



Business Connectivity Market Review: Further consultation

EE Response to Ofcom Consultation

17 December 2012

Non - Confidential version

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2 Introduction and summary

This document provides EE's response to the additional consultation on the Business Connectivity Market Review¹ (BCMR) and should be read in conjunction with EE's prior responses on this market review (the September 2012 Responses).² As set out in our previous responses, this market review impacts on the pricing and provision of mobile backhaul services (connecting mobile cell sites with mobile core networks through the use of BT's network elements). As 4G radio networks³ are rolled out in the coming years, availability of suitable - and appropriately priced – mobile backhaul services will be an important part of the jigsaw involved in ensuring the next generation of mobile technology realises its full potential for UK consumers.

High quality backhaul linking mobile base station sites end to end with core networks using suitable grades of Ethernet circuits will be important to ensure that backhaul does not end up being a constraining bottleneck to the 4G mobile experience overall.

In relation to the current consultation, our high level views are therefore summarised as follows.

- We are disappointed that these revised proposals do not update the overall approach to the BCMR in line with the changes we proposed in previous responses, but continues using the same approach on issues such as geographic market definition.
- We continue to believe that the future roll out of mobile networks, especially the significant 4G network investments which will occur in 2013, require a new approach to mobile backhaul: the nature of this product and its importance justifies a new approach.
- In particular, we urge Ofcom to put in place a mobile backhaul specific charge control and, in the longer term, to reconsider promoting competition in relation to the provision of mobile backhaul through passive remedies.
- Ofcom's revised proposals to continue a cost accounting obligation on BT are to be welcomed, but to be an effective remedy such information must be transparent and published.

The remainder of this response elaborates on these issues, in particular:

- Section 3 summarises our views on the need for mobile backhaul to be subject to specific remedies and the high level reasons behind this which were set out in greater detail in our September 2012 Responses;
- Section 4 repeats our view on the continuing need for cost orientation and sets out our views on Ofcom's revised proposals on cost

¹ "Business Connectivity Market Review: further consultation" published by Ofcom on 15 November 2012.

² See "Business Connectivity Market Review and Leased Lines Charge Control" Combined response of EE and MBNL, dated 4 September 2012 and EE's complementary response "Business Connectivity Market Review and Leased Lines Charge Control", also sent 4 September 2012.

³ Fourth generation (4G) mobile networks based on the Long Term Evolution (LTE) standard will provide greater speed, capacity and higher quality mobile data connections (for example, with better latency). EE launched its own 4G network using its liberalised 1800 MHz spectrum on 30 October 2012 which will be rolled out over the coming months. EE plans to reach 98% population coverage with this network by the end of 2014.

accounting requirements, in particular the on-going need for such cost measures to be published;

- Section 5 concludes with a summary of the underlying data needs which 4G networks will need to address and the resulting regulatory requirements we believe are necessary now; while
- Section 6 sets out our detailed views on the other changes to Ofcom's proposals in the current consultation, through our answers to the specific consultation questions in this consultation.

3 Mobile backhaul services

EE is disappointed that, in proposing specific changes to its proposals for the BCMR. Ofcom has not taken the opportunity to also deal with the specific issues relating to mobile backhaul services which it raised in the September 2012 Responses. While not repeating everything said in that response, we do wish once again to draw Ofcom's attention to the differences in the provision of mobile backhaul and the implications of this for assessing the appropriate regulatory approach to such provision.

Mobile backhaul by its nature involves connecting thousands of individual sites, which are very geographically dispersed, and in many cases not in urban areas, back to a small number of core network connectivity sites. The aggregate traffic needs are therefore very significant and it is efficient to purchase a combined end to end service across this whole connectivity need. This is because the peaks in traffic vary across geography and times of day and the efficient way to manage traffic is for the major routes to combine the traffic volumes from a range of sites. The end to end managed service which mobile networks require (and which is the efficient way for such services to be provided) therefore includes both services where BT has been found to have SMP (the "tails") as well as more long distance services across BT's 21CN. What this means in the alternative interface environment is that mobile networks are logically and reasonably moving towards the managed end to end BT service using aggregation networks like that of BT's 21CN in conjunction with MEAS (Mobile Ethernet Access Service).

Further, it is important to note that the location of mobile radio network sites is dictated by radio planning requirements, in turn driven by the needs and demands of customers. Corporate and enterprise sites can, to a significant degree, locate themselves where the appropriate resources are available, including by being near to existing fibre assets. Where corporate sites locate together, economies of scale and scope are also achievable which lead to investment in fibre assets making sense to those wider campuses. No such positive feedback loop is possible in relation to mobile base station sites which are logically required to be dispersed across the country and where location requirements are driven by the need to meet the capacity and coverage requirements of the radio access network.

In the context of the current significant increases in mobile data, which will be further enabled and fuelled by the rolling out of 4G networks, ensuring such services are provided at a reasonable price is vitally important. Increasing traffic on 3G and 4G networks will require greater backhaul capacity and the higher quality of service (to retain the improved latency benefits of 4G for example) provided by newer managed products such as MEAS. In significant

areas, as set out in our September 2012 Responses, BT is the only viable provider and the only viable potential nationwide provider – and as such is an unavoidable trading partner for mobile networks.

For these reasons, as set out in more detail in our September 2012 Responses, we firmly believe that mobile backhaul is in a different situation to other connectivity needs at the moment and the above factors warrant it being treated separately. Section 5 below reprises and summarises our views on what the BCMR needs to achieve in practice here.

4 Cost orientation and accounting obligations

Our September 2012 Responses set out our views as to why cost orientation remedies continue to be appropriate and required in these relevant markets – especially as a complement to the charge control remedies. We continue to hold these views and are disappointed Ofcom has not taken the opportunity in this consultation to revise its proposals and seek to explore how cost orientation obligations are a necessary complement to price controls (in contrast to the main reasons Ofcom set out in its prior consultation for not imposing such remedies, which essentially considered whether cost orientation obligations were an appropriate substitute to such charge controls).

In relation to the cost accounting requirements, our September 2012 response highlighted that this is a separate issue to that of the cost orientation requirements. Regardless of the decision ultimately made on whether to continue to apply a basis of charges obligation, there are still significant benefits to retaining a cost accounting obligation in respect of the markets covered by the BCMR. We agree with the reasons for this as summarised by Ofcom in paragraph 4.10 of the current consultation. We therefore appreciate this aspect of the current consultation and agree with the need for Ofcom properly to consider the issue of applying cost accounting obligations. The original consultations⁴ treated this issue far too briefly providing no real reasoning for Ofcom's proposed approach and the current consultation is therefore important and welcome.

EE also considers that many of the reasons it provided as to the benefits of retaining a basis of charges obligation⁵ also apply in relation to cost accounting obligations. Although the latter will not promote these benefits to the same degree as a full cost orientation requirement applying a transparent accounting requirement will at least provide these benefits to some degree. Therefore, we think the case is even stronger than Ofcom has summarised in paragraph 4.10 of the current consultation. In particular:

- A cost accounting obligation would provide information at a more granular level than the proposed tariff baskets and, importantly, this would provide information to purchasers which at least partially levels

⁴ See the Business Connectivity Market Review Consultation of 18 June 2012 and the Leased Lines Charge Control Consultation of 5 July 2012 (together, the "Summer 2012 Consultations").

⁵ As set out in a list of bullets towards the end of Section 4.2 of our 2012 September Response.

the negotiating playing field when purchasing products from BT as an SMP operator. Put simply, without such transparency BT's pricing of managed services becomes a black box which purchasing CPs have little ability to challenge without access at the very least to cost accounting type information. In practice, this is likely to lead to greater reliance on disputes and the less frequent charge control process.

- Related to the previous point, cost accounting obligations would also allow purchasing CPs to review charges which are not covered by specific charge controls for reasonableness and better to negotiate managed and combined services by understanding the costs of components provided within these services by BT where it is designated with SMP.
- Transparent (and annual) cost accounting information would provide better understanding to all stakeholders on the extent to which any sub-caps are actually working in the sense of ensuring individual prices remain cost orientated and reasonable.
- Cost accounting is also actual data – rather than being based on regulatory forecasts at the time of a charge control process. Given the rate of change in these sectors it is therefore important to capture this actual information on how costs are evolving rather than to rely on a market review process every three years.
- Finally, having access to cost accounting information will also enable stakeholders to understand whether individual prices and combinations of prices are anti-competitively low (or impose margin squeezes) in a way which cannot be ascertained simply from compliance with charge controls.

We therefore believe that Ofcom should also take account of these factors in deciding whether to retain cost accounting information. This makes the case for retaining at least cost accounting requirements (and ideally cost orientation obligations as well) even stronger than Ofcom contends in the current consultation.

Ofcom mentions in paragraph 4.21 of the current consultation that, while its current proposal is that BT continues to be required to collate and provide cost accounting information to Ofcom, BT will not be required to publish such information. Most, if not all, of the benefits of retaining cost accounting requirements set out in the bullets above are significantly diluted or negated if such information is not published. We therefore vigorously disagree with this proposal to reduce what BT is required to publish and believe that there are important benefits arising from this information being published, even absent any cost orientation obligation. These are competition benefits. We do not consider that there are any significant incremental costs to publishing this data, given that BT will be required to collate it. We note that the current consultation provides no cost / benefit analysis of the removal of the requirement to publish this information. The significant competitive benefits of doing so would seem easily to outweigh the negligible costs of so doing.

Finally, we note that the discussion on these issues in the current consultation is all around a requirement to produce Distributed Long Run Incremental Cost figures (for cost floors) and Distributed Stand Alone Cost figures (for cost ceilings). Paragraph 4.24 of the current consultation notes that Ofcom is

considering the overall approach to cost orientation in the “cost orientation and regulatory financial reporting project”. We are concerned that any output from this project in relation to the appropriate cost benchmarks will not be taken into account in leased lines markets until a subsequent market review process given the relative timings of these regulatory processes. We note that Ofcom also states in that paragraph that it still intends to publish a document on cost orientation. The timing, scope and status of this document are currently unclear to stakeholders and it is important that this project is not undermined by being delayed such that it cannot be implemented in the market reviews to which it should apply. We urge Ofcom to provide greater clarity on both the nature and timing of this associated work stream as well as how it will interact with on-going market reviews such as the BCMR.

5 Conclusion: the regulatory changes required

The implications of what we argue above, and have previously set out in our September 2012 Responses, is that the needs of mobile backhaul require specific and separate consideration in the BCMR.

- In the short term these needs would best be met through a separate specific price cap or sub-cap on relevant alternative interface services used for mobile backhaul.
- In the longer term, the needs of this market could be met through promoting further competition in leased lines markets, for example through the introduction of passive remedies.

As we have also argued, this provides a specific strong reason for also retaining the cost orientation and cost accounting SMP conditions. EE is therefore concerned that Ofcom has taken the opportunity of the current consultation to address these issues and modify its proposals. We urge Ofcom to take these points into account in modifying its final proposals from those on which it consulted in the Summer Consultations.

2013 will see accelerating deployment of 4G networks both by EE and by those winning licences in the forthcoming auction of 800 MHz and 2.6 GHz spectrum licences. Creating both deeper coverage and meeting capacity requirements will lead to a denser network of radio sites. It is vital that backhaul does not become a bottleneck which undermines the massive potential benefits of this roll out. It is clear that the demand for mobile data is there and growing as Ofcom has recognised elsewhere.

The growth in data demand can be seen in the most recent forecasts in Cisco's Visual Networking Index which predicts mobile data traffic in the United Kingdom will grow 12-fold from 2011 to 2016, a compound annual growth rate

of 65%.⁶ Similarly, a recent report by Real Wireless for Ofcom also predicts significant growth in mobile data usage in the coming years.⁷

For 3G and 4G networks to be able effectively to meet this demand, and take advantage of the additional capability of 4G, mobile network operators will need to purchase significant backhaul requirements from BT. As the only ubiquitous fixed network in the UK, is no choice. Other backhaul solutions based on microwave and cable certainly have their part to play, but for a significant proportion of backhaul needs the BT network will be required. Ofcom needs to set a regulatory framework as described above now, which will ensure that this does not become a constraining factor on the roll out of 3G and 4G networks and on the mobile sector's ability to continue to provide massive consumer benefit.

6 Response to consultation questions

Question 1: Do you have any comments on our proposal to include the Slough sectors in the WECLA?

The proposal to include the relevant Slough postcodes in the West, East and Central London Area (WECLA) is based upon the same methodology and approach to defining the relevant geographic market which Ofcom used in the Summer Consultations. Our September 2012 Responses provided a number of criticisms of that approach which do not appear to have been addressed in its continuing use in the current consultation. We do not repeat those points here but consider that the extension to the Slough area is flawed as the approach to defining the geographic market is flawed. Ofcom has not explained why, in its view, its approach remains robust or why this approach is appropriate to apply to mobile backhaul products given the different way in which they are used (as explained in Section 3 above and in our September 2012 Responses).

Even if the issues with the overall methodology are ignored, we note that the cumulative network reach of different numbers of operators is materially less in Slough compared to the rest of the WECLA (for example, as can be seen by comparing the relevant columns in Figure 2.5 of the current consultation which relate to mobile sites). There appears to be no justification in the current consultation as to where the boundary lies in terms of network reach which leads to a specific area either being within or without the WECLA. This illustrates a further flaw and subjectivity in the overall methodology.

Question 2: Do you have any comments about the proposed amendments to the Proposed SLG Direction?

EE agrees with Ofcom's views that the SLG Directions set by Ofcom should be set so that the contractual arrangements for the wholesale products CPs buy from BT in this market are such that:

⁶ See http://www.cisco.com/web/solutions/sp/vni/vni_mobile_forecast_highlights/index.html.-Country

⁷ See Figure 1.9 of "Techniques for increasing the capacity of wireless broadband networks: UK, 2012-2030" published by Ofcom at: <http://www.ofcom.org.uk/static/uhf/real-wireless-report.pdf>

- they incentivise the efficient provision of reliable services to BT's wholesale customers;
- they set out fair and reasonable compensation payments for delays in delivery and repair of such services, subject to specified compensation caps; and
- they allow BT and its wholesale customers to monitor effectively the performance of BT's provision and repair of wholesale regulated products (paragraph 3.8 of the current consultation).

[3<]

We understand that Ofcom is in the early stages of initiating a wider project on this topic and urge Ofcom to ensure that this addresses Openreach's quality of service across all markets, considering the appropriate way to implement any policy findings in relation to all markets where Openreach is found to have SMP.

Issues such as the caps under consideration here will need to be considered in terms of the incentives they provide for all relevant parties – it is important that any cap on the payments which BT makes do not lead to a distortion in its incentives (for example, to prioritise less serious faults which are below the cap and effectively further ignore or delay fixing more serious faults which have already hit the cap).

Question 3: Do you have any comments about our proposal that BT should be subject to cost accounting obligations and not required to publish DLRIC & DSAC figures?

Please see Section 4 above of this response. Broadly, we remain of the view that cost orientation obligations should be retained. Even if they are not there is still value in retaining a cost accounting obligation and the DLRIC and DSAC figures produced under this obligation (assuming these measures are retained as the relevant cost benchmarks) should be published.

Question 4: Do you have any comments about the proposed TAN definition or the proposed circuit routing rules?

The information provided in the current consultation makes it hard to understand the detail of the concerns the proposed changes are trying to address and the consequences of so doing. In particular, it is unclear to what extent the proposed changes to circuit routing rules (and the resulting obligation on BT to supply) will impact on the mobile backhaul services which mobile radio networks purchase. As explained above, these services contain a "trunk" element and therefore the extent to which this will or will not flow through to such end to end managed services is not clear from the description provided by Ofcom.

[3<]

Question 5: Do you have further evidence on competition in the MISBO market outside the WECLA, including the use and impact of dark fibre?

EE supported the recognition that BT had SMP with respect to the high bandwidth markets in its September 2012 Responses and continues to do so. Realistically, we currently consider that there are only really two potential

providers of such high bandwidth circuits with the geographical spread required to supply mobile backhaul. [36]

As such, we continue to believe that for the complexity and density of connectivity which a mobile network requires BT remains an unavoidable trading partner on a national scale, even for very high bandwidth services, and as such retains market power with respect to the provision of such services. Virgin Media is able to provide some competition, but this is not across the whole country on the end to end basis mobile networks require and for these reasons is limited in the extent to which it can constrain BT. There are a number of very small geographically niche providers, [37]. Given that no other operator has the national reach required, and dark fibre is not available from BT, we do not consider that access to dark fibre changes this picture.