Vodafone non confidential version

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Response to Ofcom's Consultation:

Business Connectivity Market Review:
Very low bandwidth leased lines

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1. Executive summary

BT continues to have SMP in the retail very low bandwidth leased lines market with 100% market share for analogue services and circa 60% for digital. If anything at this stage in the product life cycle, remaining customers require more regulatory protection rather than less.

- In the upstream market for digital PPCs Ofcom proposes immediate reductions to starting charges and then tight ongoing charge controls for the review period. This will result in average prices falling by CPI -44.5% over the period. In direct contrast to the digital wholesale market Ofcom proposes that in the digital retail market not only are prices *not* reduced in line with wholesale products but that BT is permitted to increase them by RPI + 24% over the period. At the extremes, the contradictory regulatory proposals could result in digital RPC diverging in price by over 68% compared to digital PPCs charges by the end of the charge control period.
- The situation is just as stark for analogue circuits. There is no upstream wholesale market for analogue services with BT being the monopoly retail provider.

The planning and execution of migration, by both the CP and the end customer, is a substantial task which will require a substantial notice period. We propose that BT is required to provide a three year notice period which definitively confirms the very low bandwidth platform closure in 2017.

We do not believe the voluntary commitment made by BT reflects the needs of customers who are moving away from RPCs, often at considerable expense. BT is not merely recovering costs with these proposals, but over-recovering from loyal customers.

It would be more appropriate if:

- migration measures were required from BT to help customers to move away from their legacy platform
- charge control was put in place upon BT's RPCs that mirrors the PPC proposals.

2. Introduction

Ofcom has consulted on proposals to remove regulation from Very low Bandwidth Retail Private circuits. The proposal appears to be based on the presumption that this is a legacy platform and new supply is not taking place. These facts are undoubtedly true, but this does not lead to the conclusion that a Market Review is unnecessary. As customers face pressure to move off legacy platforms, it goes without saying their costs increase and service is disrupted. In a competitive market, the supplier would do everything to mitigate this level of disruption, hoping that good service would retain the customers. Instead we find that BT is offering to increase prices by no more than 8% a year. This feels an inadequate response.

The remainder of this document is structured as follows: the following chapter discusses the importance of regulatory policy in an environment where products and platforms are at the end of life and customers are forced to find another platform. We then discuss Ofcom's specific questions in more detail.

3. Migration policy

Ofcom correctly identifies that migration needs to start to occur in earnest during the review period. In a competitive market the supplier would incur the costs and management to avoid losing the customer. BT is the primary beneficiary from the current migration requirement:

- BT profits from the delay to migration as a result of being permitted to charge higher service prices,
- BT can charge again for the new connection as it can expect the customer to migrate to another of its SMP services (wholesale if not retail),
- BT itself has received the life time profits of these services and yet proposes to avoid the migration costs

The failure by BT to appropriately support the migration of customers is a reflection of its Significant Market Power.

Migration policy needs a fundamental rethink with obligations placed upon BT to facilitate the cost and process of migration. It is a regulatory failing to only protect the adopters of the newest service. We consider migration to be an unresolved void in the set of remedies which we recommend is dealt within this review.

Migration policy

BT's pan-market SMP has resulted in a substandard approach to supporting customers through platform closure. In a more competitive market migration would be handled very differently, as the competitive supplier would want to ensure no loss of customers as a result of the transition. Compare BT's stance of raising prices at the end of life of a product with its proposals to migrate customers, some 10 years ago under 21CN, where BTWholesale proactively offered compensation and other help for CPs in order to smooth through its proposals.

We recommend that more consideration is placed upon end of platform migration policy, such that BT could be incentivised to better mimic the functioning of competitive markets. We consider that there is a failure within the market and of the current regulations to put in place adequate and appropriate migration and switching options. BT must be required to continue to provide the service with appropriate and fair charges until it has supported the customer base through a migration path. The cease and reprovide migration scenarios on offer from BT simply could not be sustained in a competitive market.

The current SMP framework remedies do not adequately mimic the outcomes that would occur in a competitive market. In a competitive market a supplier would not wish to give the end customer the opportunity to rethink its service supply options and risk the loss of the customer, therefore the supplier would do all he could to ease the transition for the customer.

BT has SMP in all the relevant access markets; the markets that customers are migrating from and the markets they are migrating to. As a result of this, BT does not treat the migrating customer in a manner comparable to a competitive market as the risk of losing customers is markedly reduced, if indeed, at all present.

To date Ofcom has permitted BT to raise prices on legacy services. For some end customers this has prompted proactive migration. For the remaining customers increased prices do not and will not act as an incentive to promote migration: they are treated as a cash cow by BT. The result is simply higher profits for BT for the ongoing life of the service and a postponed migration headache.

Migration proposals

BT has notified that the platform that supports sub 2Mbit/s circuits, will close in 2020. This creates an enormous overhead for CPs and other intermediaries, and yet at the same time, BT is allowed to recover more than its costs, in the same time period. This feels like an imbalance of risk and reward. The number of circuits that will require to be migrated before this date is substantial. Ofcom proposes that BT must give a period of no less than 12 months' notice of platform closure. This would be fatal for a number of customers if a period this short was to be implemented. Customers must plan ahead capital expenditure, project management and systems development months if not years ahead. One year notice from beginning to end would give customers (at current delivery rates of 60 days delivery) approx. nine months to order an alternative circuit such as EAD (and that assumes that BT could deliver such a volume in a short time scale, which given current performance is high risk). The time frame fails to reflect the need to swap out the equipment in customer networks and the sheer volume of orders that BT would need to manage if it really only gave one year's notice. We urge Ofcom to reconsider this proposal and set the minimum notice period to be at least three years. Customers can plan, if they have certainty, one year's notice does not give them any certainty and in fact leaves them with little room to react usefully.

As set out in the report commissioned by Vodafone and attached at the Annex, we consider that new regulatory obligations for migration are necessary. BT should be required to support the migration of customers to newer and more efficient technology (where it is choosing to close platforms) by way of managed down time at BT's cost in the same way that alternative network providers do. In more complicated situations BT should again undertake the management (and cost) of transition to a replacement service. In the later situation where end user on site technology refresh is required it will be necessary to fit plans with the end users own deployment programme.

4. BT has SMP in retail very low bandwidth leased lines

Ofcom sets out the BT has 100% market share in analogue and over 60% in digital very low bandwidth retail leased lines. Yet Ofcom declines to analyse the market and impose SMP upon BT to protect users.

Customers of these services need even more regulatory protection at this late product lifecycle stage. The products will continue to be sold for a further 5 years (at least), but competition is limited. Customers face significant time consuming change programs and substantial migration costs for change to their internal networks and to cease and reprovide their connectivity.

Retail leased lines are purchased by both end customers and CPs. Vodafone continues to rely upon BT for the provision of these retail services. We do not consider that upstream PPC regulation acts as a sufficient constraint to BT's retail market power at this late stage of the product lifecycle.

Upstream purchasing options open to us only exist for digital services. The time period ahead is inadequate to recoup circuit optimisation or cease and reprovide costs for circuits bought as retail circuits today. Therefore any greater upstream competition will not flow to retail supply.

30% of the RPCs we buy from BT are analogue so in these cases we are not in the position to even consider switching to alternative low bandwidth leased lines inputs.

We consider at this late life stage cycle BT' s SMP is even further entrenched. Ofcom proposes not to regulated because:

Criteria 1: Users can migrate to alternative services and will increasingly do so over the next three years

It is interesting to note, that Ofcom says that 'customers *can* migrate to other services…'. In this case customers *must* migrate, given that BT has given notice that the platform is closing. We highlight that customers have always been able to migrate to other service, however this was not previously been a barrier to Ofcom establishing SMP in the past and protecting those users who did choose to use RPCs.

We observe that low bandwidth leased lines services have been subject to price increases for the last two market review periods. Users that are capable of moving, and incentivised to do so by rising prices. will have done so. The remaining users will be those most unable to rapidly migrate and consequently be those that require ongoing protection from excessive charging by BT.

Ofcom's has in our view underestimated the value placed on these services by some users. Ofcom has identified particular user groups which value the service characteristics of low bandwidth TI and those who are limited in their ability to alter investment timetables and strategy as they themselves are part of a regulatory charge controlled system.

We consider that a good proportion of remaining customers will remain for the long haul and not switch until absolutely necessary at the end of the product life. It is worth observing that BT has been announcing PPC platform closure since 2004 and therefore customers are not surprisingly sceptical about whether to react or not to the latest announcement.

Without migration management and cost mitigation from BT, migration will not be rapid. At this stage of the lifecycle (5 years before platform closure) we would expect to see natural customer churn. We would not start conversations with customers about forced migration until 2017. Planning from this point will account for the fact that these customers will need to have business plans to accommodate the change internally. The cost of which will also be substantial.

Criteria 2: BT is managing an orderly process of service withdrawal of VBL leased lines over the next few years

Ofcom sets out the journey of BT's plans for service withdrawal

- It was first proposed that RPC/PPC service closure would take place in 2006
- In 2013 BT announced that platform closure would be in 2018.
- In 2015 BT has moved this to 2020.
- New circuits will continue to be supplied up until September 2016.

It is clear that BT's plans have evolved and that customer demand has not abated, with new supply continuing despite platform closure announcements. However, we have not seen any evidence that BT is offering an 'orderly process of service withdrawal':

- The notice of end of life has moved so much that it feels as if we could never have a credible conversation with our customers.
- BT is proposing to increase prices
- There is a lack of support for customers to move to an alternative technology in any managed sense.

A managed orderly process for migration would instead include:

- 3 years notice of firm and final platform closure

  BT to provide 3 year notice of platform closure and as part of this, put in place effective plans to support customer migrations to alternative services. This would include but not be limited to project management and hot switch-over (where applicable).

- Circuit and project Migration management by BT

  BT to provide customers with effective project and circuit management in order to aid transition from a legacy platform to a newer, modern technology.

- Migration cost being placed firmly with BT

Costs of migrations are factored into new and alternative platforms, and not wholly borne by the customers. This reflects a more competitive market, where a CP actively seeks to minimise disruption to the end customers.

For these reasons, we believe that ongoing regulation is necessary.

Question 3.1: Do you know of other CNI operators that will be affected by the withdrawal of VLB services that we have not considered above? If so, please provide details of these CNI operators, and, if possible, please outline their awareness and preparedness for the withdrawal.

One of our CNI customers with low bandwidth circuits has put in place migration plans. As with any network delivery project, this is taking longer and proving more complex than originally envisaged. It requires the full migration of not just circuits but technology, moving from copper based to microwave. The costs to establish this network are substantial.

Another CNI customers is moving from very low bandwidth circuits to Ethernet, requiring fibre delivery. This brings its own challenges with Openreach's ability to deliver fibre and has resulted in the CNI provider being late in delivering on their own regulatory obligations.

Ofcom and BT's lack of support for these customer by suggesting that a complete regulatory withdrawal is the right thing belies the complexity of what is going on in this market.

We recognise that SMP designation in a retail market is nowadays an oddity, however SMP designation is made in direct response to the market situation which in this market continues to be observed.

Criteria 3: Further protection will be provided by regulation of the related upstream wholesale low bandwidth TISBO market which will remain in place

Ofcom proposes that the upstream remedy will provide the protection required downstream. This is not the case. In 2013 BT has 84% market share of retail very low bandwidth private circuits. This means that only the remaining16% of retail customers are buying services from CPs who are using a BT wholesale input (or less likely their own input) and are therefore protected by upstream regulation. Customers that purchase their retail services from BT are not given additional protection by the upstream regulation as there is absolutely no linkage between the retail and wholesale regulation proposed.

We find the disparity between the wholesale and retail proposals mystifying. At the wholesale level Ofcom has identified the excess profitability that BT has achieved and is proposing stringent CPI minus charge controls for the review period (which we consider could be tougher yet). In complete contrast for retail circuits Ofcom proposes not only that the excess present already today remains, but that BT can charge even more. It is possible to imply (using the evidence from PPCs) that today's retail prices are at least 44.5% over priced. The proposals on the table are that those excessive prices may be increased further by RPI+8% per service per year over the coming period.

Given that 84% of the market, for whatever reason is not based on a wholesale input, we fail to understand how upstream regulation will protect these customers. A direct price control and commitments to aid migration are necessary.

Question 3.2: Are there any other developments since the last BCMR or prospective developments that may be relevant to our review of this market? Please identify specific developments, explaining why they may be relevant.

Since the last market review it is clear that neither competition at the wholesale level or retail level has increased. While BT's profitability for these services has increased, customers are left in the lurch to deal with transition to alternative products on their own. In a competitive market customers would be carefully transitioned to a replacement service by their supplier.

Since the last market review, undoubtedly in light of growing profitability BT has extended out platform closure. Ofcom has seen fit to regulate the price of the upstream service far more rigorously in response to BT's SMP and to address the over recovery that has accrued in previous charge controls. The benefits of upstream regulation will not necessarily flow to the retail market as BT continues to have high retail market share of over 60% for digital services and 100% for analogue services. The lack of flow through of improved wholesale terms to the retail market is highlighted by BT's voluntary commitment offer. In a backdrop of substantially falling wholesale prices BT feels capable of continuing to raise retail prices!

In contrast to Ofcom's view we consider that the later product life cycle stages are likely to warrant additional regulatory oversight than earlier periods which would have seen greater, or potential for greater competition.

In our view this proposal is one or even two market review periods premature.

Question 4.1: Are there industry associations among the CNI community that you consider we need to contact to increase awareness of the withdrawal of these services?

We are not aware of any other industry associations.

Question 4.2: Do you know of any other category of CNI operator that will be affected by the withdrawal, but that would not become aware of it through our programme of engagement? If so, please provide details of the category of CNI operator and your view on how best to raise awareness with them.

We are not aware of any.

Question 5.1: Do you agree with our conclusion that the VLB TI retail market no longer satisfies the EC's three criteria test? If not, please explain your view.

No, we do not agree and discuss each one below:

Criteria 1: The presence of high and non-transitory structural, legal or regulatory barriers to entry

Ofcom identified that in the 2013 review there remained high and non-transitory structural, legal or regulatory barriers to entry. The only difference in market circumstance since the last review, concerning ability to serve the market is that overall volumes have reduced. BT will continue to hold SMP but over a smaller overall volume. The fact that the market is smaller does not deviate from the fact that it requires protection. If anything the remaining customers will be those that require the most protection from BT's SMP.

We still purchase a large number of these RPCs from BT, circa [✂] circuits[1]. In instances where we use RPCs they are used as a wholesale input as a legacy rollover from the time period before PPCs where available, or where PPCs were not made available or due to contract novations.

Where RPCs are purchased by us as an intermediary (between the end customer) the intended motivation of price rises will not necessarily occur. This is because in many case the nature of the contracts we have with the customer prevents such price rises being passed through. In such cases the rise in price does not further increase migration away (an argument we consider no longer has sway with the remain TI user base in any event) but simply lines BT's pockets with further excess recovery for these services.

The market failure evidenced by BT's ongoing SMP in the provision of these retail services has not changed over the course of this review period.

Ofcom's planned overnight removal of BT's SMP and proposed acceptance of BT's voluntary price commitment takes no account of the fact that planning for the replacement of these services is long and the process to do the required network activity is even longer.

Criteria 2: A market structure which does not tend toward effective competition within the relevant time horizon, having regard to the state of infrastructure base and other competition behind the barriers to entry

The market review period runs up until March 2019. Very low bandwidth RPCs will continue to be sold until September 2016 and the platform will remain available until March 2020. This assumes that BT decides not to extend the product life longer.

Rather than being a period where regulation should be lifted we consider this is a period where regulation would reasonably intensify to ensure that BT manages and aids migration for these customers. We set out the CPs purchase RPCs as wholesale inputs to their retail services. BT has SMP in all the product markets for the services CPs might consider as alternatives to "wholesale" RPC. Therefore just like with PPCs BT faces insufficient competition to provide migration on terms usually found in a competitive market.

Criteria 3: Competition law alone is insufficient to adequately address the identified market failures

Competition law is wholly inadequate to address the supply of these services. We cannot wait for prices to increase or BT to refuse to help to migrate customers onto a new platform in order to use Competition Law to take action. It is evident that the lack of competition over the last years has enable BT to tighten its grip on the market and despite falling volumes, revenues above WACC have escalated as shown in the table below.

PPC returns above WACC

	2006	2007	2008	2009	2010	2011	2012	2013
TISBO up to and inc 8Mbit/s	4.3%	1.3%	9.2%	7.6%	11.8%	21.6%	28.8%	43.4%
TISBO above 8Mbit/s up to and inc 155Mbit/s	0.1%	15.9%	8.2%	8.9%	18.6%	20.7%	41.2%	31.3%

Source: Frontier Economics

[1] Nearly [✂] across all RPC bandwidths

Question 6.1: Do you know of any CNI operators that rely on retail VLB leased lines provided by KCOM? If so, please provide information about the CNI operator and contact information.

We are not aware of any at this time.

Annex Migration Report