



Retail Bundling in Hull

KCOM Bundling of SMP and non-SMP Products

Consultation

Publication date: 5 August 2010

Closing Date for Responses: 2 September 2010

Contents

Section		Page
1	Summary	1
2	Background	2
3	KCOM proposal	5
4	Impact assessment and conclusion	7
Annex		Page
1	Responding to this consultation	9
2	Ofcom's consultation principles	11
3	Consultation response cover sheet	12
4	KCOM proposal	14
5	Pricing Spreadsheet	15

Section 1

Summary

- 1.1 On 15 September 2009 Ofcom published a Statement setting out the conclusions of its review of the retail narrowband telephony markets (the “Market Review Statement”), which covered calls and telephone lines (both analogue and digital) for residential consumers and businesses.
- 1.2 Our conclusion was that most of the UK retail markets, with exception of Hull, were now effectively competitive, leading to deregulation of BT in the provision of retail fixed narrowband access and retail calls markets in both the residential or business markets. However, Ofcom concluded that in the Hull area KCOM retained Significant Market Power (SMP) in all retail narrowband markets and existing regulations were retained.
- 1.3 We considered that this deregulation of BT would lead to a further increase in competition in the relevant retail markets and allow BT to more freely compete in the supply of bundled services. We were conscious, however, that the continued regulation of KCOM, particularly the restrictions on bundling of SMP and non-SMP services could leave Hull consumers disadvantaged. Hull consumers alone would be unable to access such bundles which are increasingly a major part of telecommunications competition¹.
- 1.4 In response to this concern, we noted in the September 2009 Statement that we would engage with KCOM to explore options that would allow the provision of SMP and non-SMP bundle service options to Hull residents. This consultation sets out the results of this investigation.
- 1.5 We are proposing to allow KCOM to bundle broadband, landline and other services, in a way that is similar to packages offered by other communications providers throughout the rest of the UK.
- 1.6 Our proposal is subject to a number of conditions to ensure that consumers in Hull get the most benefit from bundles while protecting the opportunity for competition in the provision of the services in Hull. In particular, we require that:
 - bundles are made available to all residents (and businesses) equally in the Hull area; and
 - prices for bundles are set in a way that will not discourage other communications providers from offering their services to consumers in Hull, should they wish to do so.
- 1.7 This consultation sets out the proposal KCOM has made in response to those conditions including the methodology it will use in setting bundle prices.
- 1.8 We endorse KCOM’s proposed approach. We consider that it will allow Hull residents to benefit from a similar range of choices that are increasingly available in the rest of the UK, with related benefits in greater value for money and access to new and innovative services.

¹ In the first quarter of 2010 half (50%) of UK consumers bought a bundle of communications services of two or more services, up from 29% in 2005

Section 2

Background

Fixed Narrowband Retail Services Market Review

- 2.1 On 15 September 2009 Ofcom published a Statement setting out the conclusions of its review of the retail narrowband telephony markets (the “Market Review Statement”), which covered calls and telephone lines (both analogue and digital) for residential consumers and businesses.
- 2.2 We concluded that while most of the UK retail markets, with exception of Hull, were competitive, KCOM retains Significant Market Power (SMP) in all retail narrowband markets in the Hull area and that the following retail remedies would be retained:
- No undue discrimination in the pricing and provision of services; and,
 - Price publication for all services.
- 2.3 We considered that deregulation in the UK outside of Hull would lead to a further increase in competition in these retail markets, and envisaged that BT would be able to more freely compete in the supply of bundles of services which include fixed telephony together with other telecommunications such as mobile communications, broadband and television. We assessed that this would lead to enhancements in services and greater value for money for customers. However, we were concerned that Hull residents would not be able to access fully changes to the choices available in the relevant markets due to the continued SMP position of KCOM and related regulations.

Remedies for KCOM

- 2.4 In the March 2009 Market Review Consultation document (the “Market Review Consultation”) we observed that the remedies of no undue discrimination and price publication previously imposed upon KCOM had not led to significant entry by retail competitors in the access markets, although there had been some entry in the calls markets.
- 2.5 We discussed whether competitor entry could be encouraged through wholesale products alone, but concluded that given the lack of competitive entry the case for reliance on wholesale remedies would not be appropriate. We also considered whether it was necessary to introduce more direct intervention on pricing but concluded that because KCOM charges were not out of alignment with national charges, there would be no clear benefit from such a costly intervention. We therefore concluded that it was appropriate to continue with the remedies already in existence for all markets.
- 2.6 However, we noted a potential complication with the retention of the no undue discrimination remedy in particular, to the extent that this SMP remedy is considered to prohibit the bundling of SMP and non-SMP products.
- 2.7 We expressed concern that in the absence of competition, residential and business customers in Hull would not have access to emerging trends in bundled services (specifically narrowband and broadband bundles), allowing both savings at the retail level through the purchase of multiple products and future innovation in service

offerings. Such bundles are offered by many Communications Providers in the UK (excluding Hull) and we could foresee the situation where the only consumers/business customers unable to benefit from such an arrangement would be those in Hull.

- 2.8 We set out the following options in the Market Review Consultation to address this issue although we did not make a specific recommendation:
- Option 1 – Allow the situation to evolve and continue to restrict KCOM from bundling SMP and non-SMP products
 - Option 2 – Allow KCOM to offer bundled SMP and non-SMP products without specific further conditions
 - Option 3 – Allow KCOM to offer bundled products but require referral of each bundle to Ofcom for consideration – with the aim of minimising the increase to barriers to entry
- 2.9 Only KCOM responded in any detail to the discussion of KCOM's SMP remedies and the options for allowing KCOM to offer bundled products. KCOM proposed the potential for lighter touch regulation in the residential calls and access markets and argued that, according to KCOM's understanding, our current interpretation of the undue discrimination obligation resulted in Hull residents being unduly disadvantaged compared to residents in the rest of the UK. KCOM suggested that an alternative approach to formal SMP regulation would be for us to accept a number of voluntary undertakings designed to provide consumers and other Communications Providers with an appropriate level of visibility and certainty regarding KCOM's retail offerings.
- 2.10 Our conclusion in the Market Review Statement was that KCOM had not put forward sufficiently strong arguments to justify a move away from the SMP findings, and given the lack of substantial change in the level of direct competition in the relevant markets, there was insufficient evidence to support general deregulation or reliance on voluntary commitments.
- 2.11 However, we stated our intention to discuss options for the development of new bundled services with KCOM in the interest of consumers in Hull, subject to controls commensurate with the SMP KCOM continues to hold.

Interpretation of undue discrimination

- 2.12 In the Market Review Statement Ofcom considered the extent to which the current conditions prohibit bundling. It is not explicit in the SMP conditions where non-discrimination is applied, but as noted in earlier reviews, Ofcom's current stated position is that bundles of SMP and non-SMP services would be likely to be unduly discriminatory².
- 2.13 However, this presumption may be rebutted where certain criteria are met, in particular:
- competitors can replicate, technically and commercially, each element of the bundle;

² For example the Consent on Business Exchange Line Replicability, published 29 May 2007
<http://stakeholders.ofcom.org.uk/binaries/consultations/draftconsent/consent.pdf>

- the bundled price passes a net revenue test;
 - eligibility for any level of discount for the overall bundle of services is not dependent on the customer spending a minimum sum on any individual service within the bundle;
 - details of the bundles price or discount scheme are published; and,
 - the bundled price or discount scheme is made available to all broadly comparable customers.
- 2.14 In the case of BT, the key test with respect to the market for retail narrowband telephony became an assessment of the whether the replicability criterion could be met as it was clear that BT could be required to adhere to the other criteria in constructing any bundle. In May 2004 and April 2006, we published Statements relating to the replicability of BT's regulated retail business services³. In these Statements it was established that service bundles which mix SMP and non-SMP products would no longer be considered to be discriminatory once BT's retail service could be replicated on the basis of wholesale inputs.
- 2.15 Our approach to bundles is consistent with the ERG common position on remedies in that specific requirements can be imposed under Article 17(2) of the Universal Service Directive to not unreasonably bundle services⁴.
- 2.16 However, the common position then goes on to suggest that where such a restriction could rule out "welfare enhancing bundles", an alternate condition could be imposed that an undertaking be obliged to report proposed new bundles to the NRA who would then judge whether they were anti-competitive⁵.
- 2.17 Clearly, as discussed by the ERG, NRAs should take into account the danger of prohibiting bundles which may increase welfare and that a blanket prohibition of bundles may rule out welfare enhancing bundles, balancing that against the welfare gains in preventing dominant undertakings from distorting competition in horizontally related markets. This consideration is also consistent with our statutory duties set out in section 3 and 4 of the Communication Act 2003, in particular the duties to further the interests of consumers.
- 2.18 Accordingly, we need to consider whether in the context of provision of bundled services in Hull it is appropriate that KCOM is required to fully meet the criteria set out above. In particular, we need to consider whether the replicability test as currently set for BT is applicable in this context. We will discuss this in Section 4 following a presentation of KCOM's proposed approach in Section 3.

³ http://stakeholders.ofcom.org.uk/binaries/consultations/pricing_business_customers/statement/business_pricing.pdf
<http://stakeholders.ofcom.org.uk/binaries/consultations/busretail/statement.pdf>

⁴ Directive 2002/22 of 7 March 2002 on universal services and users' rights relating to electronics communications network and services, OJ L 108, 24.4.2002, 51

⁵ http://www.erg.eu.int/doc/meeting/erg_06_33_remedies_common_position_june_06.pdf.

Section 3

KCOM proposal

- 3.1 KCOM has proposed a number of undertakings that it would give to Ofcom to enable it to offer bundles of SMP and non-SMP products in the retail narrowband telephony markets in Hull. KCOM considers that the undertakings would ensure that the bundling of SMP and non-SMP products would not be in breach of the no undue discrimination obligation.
- 3.2 In setting out the background to their proposal in its letter (attached at Annex 4), KCOM notes that since the publication of the Market Review Statement “BT has ... begun to offer bundled services to its customers, increasing the prevalence of such offerings in the residential market”. KCOM suggests that “...Hull residents are now the only UK consumers unable to benefit from bundled offers as KCOM is prevented by regulation from offering bundled services and no alternative providers have yet chosen to enter the Hull market providing service bundles”.
- 3.3 KCOM argues that it is seeing increasing demand from its customers for bundled services, and is concerned that it is being constrained by regulation in its ability to offer retail customers the services that they would like and that would be beneficial in terms of lower prices and better value.
- 3.4 KCOM agree that if Ofcom were to allow bundles of services to be offered in the Hull area appropriate safeguards should be put in place. In particular, as suggested in the Market Review Statement, it may be appropriate to link any development in the area of bundling to KCOM improving its systems supporting retail competition. KCOM consider that its proposals are therefore designed to ensure that bundled offers which include SMP products do not create competition or margin squeeze issues with regards to in that they would foreclose entry by competitors. The full proposals are attached at annexes 4 and 5 but in summary KCOM proposed:
 - Bundles will be available as widely as possible and pricing for standard service bundles will be published;
 - Bundles will be subject to a price floor below which they cannot be offered, and this will be comprised of a ‘wholesale’ equivalent charge for SMP products plus the fully allocated cost of any non-SMP services, plus relevant retail costs;
 - In order to calculate the ‘wholesale’ equivalent charge KCOM will use pricing for BT’s WLR product, KCOM IPLine product and KCOM call origination and termination interconnection services. KCOM does not currently provide WLR services in the Hull area but has proposed using BT’s WLR pricing, with an appropriate uplift to reflect differences in the KCOM cost base, as an appropriate proxy;
 - The appropriate retail costs of sale will be extracted from the model used to create the Regulatory Statements, and a retail cost per unit will be determined and applied to establish the true margin for any margin squeeze test;

- 3.4.1 KCOM will test all bundles offered against the costs outlined, and measures will be put in place to test compliance as an integral part of the process for developing pricing propositions, and detailed documentation relating to this will be retained for the period during which the bundle to which they relate is offered;
 - 3.4.2 All SMP products that form part of any bundle will continue to be offered as stand-alone products should a customer wish to purchase them separately; and,
 - 3.4.3 KCOM will notify Ofcom of new bundles, though would not seek specific approval from Ofcom before launch.
- 3.5 KCOM's letter makes clear that WLR input costs are being used as a proxy cost for this service component and they are not true wholesale product prices. However, it confirms that if there were reasonable demand for wholesale products KCOM would work with other CPS to provide products and pricing that met its regulatory obligations.
- 3.6 KCOM has provided a spreadsheet setting out in detail the calculations of costs and margins they would propose to apply in the establishment of a retail price for a bundled service. We have set out in Annex 5 a redacted version which identifies the costs elements included in the calculation.

Section 4

Impact assessment and conclusion

- 4.1 As set out in the Market Review Statement we recognise that not allowing KCOM to offer bundled SMP and non-SMP services could have a detrimental effect on consumers in the Hull area who are effectively missing out on the potential savings and innovation benefits that can be gained through purchasing bundled products.
- 4.2 When we consulted on this issue in the course of the Market Review, the suggestion that KCOM should be allowed to bundle SMP and non-SMP products without removing the non discrimination SMP condition was not contested.
- 4.3 We recognise that KCOM would be unable to meet all the criteria set out in the 2003 Pricing of Services for Business Customers Consultation document (in particular the criteria requiring replicability) as KCOM does not provide wholesale supply of all of its products. We also recognise that it would be disproportionate to impose an obligation on KCOM to supply wholesale products where there is no demand for these services.
- 4.4 We are also conscious of the ERG common position on the need to ensure that restrictions on bundles do not prohibit welfare enhancing services. Given the unique position of Hull consumers, there is a considerable risk that policies designed to encourage a competitive environment in the far larger UK market could have unintended consequences in Hull.
- 4.5 There is no evidence to suggest that in the near future there is likely to be competitive fixed retail narrowband entry in Hull of a form likely to lead to either the supply of service bundles of the form found in other parts of the UK. In these circumstances we consider that it is very likely that Hull consumers would be the only group in the UK unable to access the benefits of such bundles, if the current restrictions on KCOM remained in place⁶. Expected benefits include price reductions, additional values services and access to new innovation in combined services, for example in expansion of the range of narrowband services.
- 4.6 In these circumstances, we consider it appropriate to reconsider how our established approach to the bundling of SMP and non-SMP products applies in the Hull market. In particular, it is appropriate to consider the importance of the criterion of replicability in a market where there is no prospect of entry by a competitor in the near term.
- 4.7 In Ofcom's view the proposals set out by KCOM address concerns about potential competitive harm, specifically foreclosure. KCOM has proposed to base its retail bundled offerings on its own costs where available, and where not available, on proxy costs based on BT's wholesale service offerings. We also note that KCOM states that it will work with CPs to provide wholesale products if there is a demand for those services.
- 4.8 We have reviewed the basis for setting a bundled retail charge proposed by KCOM.
- 4.9 Our assessment of KCOM's methodology, sources of data and calculation approach is that this represents a reasonable and verifiable approach that provides KCOM with

⁶ That is the only group of UK consumers unable to receive bundles where there are no technical or physical restrictions on the provision of the services in the bundle.

a predictable approach to pricing bundles of SMP and non-SMP services that does not appear to foreclose the provision of similar services by other parties.

Proposal

- 4.10 Given the unique set of circumstances in the Hull area we consider that the bundling together of SMP and non-SMP products by KCOM as set out in its proposal would not be in breach of the no undue discrimination condition. In particular, we consider that the undertakings proposed by KCOM, combined with the specific circumstances of the Hull market, rebut the presumption of undue discrimination first established in the 2003 Pricing of Services for Business Customers Consultation document.
- 4.11 As set out below we consider that the proposal meets all the criteria for the creation of the bundle excepting Replicability.

The bundled price passes a net revenue test

- 4.12 As demonstrated in Annex 5 the price for the bundle services will cover the fully allocated cost of the component services plus a retail profit.

Eligibility for the discount is not dependent on the expenditure on individual services within the bundle

- 4.13 KCOM has confirmed that the bundles will be subject to standard bundle prices and not dependent on expenditure within a bundle.

Bundle prices will be published

- 4.14 KCOM has confirmed that the bundles prices will be published.

Bundled price or discount scheme is made available to all broadly comparable customers

- 4.15 KCOM has confirmed that the bundles prices will be standard for all customers.
- 4.16 Accordingly we consider that in these specific circumstances for the Hull market, an exception is justified to the normal interpretation of the no undue discrimination remedy set out in our earlier market review statements. This exception is in line with Ofcom's statutory duties and obligations set out in sections 3 and 4 Communications Act 2003, in particular because it will further the interests of consumers by enabling them to benefit from cheaper and more diverse offerings from KCOM, which are unlikely to be delivered in the medium term otherwise.

Question 4.1 Do you agree that it is appropriate to make an exception with respect to our interpretation of the no undue discrimination remedy in these circumstances in order to further the interests of consumers in Hull? If not please give your reasons.

Question 4.2 Do you agree that the proposed approach to the setting of the retail prices for bundles including SMP and non-SMP products offers sufficient safeguards to prevent foreclosure of future competition in Hull? If not please give your reasons.

Annex 1

Responding to this consultation

How to respond

- A1.1 Ofcom invites written views and comments on the issues raised in this document, to be made **by 5pm on 2 September 2010**.
- A1.2 Ofcom strongly prefers to receive responses using the online web form at <http://stakeholders.ofcom.org.uk/consultations/retail-bundling-in-hull/>, as this helps us to process the responses quickly and efficiently. We would also be grateful if you could assist us by completing a response cover sheet (see Annex 3), to indicate whether or not there are confidentiality issues. This response coversheet is incorporated into the online web form questionnaire.
- A1.3 For larger consultation responses - particularly those with supporting charts, tables or other data - please email Katherine.Dinsdale@ofcom.org.uk attaching your response in Microsoft Word format, together with a consultation response coversheet.
- A1.4 Responses may alternatively be posted or faxed to the address below, marked with the title of the consultation.
- Katherine Dinsdale
Floor 4
Competition Group
Riverside House
2A Southwark Bridge Road
London SE1 9HA
- Fax: 020 7783 4109
- A1.5 Note that we do not need a hard copy in addition to an electronic version. Ofcom will acknowledge receipt of responses if they are submitted using the online web form but not otherwise.
- A1.6 It would be helpful if your response could include direct answer to the questions asked in this document and set out at the end of Section 4. It would also help if you can explain why you hold your views and how Ofcom's proposals would impact on you.

Further information

- A1.7 If you want to discuss the issues and questions raised in this consultation, or need advice on the appropriate form of response, please contact Katherine Dinsdale on 020 7783 4166.

Confidentiality

- A1.8 We believe it is important for everyone interested in an issue to see the views expressed by consultation respondents. We will therefore usually publish all responses on our website, www.ofcom.org.uk, ideally on receipt. If you think your response should be kept confidential, can you please specify what part or whether

all of your response should be kept confidential, and specify why. Please also place such parts in a separate annex.

- A1.9 If someone asks us to keep part or all of a response confidential, we will treat this request seriously and will try to respect this. But sometimes we will need to publish all responses, including those that are marked as confidential, in order to meet legal obligations.
- A1.10 Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use. Ofcom's approach on intellectual property rights is explained further on its website at <http://www.ofcom.org.uk/about/accoun/disclaimer/>

Next steps

- A1.11 Following the end of the consultation period, Ofcom intends to publish a statement in September 2010.
- A1.12 Please note that you can register to receive free mail Updates alerting you to the publications of relevant Ofcom documents. For more details please see: http://www.ofcom.org.uk/static/subscribe/select_list.htm

Ofcom's consultation processes

- A1.13 Ofcom seeks to ensure that responding to a consultation is easy as possible. For more information please see our consultation principles in Annex 2.
- A1.14 If you have any comments or suggestions on how Ofcom conducts its consultations, please call our consultation helpdesk on 020 7981 3003 or e-mail us at consult@ofcom.org.uk . We would particularly welcome thoughts on how Ofcom could more effectively seek the views of those groups or individuals, such as small businesses or particular types of residential consumers, who are less likely to give their opinions through a formal consultation.
- A1.15 If you would like to discuss these issues or Ofcom's consultation processes more generally you can alternatively contact Vicki Nash, Director Scotland, who is Ofcom's consultation champion:

Vicki Nash
Ofcom
Sutherland House
149 St. Vincent Street
Glasgow G2 5NW

Tel: 0141 229 7401
Fax: 0141 229 7433

Email vicki.nash@ofcom.org.uk

Annex 2

Ofcom's consultation principles

A2.1 Ofcom has published the following seven principles that it will follow for each public written consultation:

Before the consultation

A2.2 Where possible, we will hold informal talks with people and organisations before announcing a big consultation to find out whether we are thinking in the right direction. If we do not have enough time to do this, we will hold an open meeting to explain our proposals shortly after announcing the consultation.

During the consultation

A2.3 We will be clear about who we are consulting, why, on what questions and for how long.

A2.4 We will make the consultation document as short and simple as possible with a summary of no more than two pages. We will try to make it as easy as possible to give us a written response. If the consultation is complicated, we may provide a shortened Plain English Guide for smaller organisations or individuals who would otherwise not be able to spare the time to share their views.

A2.5 We will consult for up to 10 weeks depending on the potential impact of our proposals.

A2.6 A person within Ofcom will be in charge of making sure we follow our own guidelines and reach out to the largest number of people and organisations interested in the outcome of our decisions. Ofcom's 'Consultation Champion' will also be the main person to contact with views on the way we run our consultations.

A2.7 If we are not able to follow one of these principles, we will explain why.

After the consultation

A2.8 We think it is important for everyone interested in an issue to see the views of others during a consultation. We would usually publish all the responses we have received on our website. In our statement, we will give reasons for our decisions and will give an account of how the views of those concerned helped shape those decisions.

Annex 3

Consultation response cover sheet

- A3.1 In the interests of transparency and good regulatory practice, we will publish all consultation responses in full on our website, www.ofcom.org.uk.
- A3.2 We have produced a coversheet for responses (see below) and would be very grateful if you could send one with your response (this is incorporated into the online web form if you respond in this way). This will speed up our processing of responses, and help to maintain confidentiality where appropriate.
- A3.3 The quality of consultation can be enhanced by publishing responses before the consultation period closes. In particular, this can help those individuals and organisations with limited resources or familiarity with the issues to respond in a more informed way. Therefore Ofcom would encourage respondents to complete their coversheet in a way that allows Ofcom to publish their responses upon receipt, rather than waiting until the consultation period has ended.
- A3.4 We strongly prefer to receive responses via the online web form which incorporates the coversheet. If you are responding via email, post or fax you can download an electronic copy of this coversheet in Word or RTF format from the 'Consultations' section of our website at www.ofcom.org.uk/consult/.
- A3.5 Please put any parts of your response you consider should be kept confidential in a separate annex to your response and include your reasons why this part of your response should not be published. This can include information such as your personal background and experience. If you want your name, address, other contact details, or job title to remain confidential, please provide them in your cover sheet only, so that we don't have to edit your response.

Cover sheet for response to an Ofcom consultation

BASIC DETAILS

Consultation title:

To (Ofcom contact):

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

CONFIDENTIALITY

Please tick below what part of your response you consider is confidential, giving your reasons why

Nothing

☐

Name/contact details/job title

☐

Whole response

☐

Organisation

☐

Part of the response

☐

If there is no separate annex, which parts?

If you want part of your response, your name or your organisation not to be published, can Ofcom still publish a reference to the contents of your response (including, for any confidential parts, a general summary that does not disclose the specific information or enable you to be identified)?

DECLARATION

I confirm that the correspondence supplied with this cover sheet is a formal consultation response that Ofcom can publish. However, in supplying this response, I understand that Ofcom may need to publish all responses, including those which are marked as confidential, in order to meet legal obligations. If I have sent my response by email, Ofcom can disregard any standard e-mail text about not disclosing email contents and attachments.

Ofcom seeks to publish responses on receipt. If your response is non-confidential (in whole or in part), and you would prefer us to publish your response only once the consultation has ended, please tick here.

☐

Name

Signed (if hard copy)

Annex 4

KCOM proposal

A4.1 See website <http://stakeholders.ofcom.org.uk/binaries/consultations/retail-bundling-in-hull/annexes/annex4.pdf>

Annex 5

Pricing Spreadsheet

- A5.1 See website <http://stakeholders.ofcom.org.uk/binaries/consultations/retail-bundling-in-hull/annexes/annex5.pdf>