based and LLU-based products. Ofcom proposed to segment the market regionally and defined the following relevant geographic markets: (i) the Hull area where only KCOM is present; (ii) market 1: local exchanges where only BT is present; (iii) market 2: local exchanges with two or three principal operators⁹, and (iv) market 3: exchanges where four or more principal operators are present or forecast.

Ofcom concluded that there was no SMP on market 3, accounting for 71.8% of UK delivery points (excluding Hull), while BT held SMP on markets 1 and 2, and KCOM was found to have SMP in the Hull area.

With regard to markets 1 and 2, Ofcom proposed to impose on BT the following obligations: (i) requirement to provide network access on reasonable request; (ii) requirement not to discriminate unduly; (iii) requirement to publish a reference offer; (iv) requirement to notify charges, terms and conditions; (v) transparency as regards quality of service; (vi) requirement to notify technical information; (vii) accounting separation; (viii) cost orientation; and (ix) cost accounting. In addition, Ofcom proposes to impose on BT a charge control obligation on market 1.

In the Hull area, KCOM should comply with: (i) the requirement to provide network access on reasonable request; (ii) the requirement not to discriminate unduly; (iii) the requirement to publish a reference offer; (iv) the requirement to notify charges, terms and conditions; (v) transparency as regards quality of service; (vi) the requirement to notify technical information; and (vii) accounting separation. Ofcom did not propose to impose cost orientation on KCOM.

The Commission commented on the inclusion of cable- and LLU-based WBA services in the relevant market on the basis of indirect constraints stemming from the underlying retail markets, as well as on the criteria used for geographic segmentation of the WBA market.

In August 2010 Ofcom notified to the Commission a revised assessment of the geographic market definition, while leaving the SMP and the remedies unchanged (UK/2010/1123). Ofcom proposed, in addition to the number of principal operators present in a local exchange, to consider also BT's *exchange level service share criterion*.¹⁰ Ofcom proposed to redefine market 3 in such a way as to include also the local exchanges where three principal operators are present and BT's share is below 50% (previously market 3 encompassed only the exchanges with 4 or more principal

⁸ UK/2010/1065, SG-Greffe (2010) D/7658.

⁹ For the purposes of the review, Ofcom identified the following LLU principal operators: Talk Talk, Sky, Orange, O2 and Cable & Wireless Access.

¹⁰ Service shares are calculated at the wholesale level based on exchange level LLU data, i.e. on the basis of the number of lines provided to each operator, including BT.

operators). The Commission reiterated its comments on the inclusion of self-supply on the basis of indirect constraints stemming from the retail market, as well as on the criteria used for the geographic market segmentation.

II.2. Market definition

II.2.1. Wholesale local access

In line with its previous market reviews Ofcom proposes to define the relevant WLA market as including copper-based, cable-based and fibre-based local access at a fixed location. Ofcom does not distinguish between WLA used to provide business or residential services. Similarly as in its previous market review Ofcom considers that because of the retail competition between copper-based and cable-based services, at the wholesale level the cable networks exert indirect constraint on the provision of wholesale local access by a network that uses copper/fibre lines.

With regard to these indirect constraints Ofcom provides a more extensive explanation when compared to its previous market review. Ofcom's assessment of demand side substitutability is based on product characteristics, intended uses, pricing of the different retail offerings, and likely responsiveness (and attitudes) of retail consumers. Ofcom's assessment is qualitative in nature and Ofcom does not provide a quantitative assessment of the pass through and/or absorption capacity by alternative operators of a potential increase of wholesale prices. Ofcom explains that it does not have reliable data to conduct a SSNIP/critical loss analysis.

Ofcom assessed also other forms of access (such as mobile, satellite and fixed wireless access) and concluded that there is only very limited substitutability at the retail level, and that such access products would not provide a sufficient indirect constraint at the wholesale level to justify their inclusion in the relevant market.

Ofcom proposes to define two geographic WLA markets: (i) the UK excluding the Hull area and (ii) the Hull area.¹¹

II.2.2. Wholesale broadband access

With regard to the products included in the market definition Ofcom proposes that the market remains unchanged and is defined as: asymmetric broadband access and any backhaul which is necessary to allow interconnection with other communications providers, which provides an always-on capability, allows both voice and data services to be used simultaneously and provides data at speeds faster than a dial-up connection.

Ofcom includes in the relevant product market self-supplied cable and LLU-based access products, by taking into consideration the indirect constraints stemming from the underlying retail markets. Ofcom considers that the relevant wholesale market should in general comprise all the upstream access services which correspond to the competing products at the retail level. With regard to substitutability at retail level, Ofcom's analysis follows the analysis carried out in the context of market 4.

Unlike in its previous review, Ofcom now proposes to define only 3 separate geographic markets: (i) Hull area; (ii) Market A – exchanges where there are no more than 2 principal operators (POs)¹² present or forecasted, which accounts for 9.5% of UK premises; (iii) Market B – exchanges where there are three or more POs present or

¹¹ "The Hull area" refers to Kingston upon Hull and covers 0.7% of UK premises.

¹² Principal Operators are those that are likely to exert a substantial competitive constraint on other operators. For this market review period Ofcom considers the following undertakings as Principal Operators: BT, Sky, TalkTalk, Vodafone and Virgin.

forecast, which accounts for 89.8% of UK premises.

I.3. Finding of significant market power

II.3.1. Wholesale local access

Following its analysis of the market for wholesale local access, Ofcom concluded that BT has SMP in the UK, excluding the Hull area, and that KCOM should be designated as SMP operator in the Hull area. With regard to BT's SMP position, Ofcom analysed the following main criteria: (i) high and stable market shares¹³; (ii) barriers to entry; and (iii) countervailing buying power. As far as KCOM is concerned, the following criteria were analysed: (i) 100% market share; (ii) barriers to entry; and (iii) countervailing buying power.

II.3.2. Wholesale broadband access

Similarly to the approach taken in its third review of this market, Ofcom concludes that there is no SMP on market B. Furthermore, BT is considered to have SMP on market A and KCOM is found to have SMP in the Hull area. The SMP assessment is based on: (i) market growth and market shares¹⁴ taking into account self-supply by cable and LLU operators; (ii) future potential market shares; (iii) barriers to entry and expansion; (iv) economies of scale and scope; and (v) countervailing buying power.

II.4. Regulatory remedies

II.4.1. Wholesale local access

Ofcom proposes to maintain currently imposed remedies for both BT and KCOM: (i) network access on reasonable request; (ii) non-discrimination (for BT on the EoI basis¹⁵, while for KCOM on the NUD basis (no undue discrimination)); (iii) transparency requirements (publication of reference offer, notification of charges, terms, conditions and technical information); (iv) cost accounting; and (v) accounting separation.

With regard to BT only Ofcom proposes to impose in addition cost orientation and charge controls, specific requirements and minimum standards with regard to quality of service.¹⁶

Furthermore, Ofcom proposes specifically to impose on BT the requirement to provide local loop unbundling (LLU) services (including shared access) and, in the case of the NGA networks, the requirements to provide (i) virtual unbundled local access (VULA); (ii) sub-loop unbundling (SLU); and (iii) physical infrastructure access (PIA) consisting of duct and pole access.

Regarding copper based LLU, Ofcom proposes to maintain the charge control obligation which it had previously imposed. The previous charge controls on LLU expired on 31 March 2014. The new charge controls are proposed to enter into force on 1 July 2014 and

¹³ According to Ofcom, BT's market share is consistently very high and is above 80%, while in 2009 it was 84%.

¹⁴ BT's market share in market A is 88.8%, while KCOM has close to 100% in Hull area. While fibre is included in the market Ofcom does not include fibre connections in the calculation of market shares. Ofcom considers that currently the fibre connections constitute a very small part of total broadband market (2.5 million lines out of total of 22 million connections), and that BT owns majority of the fibre connections (1.9 million). Given the low fibre penetration its inclusion in the market share calculations would not lead to materially different outcome.

¹⁵ The imposition of non-discrimination based on EoI with regard to legacy infrastructure applies only to the extent to which BT is currently supplying wholesale services on the basis of EoI.

¹⁶ Such as minimum standards for provisioning and fault repairs, increased KPIs, improved SLAs/SLGs.

cover the period to 31 March 2017. The charge control is based on a top-down cost model¹⁷ using BT's Regulatory Financial Statements together with Asset Volume Elasticities (AVEs) and Cost Volume Elasticities (CVEs) to forecast the costs of operating a hypothetical on-going copper network to 2016/17.¹⁸ In 2013 the LLU monthly rental fee was Euro 8.34 and will increase (up to Euro 9.30) in the review period 2016/17.

In addition, Ofcom proposes that BT should price PIA (passive infrastructure access like poles, ducts, etc.)¹⁹ and SLU at their long-run incremental cost (LRIC), allowing a mark-up for common cost recovery. With regard to SLU at this stage Ofcom does not propose any changes to take into account the investments in deploying the vectoring technology. However Ofcom provides non-binding guidance that it intends to protect both BT's investment in vectoring, as well as investments of other communications providers who have actually used SLU.²⁰ Ofcom will review its position when technical solutions emerge, which would enable vectoring and SLU to co-exist.

In the case of the VULA, Ofcom would like to continue with allowing pricing flexibility, e.g. geographic variations, volume discounts and tiered pricing. However, BT is required to provide VULA to CPs on an equivalence of input (EoI) basis, i.e. on the same timescales, terms and conditions (including price and service levels), by means of the same systems and processes and by providing the same information as to its own downstream divisions. However, with the current notification Ofcom proposes to set the charges for VULA migration (i.e. in case the retail customer switches from one CP to another), to GBP 11 from currently GBP 50.

While not being part of currently notified draft measure, Ofcom will in the near future publicly consult and notify its decision concerning the VULA margin, and a general prohibition to set VULA charges at a level leading to a margin squeeze.

II.4.2. Wholesale broadband access

With regard to market A for BT and for KCOM in the Hull area, Ofcom proposes to

¹⁷ The cost model includes an efficiency target of 5% per year and the level of engineering costs is increased by 3.9% to enable Openreach to recover its efficiently incurred costs related to the new Quality of Service remedy. The WACC is set at 8.6%.

¹⁸ Total costs to be recovered from the charge controls will, with the exception of pre-1997 local access ducts, be forecast on the basis of current cost accounting fully allocated costs (CCA FAC). The CCA FAC cost base will be subject to an adjustment in that the regulatory asset base (RAV) of the pre-1997 local access duct assets will be based on historic cost accounting (HCA) value, indexed for inflation.

¹⁹ Ofcom maintains unchanged the restrictions as to the allowed use of PIA, namely only with relation to the retail services downstream of markets 4 and 5. In 2013 Ofcom has specifically considered whether to allow use of PIA for leased lines services, and based on the evidence and its analysis decided not to impose passive remedies for the markets for leased lines services (case UK/2013/1428).

²⁰ In view of rapidly changing technology and uncertainty as to the deployment of vectoring Ofcom does not consider it appropriate to put in place specific rules related to vectoring. Ofcom intends to encourage coordination between BT and access seekers, and explore technical possibilities for coexistence between vectoring and SLU. Ofcom provides guidance on how it will likely react in two scenarios: i) if an access seeker requests SLU in a cabinet where BT has already deployed vectoring (request for SLU should not degrade the services provided to end customers at that cabinet; BT could refuse SLU access, if it can demonstrate that it has taken all reasonable steps to coordinate vectoring, based on available technology at that time); and ii) where BT intends to deploy vectoring in a cabinet in which an access seeker already buys SLU (Ofcom considers that it will be unlikely to be reasonable for BT to withdraw SLU access already granted, as it would undermine investments in SLU; if co-existence of vectoring and SLU will not be devised until next review, Ofcom will consider whether continued provision of SLU is appropriate, given the actual volumes of SLU take-up and benefits realised through vectoring).

impose the following obligations: (i) requirement to provide network access on reasonable request; (ii) requirement not to discriminate (for BT on the basis of EoI, while for KCOM less strict standard not to unduly discriminate); (iii) requirement to publish a reference offer; (iv) requirement to notify charges, terms and conditions; (v) transparency as regards quality of service; (vi) requirement to notify technical information; and (vii) accounting separation.

In addition for BT in market A Ofcom proposes to impose charge control based on CPI-X²¹ and cost accounting. On the contrary, for KCOM in the Hull area, Ofcom does not propose any price control. Ofcom considers that the imposition of price controls would be too costly, given the size of the market and potential market entry. Moreover, Ofcom considers that it would also be disproportionate to impose non-discrimination on the basis of EoI, and that the requirement not to unduly discriminate²² is sufficient and effective to ensure the provision of wholesale broadband access.

III. COMMENTS

The Commission has examined the notification and the additional information provided by the Ofcom and has the following comment:²³

Inclusion of self-supply in the market definition on the basis of indirect constraints

Ofcom defines the relevant Wholesale Local Access and Wholesale Broadband Access markets by taking into consideration indirect constraints stemming from the underlying retail markets. Therefore self-supplied cable- and LLU-based services are included in the relevant markets.

The Commission notes that Ofcom's proposed broad definition of the wholesale markets is based on the fact that certain products are considered as close substitutes at the retail level, and that Ofcom's analysis in this respect is rather qualitative in nature.

As laid out in previous cases²⁴, the Commission considers that if there is competitive pressure stemming from alternative platforms at retail level, such platforms should only be included in the wholesale markets if the following conditions are met: (i) access seekers would be forced to pass a hypothetical wholesale price increase onto their consumers at the retail level based on the wholesale/retail price ratio; (ii) there would be sufficient demand substitution at the retail level based on indirect constraints such as to render the wholesale price increase unprofitable; and (iii) the customers of the access seekers would not switch to a significant extent to the retail arm of the integrated hypothetical monopolist, in particular if the latter does not raise its own retail prices. When the above-mentioned criteria are fulfilled, constraints should be deemed to be strong

²¹ The charge control will lead to significant price reductions due to the adopted value of X (CPI-10.7%). Ofcom explains that the charge control is based on LRIC and that the price-cap regulation is designed to, inter alia incentivise cost-minimisation since BT can keep the profits if it is able to deliver the required services at a lower cost than has been forecasted.

²² Ofcom considers that the requirement not to unduly discriminate is consistent with the Equivalence of Output in that it requires the SMP operator to provide wholesale inputs in a manner which is comparable in terms of functionality and price to those provided by the SMP operator to itself.

²³ In accordance with Article 7(3) of the Framework Directive.

²⁴ See cases UK/2003/0032, NL/2005/0281, AT/2005/0312, UK/2007/0733, UK/2010/1065 and UK/2010/1123.

enough so that the platform concerned is included in the market.

When indirect constraints are found to exist but are not strong enough to constrain the price of other WLA or WBA products, they should be taken into account when assessing whether the incumbent operator has SMP on the relevant market, as well as alternatively in the assessment of the appropriate remedies.

In order to estimate the degree of strength of indirect constraints, Ofcom should therefore have provided *inter alia* a qualitative and a quantitative assessment of factors including the effective pass-through from wholesale to retail prices (including an assessment of the wholesale/retail price ratio), the (in)capacity of operators to absorb wholesale price increases depending on competitive conditions at retail level, as well as the effective willingness of retail consumers to switch their operator in response to the price increase.

The inclusion of self-supplied cable- and LLU-based access could affect the SMP finding, if an operator was found not to hold SMP on such broadly defined market. The Commission notes, however, that as BT and KCOM were found to hold SMP, the inclusion of self-supplied products on the basis of the indirect constraints makes no difference to the outcome of this market review.

Nevertheless, the Commission invites Ofcom to further substantiate its definition of markets 4 and 5 in its final measure, with a particular reference to the factors mentioned above, i.e., pass through, absorption capacity, and retail consumers' switching behaviour.

Pursuant to Article 7(7) of the Framework Directive, Ofcom shall take the utmost account of the comments of other NRAs, BEREC and the Commission and may adopt the resulting draft measure; where it does so, shall communicate it to the Commission.

The Commission's position on this particular notification is without prejudice to any position it may take *vis-à-vis* other notified draft measures.

Pursuant to Point 15 of Recommendation 2008/850/EC²⁵ the Commission will publish this document on its website. The Commission does not consider the information contained herein to be confidential. You are invited to inform the Commission²⁶ within three working days following receipt whether you consider that, in accordance with EU and national rules on business confidentiality, this document contains confidential information which you wish to have deleted prior to such publication.²⁷ You should give reasons for any such request.

Yours sincerely,
For the Commission,
Robert Madelin
Director-General

²⁵ Commission Recommendation 2008/850/EC of 15 October 2008 on notifications, time limits and consultations provided for in Article 7 of Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services, OJ L 301, 12.11.2008, p. 23.

²⁶ Your request should be sent either by email: CNECT-ARTICLE7@ec.europa.eu or by fax: +32 2 298 87 82.

²⁷ The Commission may inform the public of the result of its assessment before the end of this three-day period.