

# **Wholesale Broadband Access Market Review**

## **Response from Tiscali UK Ltd – February 2008**

The following is Tiscali's response to the consultation document published by Ofcom on 15<sup>th</sup> November 2007. This consultation follows the first relating to this market review published in November 2006 and contains a significant amount of common analysis and conclusions. Tiscali responded to the first consultation in February 2007 and this document is still completely relevant as all the issues identified then remain important to the UK market. The text of the February 2007 response is attached in the annex to this paper. As all arguments have been made by Tiscali and others during the first round of consultation, this submission simply highlights areas of concern and refers to the previous submission as appropriate.

What follows is a series of headline views on aspects of the market review, organised by subject area.

### **Market definitions**

The previous submission mentioned issues around 21CN wholesale products and how future technical and industry developments may affect provisions made as a result of the current review. It is still important to acknowledge that changes may require alteration to the regulation, even if this is undesirable. Tiscali generally agrees with product and market definitions described by Ofcom, with this point in mind, but believes that issues may arise with Next Generation Access (NGA) developments in geographic areas covered by the WBA provisions, giving rise to an ability on the part of NGA owners to avoid regulatory obligations. This should be accounted for by clear provision in the text of the final SMP conditions and may also be covered by conditions arising from the forthcoming review of new NGA developments. See the Annex for more general points on NGA and 21CN as they affect this market review exercise.

The review of product markets that Ofcom has so far carried out needs to be continued to take account of the fact that there is a break in the chain of substitution between business and residential broadband products in the UK market. This subject has been discussed in some detail by Ofcom and industry and the suggestion made that Ofcom will consider expanding the business connectivity (leased lines) market review to include business quality ADSL services. Alternatives to this that would allow the correct conclusion for product markets are to cancel proposals to deregulate market 3 or define a separate business market in this review.

Key points relevant to the distinction between business and residential/small business products and services are summarised as follows:

- There is a large difference between mass market residential and small business broadband and the low contention, high quality business products available in the UK and they are not substitutable.
- Key aspects of the difference in these product markets are contention ratios, care levels, national marketing and pricing (in business markets) and applications accessed through connections.

- LLU operators focused on residential services will not readily enter the business ADSL market, characterised by low volumes, high service quality and different systems, regardless of pricing factors and customers will not be able to substitute mass market ADSL products for business products.

Tiscali believes that the business-residential analysis in the consultation is flawed and that Ofcom should review the opportunity to include business products in the business connectivity market review and discuss conclusions with industry as soon as possible.

As mentioned in the February response (see Annex below), account should be taken of the fact that Ofcom may have to review the findings of this market review for geographical, technological (platform) and product changes. Issues discussed above serve to illustrate this necessity.

### **Wholesale markets and competition**

As discussed previously (see Annex below), the nature of Ofcom's review of wholesale markets presents various issues and causes significant concern to UK operators. The approach has not modified since 2006, so concerns must be repeated.

- Although several LLU operators may be present at a location, there is no reason to suppose that they will offer competing wholesale services under any circumstances.
- LLU operators use their access infrastructure to self-supply retail broadband downstream services in nearly all instances.
- Where self-supply LLU networks are perceived to represent competing inputs, deregulation decisions will be made even though no competitive constraints really exist.
- The use of LLU to supply the wholesale market is small and will remain so for the foreseeable future; selling, product design and technical requirements for such services are very different to those for mass market residential retail services.

### **SMP assessment**

Ofcom's SMP assessment for market 3 has been made on the assumption that there is no SMP regulation in place (therefore, as if no wholesale broadband products exist) and therefore finds LLU presence and self-supply enough to constitute competitive constraint. The reality is that regulation has allowed wholesale products and there is a small amount of wholesale competition, but nowhere near enough to warrant a conclusion that BT does not have dominance in that market.

Key points related to the text are as follows:

- Ofcom acknowledges the fact that Virgin Media does not offer wholesale supply based on the cable network (section 4.126), yet goes on to attribute significant Wholesale Broadband Access (WBA) market share to Virgin throughout the analysis.
- Table 4.5 exemplifies the issue that Ofcom has created. The WBA market share that Ofcom attributes to Virgin Media and the LLU operators do not exist. Retail competition and the use of networks for internal self-supply are

wrongly used as a proxy for wholesale competition. Non-existent internal transactions are imputed and notions of increasing share advanced that are not based on valid reasoning. The flawed analysis allows Ofcom to conclude that non-BT operators have 55% of the WBA market and that the share is growing.

- Tiscali believes that the future share assessment included in the consultation from 4.149 to 4.158 is therefore fundamentally flawed and that competitive conditions are not such that BT's ability to act without constraint is anything less than significant.
- In section 4.170 Ofcom finds that no single firm has SMP in WBA market 3, but 1) Ofcom's conclusions on market share are flawed (see above), 2) LLU sunk investments (largely money paid to BT) are of a very different nature and order of magnitude to sunk investments in network made by BT and it is misleading to classify them similarly, and 3) any economies of scale, scope or density that an LLU operator may benefit from are again of a different nature and significance to those enjoyed by true scale competitors (BT, in this case).
- In section 4.174, Ofcom states that no analysis of countervailing buyer power is necessary because no SMP has been found in market 3. Ofcom quotes the Office of Fair Trading on buyer power in section 4.123 ('Buyer power requires the buyer to have choice'). As argued, the SMP assessment is not correct and a buyer power analysis should be carried out. There is no significant choice available to customers for WBA, only the choice to self-supply with all the commitment to scale that that entails.

Ofcom accepts the presence of retail competition based on self-supply as a proxy for competition without analysing the true potential for or actual current evidence of wholesale supply of WBA by operators other than BT. The result is an error in SMP assessment resulting in the deregulation of market 3 along with the effective acceptance that there is no substantial competitive market for WBA in the UK.

## **Remedies**

In the February 2007 response (see Annex), Tiscali raised issues to do with margin protection, voluntary commitments and equivalence of inputs. The issues with remedies remain, relevant to markets where SMP has been found and to markets where it wasn't found but no real competition exists.

- Reasonable charge level and terms obligations should be included as part of SMP remedies, to prevent BT employing the benefits of dominance in such a way as to restrict competition or unfairly exploit it in charging for services.
- In section 5.177, Ofcom states that market growth and service development factors make it difficult to determine costs and maintains the view that cost orientation is not appropriate for current SMP remedies. Even if the market is growing, there is enough fundamental stability to enable an accurate cost determination and cost orientation should not be ruled out on such grounds. BT dominance is very clear and cost and reasonableness obligations should not appear unnecessarily onerous or damaging to the market, in Tiscali's opinion.
- With reference to sections 5.223 –5.225, ATM may be an outdated technology and BT wholesale products will change over time, but Ofcom does not present analysis justifying the removal of all margin protection remedies. EC guidelines and Article 16.2 of the Framework Directive together suggest that

Ofcom should have prepared more analysis and proved an absence of regulatory need in the presence of competition to support the deregulatory course of action. BT dominance continues and the margin squeeze threat remains, now more serious as margin protection remedies disappear.

- The ‘dilution’ of remedies described would become more serious in effect and impact where NGA networks came into existence and wholesale options were controlled by monopoly owners of those networks (see above and Annex).
- Voluntary WBA price ceiling commitments offered to Ofcom by BT in November 2006 will expire at the end of 2010. Price floor commitments will expire at the end of June 2009. The exact terms of these commitments are known only by BT and Ofcom and they do not constitute regulatory protection in a monopoly situation. If commitments expire, remedies have no power and Ofcom does not begin any new market review process until some time in 2010, the UK market will be at risk of coincidental deregulation and heightened commercial and technological risk (as 21CN is rolled out) at a time when BT dominance in WBA is undiminished.
- It should be obvious from arguments put forward already that Tiscali does not believe that equivalence of inputs alone is enough to provide protection against abuse of dominance in WBA in the UK. BT is truly dominant in all market areas (accounting for views expressed on market 3 above) and the ability to purchase LLU on an equivalent basis only allows for cost effective self-supply in most cases. Although BT Wholesale is required to supply IPStream to BT Retail on an equivalence of inputs basis, the version of that product internally traded is different to that used by other providers and this situation has not been resolved in all the time that the equivalence model has been operative in the UK. As new equivalence issues arise with 21CN wholesale products, ambiguity in this area will not readily diminish.

### **Transition arrangements**

A section of Tiscali’s February 2007 submission addressed some issues to do with transition arrangements proposed by Ofcom on the withdrawal of existing regulatory provisions (see Annex below). Ofcom devotes a short section to notice periods and SMP conditions in the new consultation and various concerns remain.

- Tiscali agrees in general with Ofcom’s proposals for a period of notice prior to the withdrawal of SMP conditions, but does not believe that 12 months is long enough to avoid material adverse effects on competition. If providers are in a position of having to make alternative supply arrangements in the WBA market, then knock-on effects within the industry and on the position of those providers’ customers will lengthen the risk period created by the regulatory changes. The notice period should be two years to ensure that adverse effects are avoided. The impact of this on BT is unlikely to cause great difficulty, as plans for future years probably do not include withdrawal of BT Wholesale products or discriminatory supply and pricing arrangements.
- Ofcom suggests that, for the period of notice, wholesale supply to existing customers should be maintained, but that there would be no obligation to provide new access to third parties. BT should be required to maintain supply of new connections to existing customers to enable those customers to effectively manage their networks during the period of transition and prevent

negative impacts on the end users. In practice, this may not be an issue if BT plans to continue to supply wholesale products on existing platforms in the market 3 area for the foreseeable future. The relevant section of Ofcom's final statement should be expanded to deal with this point and achieve clarity.

- Ofcom proposes to revoke regulatory obligations on BT requiring ATM interconnection (BT Wholesale's DataStream product) and setting the margin between it and IPStream without any notice period. Despite the fact that the DataStream platform supports a significant number of end user connections, its viability has been eroded over the years since the 2004 Direction as IPStream prices have been reduced without corresponding reductions in DataStream prices, which is what the margin-setting Direction was supposed to ensure. The existing threat to the future of DataStream is increased by the prospect of deregulation in market 3 without maintenance of a sensible notice period to ensure continuity of supply and non-discriminatory pricing. The fact that providers may currently be planning a transition from DataStream to 21CN platforms does not adequately mitigate the potential impacts of an early complete withdrawal of regulatory obligations that underpin the platform and its commercial viability. Tiscali believes that Ofcom should reconsider this issue and ensure that sufficient protection is given to the DataStream network and the services to consumers that are based on it in the UK.

## **Conclusion**

In the conclusion of the February 2007 consultation response, Tiscali recommended continuing constructive dialogue with the industry group and a willingness, on Ofcom's part, to review analysis and proposals where competitive reality required it. It is unfortunate that nearly all of the concerns raised by Tiscali and others with the original market review consultation are still valid and now much more urgent as Ofcom seeks to alter regulation.

It is feasible that Ofcom could deregulate WBA in large areas of the UK and the effects on the market could be minimal if BT continued to supply WBA products at fair prices without discrimination and with operating commitments to safeguard the margin between those products and LLU. However, it is not at all feasible for the market to rely on most aspects of this scenario as they are likely to negatively impact BT's commercial position. Although some wholesale LLU will continue to be available in LLU areas, it will not develop to a scale that could compete with BT WBA in the foreseeable future. Deregulatory decisions must be based on an appreciation of commercial reality as well as economic theory.

Ofcom must respond positively to all the concerns and issues that have been raised in this submission and the previous one, because the outcome of this market review will make a significant difference to communications providers and their customers across the UK. Regulatory provisions must not be withdrawn prematurely on the basis of flawed economic and market analysis, causing the benefits of effective regulation to be lost in the pursuit of deregulatory goals that may have more to do with politics and publicity than the promotion of effective competition.

## **Annex**

### **Text of February 2007 consultation document response**

#### **Basis for geographical analysis**

Some debate has already taken place between industry and Ofcom concerning the use of BT exchanges as the geographical basis for market analysis, as opposed to street cabinets or otherwise. It is probably correct to argue that analysis at more granular levels than exchange would be too complex for the current review exercise, but it may become necessary for future reviews occurring because of significant market changes or on a standard periodic basis. This would link with consideration of the viability of sub-loop unbundling, along with the nature of the market and operational plans of providers.

Other concerns exist around the mapping of Ofcom's methodology to the geographical basis of BT's rebate schemes (for DataStream and IPStream) and pricing commitments, as well as the fact that the Wholesale Broadband Connect (WBC) aggregation points determined by BT do not match the exchange-based markets defined by Ofcom. Anomalies could be caused by any of these factors, as they may conflict with regulatory provisions and render them inaccurate or ineffective. In time, WBC will be the main wholesale product that regulatory remedies in this market apply to, so it is surely important to deal with such issues at an early stage and while the product design and platform is still being agreed. It may also prove necessary to be more specific with BT wholesale product variants relevant to the market remedies, as a lack of clarity on what backhaul solutions are covered persists.

#### **Geographical contiguity**

Related to the above points is the concern that 'black holes' may arise where regulatory remedies do not apply in geographical locations surrounded by regulated areas. It may be argued that this phenomenon occurs already, where LLU may be feasible in an exchange next to others where it is not, but consideration should be given to this issue and the potential for positive action to make contiguity work. The business effects that concern Tiscali and others are mainly to do with impacts on national or regional marketing and planning and the LLU comparison is not currently proven, especially as LLU is still in roll-out and mass migration mode.

Another important issue may arise because of merger and acquisition activity that would, in theory, change the market definition of an exchange. Categories will not be altered for at least two years, on current plans, which would mean the risk of anti-competitive anomalies arising may become high. This needs to be thoroughly considered at this stage, even if it proves impractical to revise categories during the life of regulatory remedies set by the review.

#### **Competition in wholesale markets**

Careful consideration of the real nature of wholesale competition is required at this stage of the review. Although several operators with theoretical potential may be present in an unregulated area (assuming there are any of those after the review), it

could be that none of them offer competing wholesale services. In this scenario, the presence of qualifying operators in a location would have led to the deregulation of the market it constitutes, regardless of their ability or willingness to supply wholesale products. There may be no real competitive constraints, meaning that BT has an unregulated monopoly with all that that implies. There is a great difference between the use of LLU for self-supply and the wholesaling of it to other operators. Running a wholesale business entails significant resource across sales, product and technical functions that may form no part of the business plan of a large LLU operator.

The fact that Ofcom's analysis must be driven by examination of retail markets and be absent regulation is understood. It may be true that there is no other way for Ofcom to approach this task, given the risk of circular arguments and impractical complexity. However, the business and market reality of outcomes should be considered and proper account taken of potential market activity on the part of alternative operators and BT. The ultimate aim is to produce healthy competition that benefits consumers and that may not be fully realised, even though the rules of analysis are followed.

### **Transitional arrangements**

Would price and margin commitments by BT be enough to ensure the existence of wholesale competition, be it based on LLU or other wholesale products sold by BT? Provision must be made for the transition from existing regulatory remedies applied to wholesale products (ie DataStream obligations and margin rules) to new remedies or complete deregulation. Such arrangements must also take account of pricing and margin commitments applying to existing and 21CN products.

The nature of the transition arrangements and the length of time they are in place needs to be decided during this phase of the market review. It is likely that a plan over two years will be needed, covering supply obligations and pricing. This would serve to protect DataStream and IPStream supply in any deregulated areas, allowing any network changes necessary and preventing harmful impacts on consumers. It is not clear that BT would withdraw supply of wholesale products, of course. However, the answer to that question will not be required, as long as BT could withdraw and had the ability to alter prices without regulatory constraint.

### **Next Generation Access**

The subject of regulatory challenges posed by potential next generation access deployment has been raised by Ofcom elsewhere and will continue to be discussed by Ofcom and industry. The concern in the present case is that current business and regulatory models may be undermined comprehensively by the selective roll-out (by BT) of fibre access to deliver new retail products and/or reduce costs. In the simplest example, if an exchange is bypassed as a result of such plans, LLU is compromised. It has been generally acknowledged that sub-loop unbundling is not sufficiently developed as a solution to deal with this scenario, especially on any significant scale.

If Ofcom were to be forced to refresh the market review as a result of new retail products or geographical changes brought about by such developments, speed and effectiveness would be vital to avoid BT (or anyone else) gaining an unfair first-mover advantage. An 'interim' period arising due to timing of review work and the way in which such developments take place, could easily extend to years in duration,

with all the consequences implied. Key questions to be answered by new analysis would have to deal with whether products (eg 100Mb broadband) were in existing markets and subject to the same remedies.

Other questions arise now and will become more pressing in the future, around potential new wholesale products such as naked DSL and 'Wholesale Converged Access'. If new products are subject to existing remedies, it will be essential for Ofcom to maintain clarity on this from the earliest point. New markets and remedies may, of course, be required in future (eg for some form of MSAN bitstream access, where new fibre access dictated it). How quickly could such issues be dealt with? It is clear that Ofcom is against any concept of regulatory forbearance for next generation access investment, but should more be done to address the issues in the current market review? The key concerns are all around timing and the need to be prepared for all potential developments, for the good of competition and the management of regulatory workload.

## **Remedies**

No price control or cost orientation remedies are proposed in the consultation. It is understandable that Ofcom wants to avoid over-prescriptive regulatory measures and 'burn-in' of structures that may interfere with industry and market development. The issue of potential margin protection for LLU should be dealt with in the next Wholesale Local Access market review and should be considered now. Concerns are particularly acute if LLU does not present enough true constraint on BT in unregulated markets (reference points made on self-supply and wholesale competition above). Will the need for complex and secretive price commitments, such as those in operation today, continue during the life of the next review? These would become ever more complex as new products are introduced by BT, resulting from 21CN developments or for other reasons. How much reliance can be placed on equivalence of inputs obligations applied to increasingly complex product offerings and bundles? Issues of transparency and enforcement inevitably arise and these must be discussed at this point in the review process.

It should be acknowledged that a decision on SMP in market 3 is awaited. The reasoning behind any deregulation should be clear and persuasive and related to commercial reality as well as the economic theory underpinning it.

## **Conclusion**

In view of the current growth of LLU and product developments arising from BT's 21CN plans, there is an argument to say that this market review is premature. However, one could wait indefinitely for the 'right moment' to do such things and the review should be kept to schedule. The key thing is to acknowledge risks arising from geographical development and LLU, 21CN and the potential for next generation access deployment. Ofcom must be prepared to refresh or replace the review analysis and remedies in future as and when the competitive reality demands it. By the same token, BT must be obliged to cooperate and review any voluntary (but essential) commitments upon which the industry relies. These requirements place significant burdens on Ofcom and the best way to tackle them at this stage is to maintain a constructive dialogue across the stakeholder group.