Review of the Fixed Narrowband Services Wholesale & Retail Markets

UKCTA Response to Ofcom Consultation

Submitted to Ofcom: 4th June 2009

UKCTA is a trade association promoting the interests of competitive fixed-line telecommunications companies competing against BT, as well as each other, in the residential and business markets. Its role is to develop and promote the interests of its members to Ofcom and the Government. Details of membership of UKCTA can be found at www.ukcta.com.

Given the linkages between the Retail and Wholesale Narrowband Reviews we have consolidated our responses into one document for ease of reference. The response is divided into the following sections:

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The views expressed by UKCTA in the Introduction and Section One regarding the Retail Fixed Narrowband Market Review do not necessarily reflect the views of KCOM Group who will be responding separately to the consultation.

Introduction

UKCTA members represent the overwhelming majority of the UK's alternative fixed line sector and our members are acutely aware of the importance of the Retail & Wholesale Narrowband Market Reviews and the resultant Network Charge Control.

UKCTA is very concerned about Ofcom proposals to remove all SMP obligations on BT in the retail business and residential markets for fixed narrowband telephone lines and calls. We do not believe that the proposals are based on a sufficiently robust analysis of the likely state and development of competitive conditions in narrowband retail markets. We believe Ofcom harbours an overly optimistic view of the impact competitors might have on BT's market position over the next 4-5 years.

A successful wholesale market is essential if healthy competition is to flourish in the retail market. For competition to flourish UKCTA members need access to the right wholesale products at the correct price. Where market conditions have changed materially since the last review then Ofcom should be prepared to deregulate, however Ofcom must be sensitive to the needs of the UK market and take an intelligent approach towards deregulation. Where some areas of an existing market are tending towards competition, Ofcom shouldn't push ahead with full deregulation until a solution is found to protect stakeholders and consumers where market failure still exists. Even in those markets where Ofcom is proposing to deregulate there remains significant segments where competition hasn't reached and bottlenecks remain.

It is not acceptable for Ofcom to abandon these sections of the market leaving only ex-post remedies. Raising a dispute or a complaint is very much a last resort and is both costly and time consuming, drawing upon resources in both the referring communications provider and taking up Ofcom's time. Disputes also take many months (even years in extreme cases) to resolve, creating a great deal of uncertainty in the intervening period. Consumers will ultimately pay the price if Ofcom fails to address market failure. We would urge Ofcom to rethink its proposals to deregulate, taking account of those areas of the market where the evidence clearly points to continuing market failure.

Section One - Retail Narrowband Review

1.1 Current Assessment of Retail Competition

Undoubtedly, Ofcom's competition policy for fixed narrowband retail markets has been very successful in ensuring sustainable market entry by strong players who have been able to challenge BT's legacy dominance. The introduction of CPS, WLR and LLU has all contributed to the gradual erosion of BT's market influence in the last 7-8 years. We do not, however, believe that the fixed narrowband retail markets have yet reached a stage where they can be said to be effectively competitive in the sense that BT no longer holds significant market power.

The wholesale remedies have clearly reduced the barriers to entry since the last review in 2003 but it is also important to bear in mind that they have really only taken hold during this period. In other words, the signs of increasing competition are very young when compared to the 25-year period since liberalisation of UK telecommunications markets began with the privatisation of BT. With this timeframe in mind, it is premature and wrong to suggest that regulation is now already working so well that SMP remedies can be abolished.

In terms of impact on BT's market position to date, we would suggest that competition still has some way to go. Indeed, BT's market share of the relevant markets remains extremely high. Notably in the narrowband access markets, BT retains a market share of 66% for residential and 57% for business. In competition law terms, these market shares are still significantly above the thresholds set in case law where a firm should be considered to be in a dominant position.

Although the market review process needs to be forward-looking and, as such, needs to predict as far as possible what developments will take place over the next

4-5 years, we believe Ofcom is taking one step too far and too quickly. We do not believe there is enough reliable evidence present to support Ofcom's suggestion that competition will deliver a substantial reduction in BT market share in the next few years. Rather we would suggest that it is far more likely that BT will maintain a strong market position over the foreseeable future and certainly over the period covered by the current market review.

1.2 Risk of removing Retail Regulation Prematurely

We are very concerned that Ofcom would be taking a considerable risk by removing retail regulation on BT at this point in time when sustainable competition is slowly taking foothold following Ofcom's efforts to introduce effective wholesale products. BT remains in a unique position to exploit its market position in ways no other operator is able to do. Ofcom notes the fact that BT has introduced so-called renewable contracts in the residential market as "*part of a trend in the market to seek greater levels of consumer commitment*."[1]This type of contract is a worrying trend from a consumer protection perspective. However what is important to note is that no other provider has introduced them apart from BT. In other words, it is quite obvious that it is only BT who believes it is capable of trying to tie customers into these long-term commitments without repercussions from competition, i.e. customers refusing to sign up in order to go to a competitor. Ofcom should ask itself one question: why has not BT sought to introduce renewable contracts in a competitive market like broadband?

UKCTA is seeking reassurances from Ofcom that its proposals are not the result of a pre-determined agenda to deregulate BT whatever the circumstances. There is a wider concern that Ofcom has in many respects given up on supporting competition in narrowband telephony markets since the conclusion of the Telecommunications Strategic Review in 2005.

[1] Ofcom consultation document, section 5.66.

With regard to residential markets, we are particularly concerned that deregulation would give BT an unwarranted ability to leverage its dominant market position in fixed narrowband telephony into competitive retail markets like broadband. Ofcom recognises that bundling by BT is a specific possibility as a result of deregulation. In fact UKCTA notices that BT already is launching bundling propositions into the market evidently in anticipation of Ofcom confirming its proposals later on. Whilst we recognise that bundling is becoming an increasingly common feature in communications markets, it is not the case that BT has so far suffered commercially by not offering such propositions. Indeed, by way of example, BT commands an impressive market share in residential broadband where it is one of the largest providers. And, of course, it remains by far the largest fixed telephony provider in the country.

The concern is that by bundling fixed telephony and broadband, BT will be able to exploit the existing strong inertia among fixed telephony customers to switch between providers. In effect, UKCTA believes that BT would be able to use bundling as yet another measure to prevent or certainly slow down the positive effect of competition. It is a very strong argument as to why Ofcom should rethink its proposals to deregulate BT.

UKCTA is extremely concerned about the possibility for BT to leverage dominance across markets and, in particular, the increased difficulty in identifying and policing margin squeeze should BT be allowed to bundle voice with other products. With a 66% market share in retail voice access markets, and SMP in upstream markets in both voice and broadband, BT has ample opportunity to leverage its dominance. This phenomenon was recognised as early as 2002 by Oftel in its guidance in the BT Broadband product. That case related to the use by BT of telephony billing to identify customers with an interest in broadband services, and resulting in Oftel's conclusion that "Oftel would consider evidence of use of such information for marketing purposes to prima facie indicate leverage and hence abuse of its dominant position." This kind of risk will persist; and, while Ofcom may consider that

BT's share of voice markets will decline, at 66% it is easily large enough to afford ample opportunity to leverage into other markets.

Where BT can bundle multiple products together in retail markets, it is difficult to identify a standalone effective price for the components of the bundle. This will, of course, make the identification of margin squeeze much more difficult. The UK has suffered from particular problems in relation to margin squeeze in both broadband and voice markets. Indeed, Ofcom's <u>only</u> current Competition Law cases are investigations of alleged margin squeeze by BT in these markets. In addition, the UK regime has been notably slow in dealing with margin squeeze issues under competition law. For example, the Freeserve case was opened in 2003.

In these circumstances it is absurd to make in the investigation of margin squeeze <u>more</u> difficult.

In short, UKCTA considers that the risks of leveraging between markets provide another strong reason why the SMP designation in relation to BT's retail voice services should not be removed until it is <u>absolutely</u> clear that there is no SMP. Until then, at the very least, an appropriate set of identification remedies should remain in place.

1.3 Impact of Wholesale Product Deregulation on Retail Services

Ofcom is proposing to remove the SMP designation on BT in the market for local-tandem conveyance (LTC) and transit.

We understand Ofcom's reasoning that increased DLE interconnection has reduced overall demand for BT's LTC services over the last few years. However, we believe that Ofcom is underestimating the ability of BT to adopt distorting prices in relation to specific interconnect services like APCC and NTS.

We would urge Ofcom to disclose BT's total number of minutes of LTC including APCC and NTS to obtain a clearer picture of BT's position in this market. Ofcom's consultation document does not appear to include this vital piece of market information. We would argue that APCC and NTS minutes for LTC should be included in the total number of minutes of external supply to gauge an accurate picture of BT's true market position.

With regard to the APCC, we disagree with Ofcom's analysis that BT would be constrained by the competitive supply of LTC. When a porting recipient provider receives a call from BT's network, the provider currently has no ability to avoid paying the LTC (since BT does not hand over this traffic on DLE routes). BT is in complete control over how this traffic is routed and hence would have both the ability and incentive to increase the APCC. It is not sufficient to rely, as Ofcom does, on the general cost-orientation obligations in General Condition 18. If Ofcom deregulates this market, the visibility of how the APCC is built up will disappear because BT, in theory, will not have to publish the LTC element of the charge.

With regard to NTS, Ofcom is aware that the cost of NTS call termination is calculated in a specific way and includes the element of LTC when calls do not originate on BT's network (although the call may not actually be routed in this manner). We believe there is a real danger here that removing BT's SMP remedy on LTC may have some unintended consequences or certainly result in further NTS disputes between BT and other operators.

It is not sufficient and quite irresponsible to dismiss, as Ofcom appears to do this problem by arguing that there are enough competitive constraints on BT as a result of direct interconnection arrangements between other operators to ensure that a problem does not arise. On the contrary, recent history shows that BT has proven quite capable of utilising newly found “regulatory loopholes” to its advantage (e.g. NCCN 500) with operators suffering commercially as a result. With this background in mind, UKCTA would urge Ofcom to think very carefully about the possible impact of its proposal and proactively suggest way in which the position of NTS operators can adequately be protected.

We discuss this issue from a Wholesale market perspective in section 2.

Section Two - Wholesale Narrowband Review

2.1 Scope of the Review – inclusion of Non-Geographic Services

UKCTA is disappointed that Ofcom has not taken the opportunity to include non geographic services within the narrowband review. BT is currently able to exploit a regulatory loophole[2] despite a provisional finding of SMP in respect of BT in the market for NTS termination services, as no formal determination has been made in respect of BT and a market review was not completed.

This issue hasn't gone away and today (through NCCN908) BT is still effectively able to charge more for 0845 and 0870 call termination for its numbers than everyone else. Other member states include non-geographic termination within their market review and we are at a loss as to why Ofcom have excluded it.

UKCTA's view is that BT along with every other terminating communications provider in the United Kingdom should have been classified as having SMP in non-geographic call termination. This should have happened as part of the 2003 review (despite concerns raised by the Commission on this issue in the 2003 notification). This would have resulted in a consistent approach covering both Geographic and non-Geographic call termination. The arguments outlined originally by Oftel to justify applying SMP status to all geographic termination services could equally apply to non-geographic services. In the case of non-BT terminated Number Translation services, the appropriate remedy already exists in the form of the NTS call origination condition, which effectively constrains pricing. For BT terminated traffic no such remedy exists, effectively allowing BT to have a free hand in raising pricing without fear of either a market or immediate regulatory response. This oversight has cost the alternative communication provider community a significant amount of money, weakening the sector, reducing the amount available to altnets to invest and

[2] Ofcom acknowledge this in the NCCN500 decision at paragraph 6.560

ultimately depriving consumers of enhanced services offerings and/or more competitive pricing.

Despite guidance from the European Commission, Oftel chose not to include non-geographic call termination within an SMP finding. In 2003 Oftel itself noted that *the market definition is broadly consistent with the Commission's recommendation. There is a slight difference in that Oftel has focussed on fixed geographic call termination services only, whereas the Commission's recommendation (fixed call termination on each individual network) could be adjudged to include non-geographic call termination services as well*[3]. Somewhat naively Oftel/Ofcom excluded non-Geographic termination because of the apparent competitive nature of the UK's non-geographic termination market. So while the NTS call origination condition acted as a constraint on alternative communication providers, BT was then free from late 2003 onwards to charge whatever it liked.

We urge Ofcom to close this loophole at the earliest opportunity. If Ofcom do not believe that changing the market definition to incorporate non-geographic services is appropriate then an alternative solution must be found to constrain BT's pricing for non-geographic services.

2.2 Proposed Deregulation of Single Transit

UKCTA opposes Ofcom's proposals to deregulate Single Transit. There are a number of instances where CPs are compelled to buy Single Transit from BT either as a result of lack of interconnection (where it would not be cost effective to connect to every other CP) or through BT bundling Single Transit into other products (NTS, Number Portability etc) and there are many sections of the market which are not competitive (in particular the many thin routes carrying traffic to smaller CPs which aren't expected to be benefit from competition)

[3] Oftel : Identification and analysis of markets, determination of market power and setting of SMP conditions November 2003 – Section 2.4

While Transit has now dropped off the European Commissions list of Markets the characteristics of the UK Market are sufficiently different from other member states to warrant retention of SMP (this was also the case in the trunk leased lines market). The UK narrowband market has a large number of very small providers and an SMP transit product is required to provide end to end connectivity. UKCTA believes the UK transit market requires SMP on single Transit and meets the three criteria test.

BT is the default interconnect partner for all. BT remains the only provider that is interconnected to every UK CP. The nearest competitor in the transit market is a long way behind and in reality due to the economics of interconnection is unlikely to challenge BT's position during the life of the next review. There are many bottlenecks in the market due to the scale of investment needed to connect directly to the many small providers who terminate UK number ranges. Ofcom's analysis largely ignores the scale of this task; the considerable cost of digging, deploying fibre and the amount of switch port capacity that would be required. Ofcom also seem to ignore BT's massive buying power, it is able to combine all BT Retail generated minutes and the majority or all other industry generated minutes when it connects to many CPs. BT's dominance in the origination market gives them considerable advantage in the transit market and UKCTA is disappointed that Ofcom analysis appears to have ignored this. BT's call origination obligation acts to its advantage and it remains free to market its transit service to other CPs based on a known cost of termination. This isn't the case with other CPs. This in turn impacts on new entrants and gives unfair competitive advantage.

If Ofcom pushes ahead with there proposals there is likely to be a massive amount of disruption to the smooth workings on the market when price publication is removed and the Carrier Price List (CPL) is adjusted. The CPL facilitates the smooth working of the market and if it is removed or significantly altered than an industry debate is required as the CPL acts as a trigger for cross industry number ranges to be enabled and pricing to be set. Ofcom should not underestimate the impact of this change on the ability of the market to function.

BT also enjoys considerable legacy advantages which will give it an unfair advantage in a deregulated market. For example BT enjoys 56 day notice on price changes from its competitors, for most other providers the notice period is much less – around 30 days.

UKCTA believe that full deregulation of the transit market is likely to make it less competitive. BT's has voluntarily cut the price of transit beyond anything required in the charge control (as a result of BT's desire to discourage direct interconnection on key traffic routes) so pricing in the market is only likely to increase and this will allow BT to make more margin with little fear of a competitive response. Current regulation prevents BT from cherry picking routes, so BT has to offer the same price for transit on the competitive routes to mobile providers as it does to smaller CPs. If deregulation occurs BT is likely to retain lower pricing on calls to mobile providers, but increase charges on calls to smaller CPs. BT's new 180 bespoke chargeband billing system will allow it to do this with ease, as its wholesale billing engine can charge different transit charges on calls to different CPs.

UKCTA would draw Ofcom's attention to the Telekom Austria case. The Austrian NRA decided to include direct interconnection (i.e. interconnection between two operators without use of intermediate transit operators) in the market for transit services, and found that the incumbent PSTN operator (Telekom Austria) did not have SMP in that market. The EU Commission executed its right of veto and requested the Austrian NRA to withdraw its decision. The Commission concluded that RTR's approach lead to a significant underestimate of the dominant market player's market share (when it came to analysing the market). Furthermore, the Austrian NRA failed to assess the impact of deregulation on small operators[4].

UKCTA believe that Ofcom have failed to carry out a proper impact assessment on the consequences of full single transit deregulation. If Ofcom does not retain SMP on single transit then, in the alternative, we would suggest that Ofcom defines the transit market in a different way, namely that the market is divided into high volume

[4] Veto decision in case AT/2004/0090 concerning transit services (Austria)

competitive routes and low volume non-competitive routes. High volume routes (eg. mobile to mobile) could be declared competitive, but low volume routes should continue to be classed as uncompetitive in the sense that BT would retain SMP status (possibly only with a non-discrimination obligation as the SMP remedy).This would mean that the competitive pressures BT feels in the market for competitive routes are transferred to the 'thin' bottleneck or low volume routes and acts to control prices in this significant corner of the market where UKCTA believes market failure remains.

2.3 Proposed Deregulation of Local to Tandem Conveyance

Ofcom is proposing to remove the SMP designation on BT in the market for Local-Tandem Conveyance ("LTC") and transit. UKCTA understand Ofcom's reasoning that increased DLE interconnection has reduced overall demand for BT's LTC services over the last few years. However, we believe that Ofcom is underestimating the ability of BT to adopt distorting prices in relation to specific interconnect services like APCC and NTS. We would urge Ofcom to disclose BT's total number of minutes of LTC including APCC and NTS to obtain a clearer picture of BT's position in this market (see section 1.3 for more details).

We disagree with Ofcom's decision to ignore BT's self supply of LTC. BT has a very high market share through the internal purchase of Local to Tandem Conveyance. While BT self supply isn't directly contestable, the LTC minutes used to support BT's Wholesale Calls product are indirectly contestable and we have seen BT make considerable advances in the Wholesale Calls Market, with over 4 million UK exchange lines on Wholesale Calls, which is around the same total as CPS.

Ofcom's approach on this matter is inconsistent with their previous stance in other markets where self supply (that is also non-contestable) has been included within the market share analysis (eg. the market for trunk private circuits). UKCTA would ask Ofcom what justifies the exclusion of self-supply in the LTC market?

With regard to the APCC, we disagree with Ofcom's analysis that BT would be constrained by the competitive supply of LTC. When a porting recipient provider receives a call from BT's network, the provider currently has no ability to avoid paying the LTC (since BT does not hand over this traffic on DLE routes). BT has complete control over how this traffic is routed and hence would have both the ability and incentive to increase the APCC. It is not sufficient to rely, as Ofcom does, on the general cost-orientation obligations in General Condition 18. If Ofcom deregulates this market, the visibility of how the APCC is built up will disappear because BT, in theory, will not have to publish the LTC element of the charge.

The current arrangements for NTS results in Non-BT originated traffic using a proxy POLO based on single tandem (including LTC). If BT were to introduce bespoke LTC pricing then it is not clear what would happen to NTS POLOs. What Ofcom is proposing would mean an urgent need to address the impact on the NTS formula. In effect, deregulation of LTC would mean that BT could impose reduced out payments on other terminating providers (even if they purchase little or no LTC directly) as the change in LTC pricing would flow through to a reduced POLO, as unlike the de-regulation of Inter-Tandem services, terminating providers can't take any action to avoid a change in LTC for non-BT originated traffic (which makes up between 20 – 35% of overall traffic). We disagree with Ofcom's view that the existence of alternative interconnect arrangements between some originators and terminators would act as a constraint on BT's pricing for NTS LTC. In NTS the LTC component is paid by the terminating provider, not the originator who is responsible for routing. The NTS market has developed rigidly over the years and the removal of LTC from regulation is unlikely to act as any kind of incentive to change market behaviour due to the disconnect between routing responsibilities and cost ownership.

We would urge Ofcom to retain the current suite of regulation on LTC in its entirety. In the alternative if Ofcom is intent on pushing ahead with the relaxation of regulation, we propose the retention of a non-discrimination obligation on LTC pricing so that non-contestable areas of the market (like APC and NTS) would benefit from the competitive pressures in other market areas. While this would require a finding of SMP, it would at least allow Ofcom to remove many of BT’s existing regulatory constraints.

2.4 Proposed Changes to Notice Periods

UKCTA is very concerned about Ofcom’s proposed blanket reduction in notice periods and are unaware of any significant changes from previous market review that would justify such a reduction. The downstream contracts that Communication Providers have with their customers (both end user and carrier) have, in many instances been implemented to reflect the current notification periods that apply to wholesale inputs. Ofcom’s proposal of allowing a six month window to renegotiate these retail / carrier contacts wholly underestimates the scale of the task. In truth it would take many years for all such contracts to be revised.

Ofcom seem to have lost touch of the fact that existing notice periods were designed to give CPs a reasonable period to take action when input prices change, allowing the necessary billing, traffic management and routing changes to be implemented and tested before new pricing comes into force. It also allows sufficient time to revise end user pricing. The timeline for flowing through a wholesale price change usually involves new retail pricing commencing from the start of a given month (to ensure clean and transparent end user billing), with 30 days contractual notice required before that, on top of the initial time required to analyse and finalise the retail pricing response flowing from the wholesale change.

Market conditions haven’t altered on those wholesale products where SMP is being retained and we are therefore are at a loss as to why Ofcom is proposing such a significant and unjustified change to conditions in regulated markets. We believe that a key benefit of requiring a sufficient notice periods for regulated pricing is that it allows stakeholders (including Ofcom) sufficient time to assess the price changes and monitor for anti-competitive practices to ensure that any changes accord with BT's regulatory obligations. 28 days is simply not adequate for that purpose (particularly for complex charging scenarios).

The rationale of allowing BT to launch trial pricing seems to be an extremely weak one and we note the absence of any serious discussion or impact assessment in the consultation. UKCTA urge Ofcom to give this issue proper consideration and if BT trial pricing is a serious enough reason to make a change from the status quo then a more targeted approach must be considered. For clarity UKCTA is not advocating additional restrictions being place on the introduction of trial pricing to support entirely new trial products, our concerns relate to trial pricing being applied to existing products.

We recognise that there can in practice be a perceptual difference between price reductions and price increases, with the former usually being welcomed. However in some circumstances there are valid competition concerns around price reductions and that even if it were to be a potential option, the complete removal or reduction in the pricing notification period for decreases wouldn't be appropriate. If Ofcom wish to improve BT's flexibility when introducing pricing to the market then UKCTA would advocate retaining existing notice periods but streamlining the current waiver process by which BT can apply to reduce the notification period required on price reductions. This would then allow BT to introduced lower pricing into the market in a shorter time frame where it is uncontested. A streamlined waiver process which still allows sufficient time for objections to be lodged would provide BT with greater flexibility while preserving the level of certainty required by competing communication providers. UKCTA would welcome further discussion with Ofcom and BT around the implementation of this streamlined waiver proposal.

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