

Fixed Narrowband Market Review and Network Charge Control Call for Inputs

Response by KCOM

28 June 2012

Introduction

KCOM welcomes the opportunity to respond to Ofcom's Call for Inputs in advance of the Fixed Narrowband Market Review. There have been significant developments in the market for fixed narrowband call services and it is important that Ofcom has the opportunity to consider these fully in the context of the review.

Although we do offer services outside of the Hull area through our businesses Kcom and Eclipse, our response to the Call for Inputs is focused on the services provided by KC in the Hull area. Rather than responding to each question posed in the Call for Inputs, we focus on a number of key areas which are of particular concern to our business.

Retail Markets

In the Call for Inputs Ofcom states that it is not currently aware of any developments in relation to the retail markets in the Hull area which would have had a significant impact on the analysis contained in the 2009 review.

KCOM does not believe this is the case. Since the last market review interest in the provision of services by alternative providers in the Hull area has increased markedly, particularly services for business customers. We have seen the entry of providers using KCOM infrastructure to offer voice and broadband to business customers, experiencing substantial growth since they began providing services. These providers were not active in Hull at the time of the 2009 review.

Similarly, we would argue that closer consideration of the impact of mobile and other substitutes on the markets for both residential and business calls is warranted. In particular, we believe that:

- The extent of mobile substitution in the Hull area is likely to be more pronounced than in the rest of the UK due in the absence of the wider choice of fixed line providers available outside of the Hull area.
- Traffic which uses leased lines to bypass the PSTN should be taken into account in the business calls market.

These issues were raised during the previous Narrowband Market Review and Ofcom accepted that there was the possibility of a higher level of mobile substitution in Hull relative to the rest of the UK based on the decline in fixed call volumes relative to the decline in fixed call volumes in the national market.



With regard to bypass traffic, most larger or corporate entities operate private networks over a wide area, which are used for internal voice and data traffic. They are also used to transport services, including “PSTN” voice intended for destinations external to the private network to designated “breakouts”, which are generally chosen because of favourable costs, for underlying economic reasons (“far end termination” for example) or because of better commercial deals being available. In the rest of the UK market where this breakout occurs is immaterial – the traffic of whatever nature can be identified wherever it appears. For Hull, however, this is not the case and undoubtedly leads to significant underestimation of the size of the overall business calls market and overstatement of the KCOM share.

We provided some data to Ofcom about estimated volumes of calls originated in Hull and being carried over leased lines during the 2009 Market Review and Ofcom accepted that there may be some merit in the argument that there are different competitive conditions for business calls for those companies using dedicated leased lines. We intend to revisit this area in detail as part of our work on the forthcoming market review and we believe it helpful for Ofcom to analyse this issue and the extent of mobile substitution in the Hull area in more detail during the forthcoming market review. We would welcome engagement on how this might be done.

We also note that since the 2009 Market Review we have seen wireless providers becoming more active in the market in Hull. While these providers are focussed on the provision of broadband services, VoIP services form part of their offerings and should be also be considered when analysing the market for fixed call services in Hull.

Wholesale Markets

We make no specific observations with regard to the wholesale markets at this stage, except to note that there have been developments in relation to the deployment of alternative infrastructure in the Hull area since the last market review and these should be considered in Ofcom’s analysis of the market. In particular extensive deployment of fibre is currently taking place by MS3 with the aim of targeting business customers and resellers.

Non-Pricing Remedies

A key issue for KCOM is ensuring that customers in Hull are not disadvantaged by the application of SMP remedies and that they are able to take advantage of competitive developments which are readily available to customers in the rest of the country. An example of this was the inability of Hull customers to have access to bundled services due to the interpretation of the undue discrimination obligation applied to narrowband services. This anomaly was addressed through a separate consultation in 2010 which resulted in KCOM being permitted to offer bundled services subject to a number of conditions. We believe that there may be similar unwanted effects for business customers who are unable to take advantage of the range of bespoke offers available in the rest of the country.

It is therefore important that Ofcom gives full consideration to the potential negative impacts of SMP remedies in the forthcoming Market Review should SMP remedies be deemed necessary.



KCOM Group PLC

We note that Ofcom did propose continuing discussions with KCOM and other relevant stakeholders on the potential relaxation of regulation for business customers in the 2009 Market Review with the possibility of reconsulting if a clear case for relaxation or modifications of the SMP conditions became apparent. Those discussions were not progressed and the current work being undertaken provides an ideal opportunity to reopen this issue. We firmly believe that there is the potential for a more light touch regulatory regime to be applied in markets where KCOM does retain market power.

With regard to whether operators of TDM networks should be required to provide an IP interconnection service we note that this raises issues in relation to the general access and interconnection obligations placed on CPs by General Condition 1 which go beyond the market review considerations. While KCOM accepts that it is valid for Ofcom to consider NGN in the context of determining the appropriate cost basis for regulated services covered by the market review, consideration of a potential change to the physical way in which CPs interconnect is a distinct policy issue which would merit separate consideration.

Pricing Remedies

KCOM understands the need for Ofcom to consider the EC Recommendation and the possible introduction of a pure LRIC approach to the calculation of fixed termination rates. However we would caution that Ofcom must ensure that whatever approach is taken is proportionate.

The calculation of fixed termination rates by KCOM for its business in the Hull area is carried out on a different basis than the calculation of fixed termination rates of other UK providers. Unlike BT, KCOM is not subject to a charge control and KCOM's termination rates within Hull are subject to a basis of charges obligation rather than the "fair and reasonable" obligation applied to the termination rates of other providers.

KCOM has had extensive discussions with Ofcom in the past regarding the cost basis for our termination rates, the key driver for those discussions being to ensure that the imposition of a cost orientation obligation was proportionate and did not impose overly onerous obligations on our business. In this regard, Ofcom has previously recognised the disproportionate burden that requiring a provider of KCOM's size to use a full LRIC methodology would impose. As a result KCOM's termination rates are calculated using an agreed alternative to a full LRIC methodology. We are very concerned to ensure that any change in the basis of calculation does not impose a disproportionate burden on our business and enables us to recover our costs. We anticipate the need to engage with Ofcom on these issues which are key to our business.

At the current time we make no comment on whether an NGN approach to cost modelling would be appropriate for this review but would again stress that this issue needs to be considered separately in the context of the obligations placed on KCOM and the need for proportionality to be a key consideration.



Finally, while we do not yet have a particular view on time of day rates we believe it is appropriate for Ofcom to consider this in the context of the forthcoming market review given market developments. With regard to a maximum ceiling for regulated wholesale call conveyance rates, we agree that it warrants consideration however would caution that the fixed market is likely to exhibit a wider range of time of day profiles than the mobile market with clear divisions between providers focused on the residential and business markets. This is likely to be a complicating factor which requires full and proper analysis.

