KCOM Group PLC

Business Connectivity Market Review

KCOM response

31 July 2015

Introduction

The Business Connectivity Market Review is of significant interest to KCOM. As the incumbent provider in the Hull Area leased lines are a key part of the services we offer to customers and the regulation of those services is of considerable importance to our business. Our national businesses also provide leased line services outside of the Hull Area using both our own infrastructure and wholesale services provided by BT and other CPs.

Since the last BCMR was concluded in 2013 there have been a number of developments in the market in the Hull Area that have a bearing on the competitive landscape. Most importantly we have seen further market entry with two providers now deploying alternative fixed infrastructure which can and is being used to provide leased line services. KCOM is concerned that Ofcom takes these developments into account in considering the future regulation of leased line services in the Hull Area. In particular, it is important that regulation remains only where appropriate and that the remedies imposed are proportionate and take into account the relevant competitive environment in Hull.

Our response to this consultation is largely focused on the services provided by KCOM in the Hull Area, however we also comment on two other issues of particular concern; the imposition of passive remedies on BT and the implications for the wider market and the proposals regarding quality of service in relation to ethernet services provided by Openreach. Our key concerns can be summarised as follows:

- Ofcom's analysis is focused on the national market but there are specific characteristics of the market for business connectivity services in the Hull Area which warrant separate consideration.

- We welcome the removal of obligations in respect of very low bandwidth leased lines but do not accept Ofcom's view that it remains appropriate to regulate remaining retail leased line services. In particular we believe that Ofcom's application of the three criteria test is inconsistent with its application in other retail markets.

- A number of the proposed SMP obligations (both retail and wholesale) are unjustified and represent a significant additional compliance burden to the business with little benefit.

- We remain concerned about the suggestion that KCOM wholesale pricing would be benchmarked against BT pricing if issues about reasonableness were raised.

- These concerns are also relevant in respect of any retail price benchmarking is as far as what Ofcom appears to be proposing is a retail benchmark based on KCOM's benchmarked wholesale prices.

- KCOM does not see a role for passive remedies in promoting downstream competition in the market for business connectivity services. There is a significant risk that a requirement to provide passive remedies will undermine existing and future investment in networks and leased line services.

- We welcome moves to address Openreach quality of service but believe there are further steps that could be taken to ensure improvements are delivered.

Assessment of Wholesale and Retail Markets in Hull

Question 6.1: Do you agree with our approach to (wholesale and retail) market definition in the Hull Area? If not, what alternative would you propose and why?

As a general observation we note that Ofcom does not appear to have taken its usual approach to market definition starting with definition of retail markets assuming the absence of all regulation and remedies on SMP findings, then using the retail definition to inform wholesale market definition assuming the absence of regulation. Instead the wholesale market has been considered first, followed by an assessment of the retail market in light of the fact that KCOM is subject to SMP wholesale obligations.

Given retail leased lines are no longer specified by the EU as a market susceptible to regulation we would have expected to see an analysis of the retail leased lines market undertaken first with the primary aim of assisting in the definition of wholesale markets which might attract regulation.

The key impact is that differences between the product market in Hull and the product market in the rest of the UK have not been identified. Ofcom has not considered market definition specifically in relation to Hull when defining the product market, instead simply stating "We consider that our key findings regarding product market definition in the rest of the UK… are also appropriate for the Hull Area."[1]

For example, we do not currently offer an Ethernet First Mile product in Hull, yet if we did it would be included in the CISBO market even though there is no basis for concluding any product we might offer would in fact be a good substitute for leased line services. The product is simply not defined. We also note that you have clarified, in relation to BT, that although the proposal is that EFM-based services should form part of the CISBO market, you are not proposing that they should be subject to SMP regulation. Would this also be the case for KCOM if we were to launch EFM-based services in the Hull Area?

Likewise you have proposed that retail and wholesale CISBO services at all bandwidths should be regulated on the basis of a finding of SMP without considering the specific circumstances in Hull. In fact, we do not provide any >1Gbit/s ethernet services and they therefore should not be subject to regulation. They were not in the previous market review and your analysis provides no justification for extending regulation to these services. As with EFM-based services, should we start offering them, we would not expect these services would be subject to SMP regulation in the absence of a proper market analysis.

During the last BCMR we also highlighted specific characteristics of the market for mobile backhaul in the Hull Area which we felt justified separate consideration. These arguments were rejected by Ofcom.

We would reiterate that we have seen significant deployment of radio backhaul solutions for mobile in the Hull Area and backhaul for some mobile services is provided completely independently of the KCOM network. Additionally we now face a considerable constraint from the deployment of network by CityFibre underpinned by a long-term national framework agreement with EE and Three UK, along with their infrastructure joint venture, Mobile Broadband Network Limited (MBNL) to provide dark fibre backhaul connections to mobile masts across both operators' networks.[2]

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[1] http://stakeholders.ofcom.org.uk/binaries/consultations/bcmr-2015/summary/BCMR_Sections.pdf Para 6.6

[2] http://www.cityfibre.com/news/2014/11/12/cityfibre-signs-dark-fibre-deals-with-ee-and-three-to-enhance-mobile-networks

Given the more widespread use of radio backhaul solutions by MNOs in the Hull Area and the network deployment by CityFibre we believe there is strong argument that Ofcom should look separately at mobile backhaul services when considering market definition and assessing KCOM market power.

Question 6.2: Do you agree with our assessment of SMP to the markets for low bandwidth TISBO and CISBO services in the Hull Area? If not, what alternative would you propose and why?

While Ofcom has acknowledged the entry of other CPs into the market in Hull this entry has been dismissed as being not on a scale sufficient to suggest that KCOM now faces, or will face over the three year review period, effective competition.

We simply do not accept Ofcom's view that KCOM's market position will not change over the future period of the market review. As Ofcom has identified there are a number of network deployments that will provide direct infrastructure based competition to KCOM. We believe these are likely to do so in a relatively short timeframe given the limited geographic area to be covered and that they have the potential to have a significant impact on KCOM's leased line business over the future period of the market review.

When competing for leased line business we are very aware of the constraint we face from competing providers in the Hull Area. There are very clear plans to deploy alternative infrastructure which are currently being acted on. This would suggest that the barriers to entry are not as great as Ofcom believes and that there are sufficient incentives to duplicate infrastructure focussing on specific market segments.

In particular the deployment of a dark fibre backbone by CityFibre presents a significant constraint in relation to mobile backhaul which, as we highlight above, should be considered separately. As well as plans to provide EE and Three UK with dark fibre backhaul connections to mobile masts across both operators' networks, CityFibre has also announced that it will be providing Purebroadband with dark fibre backbone connectivity for its wireless mast sites throughout the city.[3]

[3] http://www.cityfibre.com/news/?tag=Purebroadband

Question 6.3: Do you agree with our assessment of SMP for the markets for low bandwidth TI and CI services in the Hull Area? If not, what alternative would you propose and why?

We reiterate our comments regarding the deployment of alternative infrastructure by other CPs. The extent of this deployment in a relatively limited geographic area suggests that there is considerable potential for retail markets in Hull to become more competitive. We anticipate that this constraint will increase considerably as demand for higher bandwidth services increases and investment in these higher value services becomes more attractive.

Ofcom has also suggested that one of the reasons that current network investments in the Hull Area will not, by themselves, undermine KCOM's SMP over the review period is that "BT's sales of retail circuits that have a local end (or more than one local end) in the Hull Area will be partly "off-net" and CPs generally have a weaker ability to compete for provision of retail circuits that are "off-net"."[4]

This completely ignores that this is also the case for KCOM in respect of these circuits. Where only one end of the circuit is within the Hull Area KCOM will also by definition have to deliver part of the circuit "off-net" negating any perceived advantage from its market position in Hull. In fact where circuits are required with a local end in Hull they are very often part of a much larger multi-site deal for which we are unable to compete. This suggests that this is a factor that undermines KCOM's SMP rather than one weakens the ability of other CPs to compete.

Question 6.4: Do you agree with our assessment of wholesale remedies not being sufficient to sustain effective competition in retail markets in the Hull Area? If not, what alternative would you propose and why?

We do not agree with Ofcom's assessment of wholesale remedies not being sufficient to sustain effective competition in retail markets in the Hull Area. Out key concern as outlined above is that Ofcom has underestimated the competitive constraint that KCOM faces from the deployment of alternative infrastructure in the Hull Area.

Question 6.5: Do you agree with our finding that the three criteria test is met when applied to the retail markets in the Hull Area?

Ofcom has already removed retail regulation on other retail markets in the Hull Area on the basis that the three criteria test has not been met. Leased lines are therefore the only retail market in Hull which remain subject to retail SMP regulation.

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[4] http://stakeholders.ofcom.org.uk/binaries/consultations/bcmr-2015/summary/BCMR_Sections.pdf Para 6.43

KCOM does not accept the market for business connectivity services differs enough from the other retail markets in the Hull Area to be the only market warranting retail SMP regulation, particularly given it is a market that demonstrates a greater degree of competitive entry than other markets which have been deregulated. We address each of the three criteria below.

Presence of high and non-transitory barriers to entry

We have highlighted the competitive entry which is taking place in the Hull Area. This market entry suggests that the barriers to entry are not as great as suggested by Ofcom and gives competitors a number of options for providing services in the Hull Area. In addition the SMP remedies Ofcom has imposed (and proposes to tighten) in the wholesale markets act to reduce barriers to entry in the retail markets. KCOM's obligation to provide wholesale leased lines on fair and reasonable terms, including pricing, is clearly relevant to an assessment of the need for SMP regulation in the retail market.

We also believe that incumbent advantage within the Hull Area for leased lines is not the significant constraint for other providers Ofcom imagines it to be. Many leased line contracts are for multi-site organisations, taking several circuits procured nationally under one retail contract. While retail CPs are likely to need to purchase wholesale circuits within the Hull Area in order to meet the requirement for any Hull Area sites under a national contract, KCOM has no intrinsic advantage winning these national tenders due to its position in the Hull Area. Once another retail CP has secured a national contract which includes sites within the Hull Area, KCOM wholesale products are available to enable the CP to provision that retail service.

Market structure which does not tend towards effective competition

We accept that the analysis undertaken by Ofcom shows a high market share but there are significant infrastructure developments taking place which we expect to have an impact on those market shares during the market review period.

Insufficiency of competition law alone to adequately address the market failure

KCOM does not accept that competition law alone would be inadequate to address any market failure.

KCOM's wholesale SMP regulation and suite of wholesale products place an incentive on KCOM to price in a fair and reasonable way at the retail level due to the potential for competition from other CPs using KCOM wholesale products. On competitive entry, margin squeeze requirements ensure that our retail pricing cannot be too low that other CPs using our wholesale access products are unable to make a margin sufficient to sustain market entry. KCOM's internal compliance process takes account of competition law and all proposed pricing is signed off accordingly.

KCOM does not recognise any tangible additional benefits the retail SMP remedies offer other CPs or end-users over and above competition law, nor do we see any evidence that competition law is an insufficient remedy in the Hull Area retail leased lines market.

It is interesting that Ofcom has come to a different conclusion in relation to the three criteria test than it did when applying the test to the fixed access market.[5] In that review despite finding that there were high and non-transitory barriers to entry and a market structure which did not tend towards effective competition within the relevant time horizon, Ofcom concluded that competition law was sufficient to address market failures that might arise in the retail markets for fixed analogue exchange lines, and ISDN2 and ISDN30 services.

We do not understand how Ofcom can justify taking a different approach in relation to retail leased lines. In the Fixed Access Market Review Ofcom noted that it had received no complaint or dispute submissions regarding KCOM's commercial practices at a retail level and that Ofcom had rarely been required to use its ex ante powers in relation to KCOM. Additionally Ofcom stated that if KCOM did engage in conduct amounting to an abuse of a dominant position, competition law would provide a sufficient means of addressing that behaviour and that prices in the rest of the UK provided a relevant (first order) benchmark for competitive retail rates that would assist in identifying excessive pricing in the Hull Area.[6]

All of this is equally true of the retail business connectivity market. Indeed, KCOM was deregulated for a period in this market and during that time Ofcom saw no need to raise competition law concerns with KCOM either formally or informally. Ofcom's proposed decision in this case appears unjustified and inconsistent with decisions it has taken in other markets.

It is unclear why Ofcom believes it necessary to continue to apply remedies at a retail level where there is clear evidence of competitive entry, no specific behaviour that has warranted intervention and no evidence that competition law would be insufficient to address any issues that should arise.

At a practical level we believe that continued SMP retail regulation has the potential to stifle the development of products in the way customers would expect in the national market. The

[5] http://stakeholders.ofcom.org.uk/binaries/consultations/fixed-access-market-reviews/summary/fixed-access-markets.pdf

[6] http://stakeholders.ofcom.org.uk/binaries/consultations/fixed-access-market-reviews/summary/fixed-access-markets.pdf Paras 6.22-6.67

removal of retail regulation would greater enable us to innovate using leased line connectivity with managed services to deliver bespoke products to customers.

Ofcom's objective at a time where competition is beginning to increase in the Hull Area retail leased lines market has to be providing confidence that the incumbent provider is not able to do anything anti-competitive to unfairly foreclose competition. However, in order to achieve the true benefits of competition, the incumbent also has to respond to market entry through greater innovation. Competition law, without prescriptive retail SMP regulation, balances these two objectives; ensuring Ofcom can act if there were any anti-competitive practice, while offering the regulatory flexibility so that all providers in the market, including the incumbent, are incentivised to behave in the way that leads to the best possible consumer outcome.

Remedies for the Hull Area

Question 14.1: Do you agree with the remedies that we propose for KCOM in the retail TI and AI markets? If not, what alternative remedies would you propose and why?

KCOM does not agree with the remedies proposed more generally for the retail TI and AI markets. As Ofcom acknowledges, these services are not on the list of relevant product and service markets susceptible to ex ante regulation. KCOM understands Ofcom's application of the three criteria test but believes the analysis is flawed and it does not follow that regulation is necessary or appropriate. No evidence has been provided to support the need for these obligations. There has been no suggestion of a refusal to supply on the part of KCOM, no allegations of excessive pricing or of undue discrimination. In particular, we note that Ofcom has not had any complaints regarding the provision of business connectivity services by KCOM. As we have also noted above we find Ofcom's conclusions in relation to the three criteria test inconsistent with conclusions reached in relation to other markets in the Hull Area.

It appears that Ofcom is gradually reintroducing more stringent regulation of retail services in the Hull Area contrary to Ofcom's stated aim of looking to "look for opportunities to deregulate where appropriate".[7]

More generally, and without prejudice to our view that retail regulation is unnecessary, there are specific obligations which we find particularly problematic.

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[7] http://www.ofcom.org.uk/content/about/annual-reports-plans/ann-plans/Annual_Plan_Statement.pdf Para A4.6

In the 2009 market review Ofcom fully deregulated retail leased line services in the Hull Area on the basis of a finding of no SMP. However, in the 2013 market review Ofcom reversed this decision and imposed an obligation on KCOM to publish maximum retail prices for retail leased lines services. This meant that KCOM was able to offer pricing below published maximum prices provided that pricing did not unduly discriminate. Now Ofcom is proposing that all prices for retail leased line services be published.

We have provided Ofcom with details of our published maximum prices and the prices which we have charged for leased line services in the Hull Area. We note that neither we nor Ofcom has received any complaints regarding the pricing we have charged so the problem which Ofcom is seeking to address is unclear. Quite simply KCOM does not believe the proposed price publication remedy is justified or proportionate and could ultimately have harmful effects for customers who have previously been able to benefit from the flexibility offered to KCOM by the previous decisions taken by Ofcom.

KCOM is not aware of any other situation where Ofcom has progressively introduced more stringent regulation as it is proposed here. This presents considerable practical challenges. Although Ofcom has not specifically addressed this point, we assume that any circuits provided when KCOM was deregulated or subject to a maximum price publication requirement would not have to be provided in compliance with a new more stringent price publication requirement. This has the potential to place KCOM at a considerable disadvantage when it comes to circuit renewals or further sales to existing customers where we would only be able to offer published prices in direct contrast to the flexible approach which we have previously been able to take with these customers.

A significant amount of work would be required to ensure compliance with the proposed obligations, including changes to sales processes and systems and training to ensure that all staff involved in the sale and delivery of business connectivity services are aware of and familiar with the new requirements.

We are also concerned what value Ofcom's proposal to provide a pricing transparency report will add. If we are to be required to publish all prices this will provide Ofcom with a clear view of what we are charging and if there are particular concerns these can be raised on a case-by-case basis. Moreover, any report would include services provided prior to the proposed price publication taking effect, i.e. those provided when KCOM was deregulated or subject to a maximum price publication obligation. Our view is that the provision of a pricing transparency report will simply create an unnecessary compliance burden that is neither proportionate nor justified and one which has not been imposed in any other retail market.

We welcome the proposal to remove the obligation to supply new TI leased lines at bandwidths below 2Mbit/s. We have responded separately to Ofcom's consultation on very low bandwidth leased lines and will continue our dialogue with you on the future withdrawal of these services. However, we are concerned that additional regulation will continue to apply to those services prior to their withdrawal, namely a no undue discrimination requirement and publication of a reference offer. We do not see the continuing relevance of these provisions where there is no obligation to supply and should we do so it would be on a commercial basis. Indeed, publication of a reference offer for these services would imply that they are in fact available on a regulated basis which has the potential to create confusion.

Finally, Ofcom is proposing that cost accounting obligations be imposed that would require KCOM to confidentially provide information to Ofcom on an annual basis showing revenues, wholesale charges and retail costs at a market level for each of the retail markets, with retail costs to be split to show operating expenditure as well as depreciation.

We do not believe this requirement is justified or proportionate. KCOM will not be subject to any pricing regulation beyond a requirement that charges are fair and reasonable. The proposed cost accounting obligation together with the requirement to provide a pricing transparency report is a heavy handed and disproportionate approach where there have been no allegations of excessive pricing and Ofcom has had no complaints regarding pricing. We note Ofcom has itself recognised that when imposing regulatory reporting requirements they "should be proportionate to the benefits that are expected to result from those requirements".[8] We are not convinced that is the case and believe that it will involve considerable effort to report on the basis that Ofcom is proposing with no corresponding benefit.

Question 14.2: Do you agree with the remedies that we propose for KCOM in the wholesale TISBO and CISBO markets? If not, what alternative remedies would you propose and why?

We welcome the proposed removal of wholesale obligations in respect of medium, high and very high bandwidth TI services. We do not anticipate future demand for these services and believe these obligations are no longer necessary.

With regard to the extent of the services to be regulated, we reiterate various points we have made above. Firstly, we do not provide any >1Gbit/s wholesale ethernet services in the Hull Area and they therefore should not be subject to regulation. They were not in the previous market review and your analysis provides no justification for extending regulation to these services.

[8] http://stakeholders.ofcom.org.uk/binaries/consultations/bt-transparency/statement/financial-reporting-statement-may14.pdf Para 2.74

Secondly, we believe that there are specific characteristics of the market for mobile backhaul in the Hull Area which justify separate consideration. We have seen significant deployment of radio backhaul solutions for mobile in the Hull Area and backhaul for some mobile services is provided completely independently of the KCOM network. The deployment of network by CityFibre is underpinned by a long-term national framework agreement with EE and Three UK, along with their infrastructure joint venture, Mobile Broadband Network Limited (MBNL). Ofcom should therefore look separately at mobile backhaul services when considering market definition and assessing KCOM market power.

With regard to TI leased lines at bandwidths below 2Mbit/s we do not understand why there should be continuing requirement to provide at a wholesale level (where a request is reasonable), while the obligation to provide in the retail market is being removed. While we provide a number of sub 2Mbit/s circuits to other CPs these are not provided on wholesale terms. We would envisage engaging with these CPs proactively regarding the withdrawal of these services as we would with other customers. We therefore think it would be reasonable for the wholesale obligation to mirror the retail obligation, i.e. no obligation to provide new services and a notice period for withdrawal. Likewise we do not believe it is necessary for additional regulation to continue to apply to those services prior to their withdrawal, namely a no undue discrimination requirement and publication of a reference offer.

We note Ofcom's proposal to amend our price publication obligation to require the publication of all prices rather than just maximum prices. In the wholesale market we do not see this as particularly problematic as all wholesale services we have provided are charged at published prices. This we believe would also go some way towards addressing the transparency concerns which Ofcom has.

As with the retail market, we are also concerned what value Ofcom's proposal to provide a pricing transparency report will add. If we are to be required to publish all prices this will provide Ofcom with a clear view of what we are charging and if there are particular concerns these can be raised on a case-by-case basis. Our view is that the provision of a pricing transparency report will simply create an unnecessary compliance burden that is neither proportionate nor justified.

In relation to pricing more generally, we note Ofcom's intention to benchmark KCOM's wholesale prices against BT's wholesale prices if in the future there were concerns about the reasonableness of KCOM's pricing. We also note your acknowledgement that KCOM and BT have adopted differing pricing structures for wholesale leased line services and may also have differing approaches to recovering costs. Nevertheless you consider that a meaningful price comparison can be produced, provided the comparison is constructed so as to assess the overall level of charges for the respective leased line services, rather than to mechanistically compare individual charges.

The benchmarking of KCOM's leased line pricing against BT's pricing was set out as an appropriate approach in the 2013 BCMR. We do not intend to repeat in detail the arguments we made at the time but we continue to have a number of concerns with a benchmarking approach. In summary:

- We would question whether BT wholesale list prices are an appropriate benchmark at all. In a determination to resolve disputes between various operators and BT during 2004/5 and 2008/9 with regard to leased line prices[9], Ofcom uses DSAC (distributed stand alone cost) as one of the main standards to determine if BT was overcharging for particular leased line services. In principle therefore BT could charge a higher price and so long as it was still below DSAC it would not be overcharging. In which case it would be wrong to draw the conclusion that KCOM's prices are excessive based on a comparison with BT wholesale list prices even if BT is (incorrectly) used as a benchmark. Likewise there could be circumstances were BT is undercharging (below DLRIC) which would also not provide a suitable benchmark.

- There are a number of key technical differences between the KCOM and BT networks due to differences in scale/utilisation and geography and technology (fibre or copper) used to deliver leased line services. These will lead to cost differences in the services being compared, and hence comparing prices for these products will not be comparing like to like.

- In imposing charge controls on BT, Ofcom undertakes extensive analysis looking at the specific market trends and evolution in the markets that BT operates in, the future evolution of the BT network including the rollout of fibre, and the changes in BT's leased line product portfolio including migration from legacy TI leased line services to AI services. To the extent that BT's charge controls which determine the prices BT can charge for its leased line services take into account these specific factors, relevant to BT and not KCOM, benchmarking KCOM prices against BT prices will be inappropriate. KCOM prices should reflect the particular market circumstances that it operates in, not the particular market circumstances in which BT operates.

- The design of the charge control on BT gives the ability (subject to compliance with the specified controls) to rebalance charges across a range of services depending on demand for services and the costs associated with those services.

9 http://stakeholders.ofcom.org.uk/binaries/consultations/ethernet_services/statement/determination.pdf

This provides a far from ideal scenario for the benchmarking of another provider's charges when that other provider may face entirely different demand and costs depending on conditions in the particular market in which they are operating.

We would expect that should Ofcom feel there is a need to consider the reasonableness of KCOM's pricing appropriate consideration would be given to these factors alongside the different pricing structure adopted by KCOM for leased line services.

We note that Ofcom is not suggesting that KCOM's retail pricing be benchmarked against BT's retail pricing, rather that if there were concerns over retail pricing, KCOM's wholesale charges plus a reasonable allowance for KCOM's gross retail margin (to cover retail costs, including a reasonable rate of return) would be a suitable benchmark for assessing KCOM's retail prices. This is more acceptable than benchmarking against BT's retail prices although we remain concerned about the impact of the approach Ofcom might take to what is a "reasonable" wholesale input price.

Ofcom is also proposing to amend the list of wholesale network components that KCOM must attribute costs to within our financial reports for each of the wholesale leased lines markets to include a number of additional components.

The consultation provides no justification for inclusion of these additional components and no overall review of the current list of components appears to have been undertaken to identify whether they remain relevant. We would like to engage further on this to understand better what exactly Ofcom requires as reporting on these additional components is likely to involve significant resource and expense to amend our model with little discernible benefit.

Specific Remedy for the CISBO Market – Dark Fibre Access

We do not intend to answer each of the questions posed in the consultation regarding dark fibre, but instead set out our general observations on the imposition of a dark fibre remedy and its impact.

KCOM welcomes Ofcom's decision not to impose specific access requirements (including a dark fibre remedy) in the Hull Area, rather relying on a general network access obligation. We consider the wholesale leased line products available are entirely sufficient to meet other CPs requirements and that a requirement to provide dark fibre would be unjustified and disproportionate.

Nevertheless, we are concerned that the introduction of a dark fibre remedy opens the door to it being considered a reasonable access requirement in the Hull Area. We also have concerns about the impact of a requirement on BT to provide dark fibre on investment incentives and the ability of other infrastructure providers to compete commercially in the provision of these services.

In July 2011 we announced plans for an initial deployment of a broadband fibre access network to 15,000 premises in Hull over an 18 month period. The first customers were connected in September 2011 and we have now passed a total of approximately 50,000 premises. We have committed to accelerate the speed of deployment, making it available to a further 60,000 homes and businesses over the next two years. By March 2017, over 100,000 properties will be able to access the service.[10]

Such investment requires a stable and predictable regulatory environment and we are concerned that acceptance of dark fibre as a reasonable requirement will create regulatory uncertainty and risk, with significant potential to disincentivise future investment. Additionally at a national level we are able to commercially offer passive access products such as dark fibre and we are aware of other providers doing the same. We would be concerned if our ability to compete successfully in this market were to be hampered by a requirement on BT to offer the same products at regulated prices. We note that Ofcom acknowledges that the "net impact of passive remedies on existing and future infrastructure investment incentives of other CPs is unclear and could be finely balanced."[11]

Indeed Ofcom goes on to state that "We consider the form and pricing of any passive remedy is likely to be particularly important in considering the scale and scope of this risk to existing infrastructure investment."[12] We agree with this but fear that the form and price of the proposed remedy is not sufficiently defined in the consultation to enable a considered view of the likely impact on investment to be taken. In particular, while an indicative calculation of the active LRIC costs that BT may avoid relative to its EAD 1Gbit/s services is provided, this by no means provides a final price against which others benchmark. Here we are concerned not only with the impact on CPs' build or buy decisions but also the ability of others providing dark fibre to compete against a price regulated product.

More generally, we remain unclear regarding what competition problem Ofcom is trying to solve by mandating the provision of dark fibre. Active remedies are already in place to address the competition issues which Ofcom has identified and the analysis of dark fibre as a remedy seems to focus on the impacts and risks of passive remedies rather than

[10] http://www.kcomplc.com/media-centre/news-2015/kcom-group-plc-kcoml-pre-close-statement/

[11] http://stakeholders.ofcom.org.uk/binaries/consultations/bcmr-2015/annexes/BCMR_Annexes_Non_Confidential.pdf Para A24.80

[12] http://stakeholders.ofcom.org.uk/binaries/consultations/bcmr-2015/annexes/BCMR_Annexes_Non_Confidential.pdf Para A24.81

addressing the question of whether they provide a proportionate and justified solution to particular market issues.

The only other market in which Ofcom has imposed passive remedies is the wholesale local access market, most recently to aid the ubiquitous deployment of NGA. Regardless of whether we agree with the imposition of that remedy, Ofcom at least had a clear competition problem it was trying to address, i.e. the deployment of high speed fibre services which poses considerable economic and geographic challenges. The leased lines market differs significantly from the NGA access market and we do not believe that Ofcom has identified a competition problem sufficiently difficult that it would warrant the introduction of a requirement to provide dark fibre alongside current active remedies.

We note that in the 2013 Business Connectivity Market Review Ofcom rejected the idea of passive remedies.[13] Reviewing the final statement, we are unclear what has changed within the market between then and now that would warrant the introduction of passive remedies. Indeed, if we consider one indicator, BT's market share has further decreased in the wholesale CISBO market since that review was completed.

In that statement a number of key points relating to passive remedies were identified:

- Ofcom did not consider that it would be appropriate to regulate "concurrently and indefinitely at multiple levels of the value chain".
- Therefore if passive remedies were introduced, a period of transition would likely follow with active remedies being restructured and potentially withdrawn.
- As the business connectivity market is well established CPs and end-users of leased lines would need to adjust their activities accordingly, and Ofcom would need to manage the transition to ensure that it would not be unduly disruptive.
- Perhaps, most importantly Ofcom expressed the view that facilitating the transition to a regulatory regime where competition based on passive remedies was sustainable and effective, would require a significant degree of regulatory support and intervention, "potentially including changes to the definition of the regulatory boundaries and to the role of Openreach." The potential need for such regulatory intervention was given as further reason for Ofcom's view that passive remedies would be likely be an alternative to active remedies rather than a compliment.

[13] http://stakeholders.ofcom.org.uk/consultations/business-connectivity-mr/final-statement/

Ofcom's conclusion was that the case imposing passive remedies would depend on there being "concrete evidence that the transition would lead to a better overall outcome".[14]

It appears to us that in the intervening period between market reviews there have been no significant changes in the market which logically would change Ofcom's view and these concerns do not appear to have been considered in detail in the current consultation. In particular, we would highlight Ofcom's view that the introduction of passive remedies would have the potential to impact on current regulatory boundaries and the role of Openreach. We find it somewhat surprising that just as Ofcom publishes its Digital Communications Review discussion document that considers and asks for views on the possibility of structurally separating Openreach it is also advocating a regulatory intervention of this nature.

We also note that the Digital Communications Review is seeking views on whether a strategic refocussing on a package of passive remedies might result in more effective sustainable competition and if so whether downstream active remedies should be removed and how such a transition is implemented.

These are important strategic issues, decisions on which will have significant long-term impacts on the industry. Ofcom has indicated that it expects to publish its conclusions at the end of the year, in advance of the final BCMR Statement. We strongly believe that it is premature of Ofcom to propose mandating passive remedies in the context of the BCMR in advance of the outcome of the Digital Communications Review and in isolation of the wider issues that Review is considering.

Finally we reiterate a point made in our response to Ofcom's preliminary consultation on passive remedies[15]. In considering the practicalities associated with passive remedies, Ofcom has not addressed the circumstances in which they might be withdrawn or how reversible they actually would be in the future. We believe that if passive remedies were to be introduced it would be very difficult to withdraw them in a later market review and that by mandating the provision of dark fibre Ofcom will simply embed dependence on passive access at the expense of alternative infrastructure-based competition.

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14 http://stakeholders.ofcom.org.uk/binaries/consultations/business-connectivity/statement/Sections8-16.pdf Paras 8.46-8.49

15 http://stakeholders.ofcom.org.uk/binaries/consultations/bcmr-passives/responses/KCOM.pdf

Remedies Quality of Service

KCOM Group purchases leased line services from Openreach in the national market and as such we have been impacted by poor quality of service, in particular in respect of ethernet provisioning. We therefore welcome Ofcom's proposals to impose specific quality of service requirements in respect of ethernet services, particularly the setting of specific targets for provisioning and repair and the requirement to produce comprehensive KPIs.

We agree with Ofcom's assessment of Openreach's ethernet provisioning process and how it has been working in practice. We note that Ofcom has provisionally concluded that the deterioration in Openreach's performance has in part been caused by under resourcing and the failure of the EST programme. We agree but would suggest that Openreach's inability to work to and deliver against provisioning targets and fluctuating levels of quality in service delivery suggests there are deep-seated issues in terms of both the service delivery organisation and the processes it uses.

We welcome Ofcom's acknowledgement of the impact that poor performance has on CPs and their end-customers and that the current remedies and other commercial and reputational factors are inadequate to incentive Openreach to deliver acceptable levels of quality of service for ethernet provisioning. Ofcom's proposals go a significant way to addressing those inadequacies but there are some areas where we believe Ofcom could and should go further.

With regard to the design of the minimum standards, Ofcom has set out a number of principles, including that the design should not be tied to any categorisation of orders that may exist from time to time as that may change. We understand Ofcom's reasoning but would prefer to see a clear target time to provide for each category of provision. This would provide us with more certainty in respect of an individual order than a mean time to provide target would and allow us to manage customer expectations accordingly.

We would also suggest that prior to finalising the targets Ofcom should consider more up-to-date information regarding Openreach performance. The 2014 data on which Ofcom has based its proposed targets will be over a year out-of-date by the time the conditions come into force and we think it would be prudent for Ofcom to test the proposed targets against more recent performance data to ensure they are appropriate in light of recent performance. We note that in its first quarter results announced on 30 July 2015 BT stated that "Businesses are waiting almost five days less for an Ethernet connection compared with a year ago."[16]

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[16] http://btplc.com/News/#/pressreleases/results-for-the-first-quarter-to-30-june-2015-1197383

While we welcome the continued application of the SLG Direction and the specification of principles for SLA and SLG negotiations, we remain concerned that this will not provide a sufficiently robust framework that levels the playing field in any negotiations. The contracts under which Openreach provides services are not normal commercial contracts. Invariably service quality provisions in Openreach contracts are not as detailed and comprehensive as we would expect to see in commercially negotiated contracts, nor do they require delivery to the standards which we and our customers would expect. We would anticipate that there will be a need for intervention on the part of Ofcom sooner rather than later and would suggest that Ofcom reconsider what role it should play in those negotiations.

Finally, the new QoS SMP condition will provide Ofcom with useful tool to ensure that the obligations imposed on Openreach in respect of QoS remain appropriate and continue to meet the needs of industry. Together with the proposed targets this package of measures should provide Ofcom with the capacity to take action where needed. But they will only be effective if compliance is properly monitored, the threat of enforcement action provides a real incentive for Openreach to get it right and enforcement action is timely when needed. We would like to understand better how Ofcom sees this working in practice in order to deliver the best outcomes for customers of Openreach and their end customers.