



Disaggregated markets: Leased lines

Summary of responses to Ofcom's discussion
document

Statement

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Section 1

Executive summary

Introduction

- 1.1 Ofcom, on 28 March 2006, published a discussion document exploring the issues related to the definition of geographic markets for the various leased lines product markets in the UK¹. The analysis presented in the discussion document built upon the analysis conducted for the leased lines market review (LLMR) published in May 2004.
- 1.2 Ofcom received seven non-confidential responses to its disaggregated markets discussion document. These responses were received from BT, Cable and Wireless, Colt, ntl:Telewest, Thus, Vodafone and the Welsh Assembly Government. In addition, Ofcom received one confidential response.

Summary of responses

- 1.3 Respondents to the discussion document generally welcomed Ofcom setting out an analytical framework for looking at the question of geographic markets in the context of leased lines services. Respondents agreed that traditional tools of market definition were not appropriate when defining the scope of geographic markets for telecommunications products. However, no respondent agreed in entirety with Ofcom's proposed analytical framework, with each having views on how Ofcom's approach could be improved.
- 1.4 While some respondents agreed with Ofcom that for some of the leased lines product markets the evidence suggested that the markets were local in scope, a number of respondents also argued that the leased lines markets in the UK are national and Ofcom should be cautious about defining local geographic markets. A significant concern of these respondents was that such a change in regulation could lead to significant costs being placed on Ofcom and operators, which ultimately would need to be borne by consumers.
- 1.5 Respondents were in broad agreement that it would be more appropriate to look at the question of geographic market definition in the context of a full market review and not seek to vary remedies on a geographic basis within a national market. This would allow geographic questions to be addressed in the context of a fuller understanding of the competitive constraints in relation to leased lines products and services.

Purpose of this document

- 1.6 This document summarises the responses that Ofcom received from stakeholders to its discussion document. It also, where possible, gives Ofcom's response to those comments.
- 1.7 This document also confirms that it is Ofcom's view that it is more appropriate to consider issues of geographic market definition for leased lines markets within the context of a full market review that considers both product and geographic dimensions rather than to vary remedies within the national geographic markets in which SMP was found in the 2004 LLMR.

¹ <http://www.ofcom.org.uk/consult/condocs/disagg/>

Section 2

Introduction

2.1 Ofcom is required by the Communications Act to conduct market reviews of prescribed markets to ensure that regulation remains appropriate. As part of a market review process, Ofcom must define the relevant market under consideration in order to assess whether or not there is SMP and hence whether regulatory remedies are required. Market definition should consider both the product and geographic dimensions. Ofcom, following its leased line market review in 2004, considered that further discussion was necessary of an appropriate analytical framework for assessing geographic markets.

2.2 Ofcom, on 28 March 2006, published a discussion document exploring the issues related to the definition of geographic markets for the various leased lines product markets in the UK². The analysis presented in the discussion document built upon the analysis conducted for the leased lines market review (LLMR) published in May 2004. Moreover, the analysis took into account the relevant regulatory principles identified in Ofcom's strategic review of telecommunications, in particular the principle:

“to accommodate varying regulatory solutions for different products and, where appropriate, different geographies”.

2.3 However, the discussion document did not seek to revisit the question of the product market definitions for leased lines services, which had been defined in the LLMR, neither did it seek to define the precise boundaries of any geographic markets that may exist. The discussion document also did not address the question of whether the Hull area constitutes a separate geographic market, or whether there were any operators that hold a position of significant market power (SMP) within any markets. Those issues are best addressed through a full review of leased lines/ business connectivity markets which Ofcom expects to consult on in the first half of next year.

2.4 The discussion document had five main constituent parts:

- it introduced the issue of geographic markets, explaining the difficulties of using “traditional” market definition tools when applied to the definition of geographic markets for telecommunications products;
- it set out Ofcom's proposed analytical framework for assessing the extent to which there are geographic variations in competitive conditions in leased lines markets for the purposes of defining the geographic scope of the markets;
- it applied that analytical framework to analyse the markets in question;
- it discussed practical implementation issues around how non-contiguous geographic areas with similar competitive conditions could be aggregated into broader geographic markets; and
- it discussed the possibilities for and implications of varying remedies within markets defined as national in scope.

² <http://www.ofcom.org.uk/consult/condocs/disagg/>

- 2.5 Ofcom sought stakeholder views on each of these areas with the intention of informing how Ofcom should seek to address issues of variations in competitive conditions, either through introducing geographic variations in remedies within the 2004 LLMR or through further analysis to be conducted in the next market review. Ofcom, after carefully considering all of the comments received in response to the discussion document, has concluded that it is more appropriate to consider these issues within the context of a full market review that considers both product and geographic dimensions. As such it intends to take this forward in the next market review, with a consultation on its proposals in the first half of 2007.

This document

- 2.6 This document, in Section 3, summarises the responses that Ofcom received from stakeholders to its discussion document. It also, where possible, gives Ofcom's response to those comments. However, in many cases, it is more appropriate for Ofcom to consider the issues further in the context of the market review and as such Ofcom intends to consider the main issues raised by respondents during that review. Section 4 sets out Ofcom's next steps for the forthcoming market review.

Section 3

Summary of responses and Ofcom's views

Introduction

- 3.1 Ofcom received seven non-confidential responses to its disaggregated markets discussion document. These responses were received from BT, Cable and Wireless (C&W), Colt, ntl:Telewest, Thus, Vodafone and the Welsh Assembly Government. In addition, Ofcom received one confidential response.
- 3.2 This Section summarises the main points from each of the non-confidential responses received, organised by the key themes of the discussion document, as set out in the Introduction. Where comments do not fit within these constituent parts, these are summarised at the end under "other issues". Where possible, Ofcom has also set out its view on the points raised, although in many cases Ofcom considers that particular issues are best addressed through the next market review.

Geographic market definition

- 3.3 There was broad agreement from respondents that commented on this issue that the traditional tools of market definition, in particular the use of demand-side and supply-side substitution analysis, were not appropriate when defining the scope of geographic markets for leased lines products. Respondents agreed that such an approach would tend to lead to overly narrow markets being defined.
- 3.4 One respondent [Colt] also commented that it was important to consider the question of geographic market definition in the proper context and as such it is necessary to revisit the product market definitions prior to conducting an analysis to inform the geographic scope of the markets.
- 3.5 Other respondents [C&W and Thus] commented on the consumer (business) research that Ofcom commissioned to inform its analysis. These respondents criticised this research as being out of date in the way it was constructed, arguing that it did not sufficiently reflect market developments over recent years.

Ofcom's views

- 3.6 Ofcom continues to believe that the use of traditional market definition tools are not appropriate when defining geographic markets for leased lines products as these tend to lead to overly narrow markets being defined. Ofcom's analysis presented in the discussion document sought to identify those geographic areas of homogeneous competitive conditions and to use such an analytical framework as a means of identifying whether or not local geographic markets exist.
- 3.7 Ofcom agrees that when defining geographic markets that this should be carried out in the proper context and that it is important that the product markets are appropriately identified prior to undertaking the analysis. However, as set out above, the discussion document did not seek to define the precise boundaries of any geographic markets that may exist. The purpose of the discussion document was to present an analytical framework (and associated implementation issues) which Ofcom believed could be useful in informing the geographic scope of leased lines

markets in a future market review, or could be used to identify distinct geographic areas in which existing remedies could be varied.

- 3.8 As noted above, there have been significant market developments over recent years and to base geographic market definitions and market power assessments on previously defined product market definitions may lead to erroneous conclusions. In this light, Ofcom agrees with the comments received regarding the consumer research and will be conducting further consumer research to inform its market review analysis.
- 3.9 It is for these reasons that Ofcom is proposing to consider many of the issues raised in the discussion document and in the comments received from stakeholders in the context of a full market review to be carried out over the next year.

Ofcom's proposed analytical framework

- 3.10 Respondents generally welcomed, in principle, Ofcom's development of an evidence-based analytical framework to assess geographic markets for leased lines in the UK. However, none of the respondents which commented on Ofcom's proposed analytical framework fully agreed with Ofcom's approach. The following summarises the main comments made in relation to Ofcom's proposed analytical framework.

Use of SMP indicators

- 3.11 Ofcom, in its assessment of geographic variations in competitive conditions included in its analysis, indicators of market power. Three respondents [C&W, ntl:Telewest and Thus] raised concerns about Ofcom's use of SMP indicators to inform questions about market definition. C&W saw Ofcom's approach as a fundamental problem. However, while C&W did not accept such an approach, it argued that if such an approach were to be adopted then Ofcom should also incorporate a consideration of economies of scale, scope and density into its analysis.

Ofcom's view

- 3.12 In defining the scope of geographic markets on the basis of the homogeneity of competitive conditions (as opposed to demand-side and supply-side substitution) it is necessary to include indicators of market power in the analysis. Precisely which indicators should be used to define the scope of the market is open to debate, but the presence of economies of scale, scope and density are reflected in some of the indicators used by Ofcom e.g. the network reach analysis. Ofcom, in the forthcoming market review will revisit its analytical framework for defining the geographic scope of the relevant markets, including an assessment of the relevant factors to be included in this stage of the analysis.

Use of postal sectors

- 3.13 Ofcom, in assessing geographic variations in competitive conditions considered a number of geographic units as the basis for conducting its analysis and concluded that postal sectors were the most appropriate geographic unit from which to conduct analysis and from which to aggregate into broader geographic areas. C&W argued that this geographic unit is irrelevant and bears no relationship with how operators consider investment decisions. Further, this geographic unit bears no relationship with BT's cost data, which could pose implementation/ enforcement issues in the event of local geographic markets being defined and remedies being imposed on a sub-national basis. Vodafone commented that there is a general issue around the

definition of local geographic market boundaries when there is a circuit that spans the boundary. In particular it is unclear in which market such a circuit would fall.

Ofcom's view

- 3.14 Ofcom recognises C&W's argument, but notes that postal sectors were used solely as a geographic unit from which broader geographic markets could be aggregated. Ofcom continues to believe that this geographic unit could be an appropriate basis from which to conduct analysis and define geographic markets. However, as noted in the discussion document, there are alternatives and Ofcom will be considering the merits of these alternatives in the forthcoming market review. The choice of geographic unit needs to find an appropriate balance between sufficient granularity (to capture any potential differences in competitive conditions) whilst being practical to analyse. Ofcom also agrees with Vodafone that the definition of the boundary of geographic markets needs to take account of the issue of circuits which span market boundaries.

Network reach analysis

- 3.15 Ofcom proposed using network reach analysis, including assumptions about appropriate build distances, to inform its assessment of geographic variations in competitive conditions. BT, in its response urged Ofcom to concentrate on developing its network reach analysis to inform the boundaries of local geographic markets. BT was concerned that if the other approaches suggested in the discussion document are progressed further then these may have the effect of delaying conclusions on these important questions, with the result that certain local geographic markets would be subject to inappropriate regulation for longer than is necessary. BT put forward two main arguments why the network reach analysis should be the focus of Ofcom's analytical framework:
- the product markets being considered are mainly wholesale; and
 - geographic variations in competitive conditions will reflect competitors' network build.
- 3.16 BT argued that this approach is the one for which data is most readily available, which means that conclusions can be reached more quickly than the other potential approaches and only need rely on a relatively limited set of further assumptions.
- 3.17 However, BT believed that Ofcom needs to revisit a number of its assumptions. In particular, BT argued that network reach analysis should be based on an analysis of operators' fibre infrastructure and not network points of presence (PoPs). C&W also argued a similar point, stating that it is its "flex points" which are the appropriate geographic point from which build-buy decisions are made. However, C&W believed that each operator will have subtly different definitions of their build points. As such it is important that Ofcom ensures that operators understand what information Ofcom is requesting.
- 3.18 At a more detailed level, BT argued that the relevant assumptions for assessing network reach would be to assume a build distance of 300m from an operator's fibre network (rather than conducting the analysis from operators' PoPs); that sites employing 250 employees should be used; and that areas identified as separate geographic markets would be those where there are two or more operators present, in addition to BT.

- 3.19 On the other-hand, some other respondents [C&W, ntl:Telewest] were concerned that Ofcom's assumptions about build distances significantly over-estimated the distance that an operator would build to (ntl:Telewest suggested that a 20m to 100m build distance was a more realistic assumption). There were also concerns that, in practice, build distances would vary by geographic location and by operator and as such, using a national average across all operators would likely lead to misleading conclusions. Therefore it was important that Ofcom collect operator-specific data if it is to progress with this analysis. Linked to this was a concern that Ofcom's proposed approach did not sufficiently reflect operators' target customers, which might vary between operators and/or geographically and this could impact on which services were offered in certain geographic locations.
- 3.20 Related to this latter comment, ntl:Telewest argued that if operators' network reach is being used to inform market boundaries then Ofcom will need to assess the impact of different operators' presence on prices and not only assume that with a greater number of competitors, there is sufficient difference in competitive conditions to either vary remedies within a national market, or to define local geographic markets.
- 3.21 Other respondents [C&W] argued that it was important to ensure that any network reach analysis was sufficiently forward-looking. This includes recognising that operators may have historically made build decisions which are now being revisited, with network being removed. It should also include the impact of developments such as NGNs on network reach.

Ofcom's view

- 3.22 Ofcom continues to agree that network reach analysis can be a useful indicator of geographic variations in competitive conditions and as such can inform the definition of the boundary of the geographic market. However, Ofcom also considers that other indicators can also be informative of geographic variations in competitive conditions, in particular in informing how such variations may change and so inform a forward-look of the market definition. In the forthcoming market review, Ofcom will consider how best to analyse such variation in competitive conditions, taking into account issues such as the availability and reliability of information on which to base its analysis. Ofcom will also have to further consider what the relevant assumptions are regarding build distances and will seek further evidence to inform this issue.

Service share analysis

- 3.23 Ofcom also conducted an analysis of operators' service shares, on a postal sector basis, to inform its assessment of geographic variations in competitive conditions. BT argued that the use of service share analysis can only be used to inform whether retail regulation is necessary, but that it is not informative of competition at the wholesale level as variations in competitive conditions at the retail level may be due to the imposition of wholesale remedies. For the wholesale markets, BT highlighted that Ofcom had difficulty carrying out its intended service share analysis because of a lack of wholesale data from alternative operators. BT argued that this weakness undermines using this approach to assess geographic variations in competitive conditions in the various wholesale markets.
- 3.24 Other respondents [C&W, ntl:Telewest] argued that Ofcom's service share analysis was less informative of variations in competitive conditions than some form of network reach analysis. ntl:Telewest also argued that the use of service shares does not include a forward-looking element.

Ofcom's view

- 3.25 As noted in the discussion document, Ofcom also believes that the use of service shares analysis is of limited use in identifying geographic variations in competitive conditions. However, such analysis can be a useful indicator of markets where there is little significant geographic variations in competitive conditions, such as for the wholesale low bandwidth TISBO market. The service share analysis for this market indicated broadly uniform market outcomes, whereas relying solely on the network reach analysis may have led to a conclusion of there being significant geographic variations in competitive conditions.
- 3.26 A further relevant consideration is that markets should be defined absent regulation at the level being considered. However, the retail market shares reflect the presence of wholesale remedies that are currently in place. As such, retail service share analysis is likely to overstate the competitive constraint that is present at the wholesale level and is a further reason why Ofcom believes that the use of service shares analysis is of limited use in identifying geographic variations in competitive conditions.

Trunk analysis

- 3.27 BT was critical of Ofcom's analysis of geographic variations in competition in the provision of wholesale trunk segments. BT does not believe that Ofcom's approach properly reflects the competitive constraints that may exist on a particular trunk route. BT further argued that Ofcom's analysis of BT's retail shares of individual trunk routes indicates that, in particular, BT faces strong competition in those routes to and from central London. However, BT does not believe that it is possible to conduct an accurate analysis of wholesale trunk shares unless Ofcom is able to obtain much more accurate data from operators.
- 3.28 C&W commented that Ofcom's network reach analysis needs to be revisited, in particular to reflect operators' customer density at each end of individual trunk routes.

Ofcom's view

- 3.29 Ofcom believes that it needs to develop further its analysis of wholesale trunk markets in order to understand better on which routes there are variations in competitive conditions. Ofcom will undertake this work in the forthcoming market review.

Statistical analysis

- 3.30 Ofcom conducted various statistical analyses to inform its assessment of geographic variations in competitive conditions. BT does not have confidence that the use of statistical analysis, as presented in the discussion document, can be refined to a sufficient extent such that it can be used to inform whether there are geographic variations in competitive conditions.
- 3.31 C&W argued that while this analysis could be useful for providing a forward-looking element, it would not be possible to incorporate to a sufficient extent the factors that explain demand for leased lines and as such this approach should not be relied upon.

Ofcom's view

- 3.32 As noted in the discussion document, Ofcom believed that the statistical analysis had a limited role in identifying areas of geographic variations in competitive conditions. However, Ofcom, in the forthcoming market review will consider if and how it can improve its analysis in this area.

Alternative analytical framework

- 3.33 Two respondents [Colt and C&W] proposed alternative analytical frameworks for assessing whether there are geographic variations in competitive conditions in the leased lines product markets. Colt suggested a three part analysis. First to use analysis similar to Ofcom's statistical analysis to understand the underlying drivers of demand and supply. Second, determine how many different types of competitive area there are likely to be and identify where these are. Third, focus on those areas which are likely to be able to support effective competition, ideally on a building-by-building basis (even if only on a sample basis).
- 3.34 C&W provided a preliminary attempt at an analytical framework for defining geographic markets in leased lines. C&W proposed as a starting point the public policy objectives of Ofcom, which would be the best deal for consumers, delivered through competition, wherever possible. On the demand-side C&W argued that it is necessary to understand retail demand patterns, including whether consumers require services provided in multiple geographic areas. It noted that some customers will require multi-site services and some customers may only be willing to take supply from a single supplier. If this is the case then this could indicate that there is a national market.

Ofcom's view

- 3.35 Ofcom's forthcoming market review will consider further the appropriate analytical framework for assessing geographic variations in competitive conditions for the purposes of defining the geographic boundary of the relevant markets. In the market review, Ofcom will assess its proposed analytical framework included in the discussion document and consider it in light of the comments received.

Application of the analytical framework

Variations in competitive conditions

- 3.36 BT agreed with Ofcom's conclusions from the application of the analytical framework that there was evidence of geographic variations in competitive conditions for the wholesale high bandwidth TISBO market, the wholesale AISBO market and possibly also for the wholesale trunk segments market.
- 3.37 Other respondents that commented on this issue also broadly agreed that the analysis suggested that there were geographic variations in these markets. However, Colt suggested that because of data integrity issues, the conclusions could be erroneous. Colt also warned that the geographic variations currently visible in the market may erode over time with BT's introduction of 21CN.
- 3.38 C&W disagreed with Ofcom's conclusions with regard to the wholesale high bandwidth TISBO, the wholesale AISBO and the wholesale trunk segments markets. C&W believes that there is a national geographic market for these products and the potential for sustainable competition is uniform across these national markets.

Ofcom's view

- 3.39 As noted in the discussion document, it was Ofcom's view that the analysis suggested possible geographic variations in competitive conditions for the wholesale high bandwidth TISBO market, the wholesale AISBO market and possibly also for the wholesale trunk segments market. However, Ofcom's forthcoming market review will revisit this question in reference to updated product market definitions.

Analysis of supply-side and demand-side factors

- 3.40 ntl:Telwest argued that Ofcom's analytical framework relies too much on supply-side factors when assessing geographic variations in competitive conditions and as such does not take into account the effect of barriers to switching. This respondent argued that if such barriers to switching were taken into account, then different conclusions on geographic variations in competitive conditions for those product markets could be reached.
- 3.41 ntl:Telwest also argued that Ofcom had not identified or fully assessed the competitive constraints that network operators are able to place on each other and as such any future analysis of supply-side factors needs to be more robust, but that this should be considered in conjunction with demand-side factors and BT's pricing policies.
- 3.42 Other respondents [Colt, C&W, Thus] also argued that Ofcom needs to take care when basing its analysis on supply-side factors. These operators cautioned that even in geographic areas where there is infrastructure from alternative operators present, this does not necessarily imply that there is alternative supply available in those areas. This could be because operators are supplying traditional interface circuits less than previously; focussing on alternative circuits and as such may not act as an effective constraint in the traditional interface market.
- 3.43 These respondents also re-iterated the point that economic build distances will vary by operator and by products. As such, Ofcom should not rely on average build distances in its analysis. C&W also suggested that further research should be conducted to inform the number of operators that would provide a sufficiently different competitive constraint to support the definition of local geographic markets.
- 3.44 Thus argued that operators' data appeared to be inconsistent and that Ofcom should take care when relying on such data to inform its network reach analysis. Moreover, this respondent argued that capacity constraints may mean that operators in a particular geographic area are unable to provide services to all customers within an area. C&W argued that in assessing geographic variations in competitive conditions it is also important to assess the sustainability of the operators present in the market e.g. whether competitors are able to benefit from sufficient cost economies.
- 3.45 ntl:Telewest argued that while there may be differences in supply-side conditions in different geographic areas, this does not necessarily lead to a requirement for geographically differentiated remedies. In particular, Ofcom needs to consider the full implications of local markets before varying remedies on a geographic basis. This respondent also argued that in any case Ofcom's analysis is not sufficiently robust to allow the drawing of geographic market boundaries. ntl:Telewest also argued that Ofcom's analytical framework did not take into account the location of demand, in particular where customers' demand is spread over different geographic locations, but where in some of these areas there is limited operator presence. In one location there may appear to be many alternative sources of supply, but in others it would be

much more limited. Such a customer would therefore be limited in its choice of operator, even in the geographic areas where there appears to be more choice available.

Ofcom's view

- 3.46 Ofcom believes that supply-side factors are important when assessing geographic variations in competitive conditions when defining geographic markets and recognises that when considering supply-side factors it is important that the analysis correctly identifies the competitive constraints that exist. Ofcom also believes that it is appropriate to consider the supply-side in conjunction with relevant demand-side factors, which could include barriers to switching and national buying patterns.

Aggregation of areas into geographic markets

- 3.47 A number of respondents [Thus, C&W] were concerned about the presence of “black holes” whereby there are geographic areas within postal sectors which do not share sufficiently similar competitive conditions but which are included within the same geographic market. This means that there will be consumers within local markets that will potentially be subject to inappropriate levels of regulation. C&W suggested that occurrence of black holes could be minimised through carrying out a building-by-building analysis. Thus argued that the detrimental impact of the introduction of black holes would be much greater than any detrimental commercial impact on BT from implementing national remedies.
- 3.48 Colt argued that the aggregation of distinct geographic areas into markets should be conducted on the basis of cost-benefit analysis, but recognised that practical considerations could also be relevant. ntl:Telewest argued that none of the approaches Ofcom suggested for aggregating geographic areas into markets were particularly robust. ntl:Telewest also stated that demand-side factors were relevant, but highlighted that Ofcom was proposing to rely on supply-side factors for the purposes of aggregation.
- 3.49 BT's view was that a final decision on aggregating areas could only be made in light of understanding how remedies would be varied on a geographic basis and explained in greater detail. However, BT's initial view was that some aggregation based on BT's exchange areas was likely to offer the best practical means of defining a boundary.

Ofcom's view

- 3.50 Ofcom recognises that when aggregating geographic areas the presence of black holes is an important issue and that any definition of geographic markets should seek to take account of the risk of these. This issue was one of the main reasons that Ofcom used postal sectors as the geographic unit on which it based its analysis. However, the risk of black holes needs to be weighed against the imposition of inappropriate remedies, including the imposition of remedies in areas where there is effective competition. Ofcom, in the forthcoming market review will be considering these responses in developing its analytical framework for geographic market definition.

Varying remedies within a national market

- 3.51 The majority of respondents did not support an outcome of varying remedies within a national market. However, BT did support the variations of remedies within a national

market, although its preference would be for separate geographic markets to be defined, SMP assessed in those markets and appropriate regulations set to address SMP where this is identified.

- 3.52 BT believes that if remedies are to be varied within a national market then the degree of variation of regulation should be greater than that set out in the discussion document. In particular BT argued that in certain geographic areas it would be appropriate to remove: the requirements to publish a reference offer; to notify charges and terms and conditions; and not to unduly discriminate; and the cost orientation and charge control conditions.
- 3.53 In terms of trunk routes, BT argued that the reasons given by Ofcom for not varying remedies on those routes identified as being more competitive are insufficient and that deregulation would make the UK consistent with a number of Member States, which have varied trunk remedies on a route-by-route basis.

Ofcom's view

- 3.54 Ofcom, after considering the responses to the discussion document, believes that the issue of varying remedies on a geographic basis should be addressed as part of a full market review, in the context of more up to date product market definitions, which can help ensure an appropriately forward-looking assessment of potential competition problems. This approach will ensure that the imposition of remedies will be considered with as full as possible an understanding of the competition problems that may exist.

Other issues raised in responses to the discussion document

- 3.55 A number of respondents raised issues that were not explicitly addressed in the discussion document. These were:
- the need for a cost-benefit analysis;
 - potential competition issues;
 - the need for consultation/ stakeholder engagement;
 - the relationship of the regulatory framework with other relevant frameworks; and
 - the introduction of NGNs.

The need for cost-benefit analysis

- 3.56 A number of respondents [Colt, C&W, ntl:Telewest] argued that any move to local geographic markets and disaggregated regulation must be supported by a full cost-benefit analysis. These respondents argued that the introduction of local geographic markets and disaggregated regulations should only be introduced if the benefits to citizens and consumers can be shown to outweigh the potentially significant costs that might arise. Colt further suggested that Ofcom should provide examples of how a relaxation of remedies in certain geographic locations would benefit the market and consumers.
- 3.57 C&W's view was that a move towards local geographic markets and disaggregated regulation would impose considerable costs on operators and on Ofcom. These costs would arise from assessing markets, imposing and policing remedies and the need

for operators to interconnect with each other. C&W stated that ultimately these costs will need to be borne by the end user and as such it would be important that the benefits from such a change outweighed the associated costs.

Ofcom's view

- 3.58 It is not necessary, or appropriate, to conduct an Impact Assessment on the question of market definition. The definition of the relevant markets, both in terms of product and geographic market definition, will be made in light of analysis of the available facts. If the available evidence and analysis shows that local geographic markets exist, Ofcom is obliged to define the geographic scope of the markets as local. However, where the assessment of market power concludes that an operator has SMP in each of the defined local markets, then an Impact Assessment is useful to inform the extent to which locally differentiated remedies are appropriate. In this circumstance, Ofcom's Impact Assessment would assess the relevant costs and benefits of imposing geographically differentiated or uniform remedies.
- 3.59 However, if there is a local geographic market where no operator is found to have SMP, Ofcom would not be able to impose any remedies in this market. This decision could not be informed by an Impact Assessment.

Potential competition issues

- 3.60 A number of respondents [Colt, C&W, ntl:Telewest, Thus, Vodafone] commented that if local geographic markets are defined and differential remedies introduced, it could increase the possibility of BT acting anti-competitively. In particular, the issue of horizontal leverage between geographic markets was of concern. In relation to this there were questions about the operation of accounting separation obligations, the policing of product bundles that span multiple geographic markets (in particular SMP and non-SMP areas) and the regulation of non-price issues e.g. SLAs. Thus argued that there is little scope for operators to interconnect with each other. Vodafone argued that geographically differentiated remedies could lead to BT price discriminating, charging higher prices in those geographic areas where there is less competition, leading to an increase in BT's overall return, which would not be in the interests of consumers.
- 3.61 C&W argued that the introduction of geographically differentiated remedies would likely lead to re-monopolisation of the market, due to factors such as economies of density which would allow BT to price below the cost of its competitors, even if it were to price above its own costs. ntl:Telewest also argued that the introduction of geographically differentiated remedies could introduce perverse incentives on BT, which may seek to encourage entry in certain geographic areas in order that it would be found to have no SMP (and be deregulated) at some point in the future, but then act anti-competitively in the future. ntl:Telewest suggests that these dynamics could lead to efficient entry being deferred.

Ofcom's view

- 3.62 Ofcom recognises that where local geographic markets exist there could remain scope for an SMP operator in one local market to leverage market power into adjacent local markets where it may not have SMP. However, it should be possible for remedies to be imposed in the SMP markets to address such leveraging. Ofcom will be considering these issues as part of the forthcoming market review.

- 3.63 To the extent that an operator benefits from economies of scope across geographic markets, then this may act to undermine the competitive constraint that competitors can exert in more competitive markets, increasing the probability that SMP will be found in all geographic markets. As such, it will be important to reflect such dynamics in market power assessments in the forthcoming market review.

The need for consultation/ stakeholder engagement

- 3.64 Colt commented that the issue of local geographic markets in the provision of leased lines services is complex and as such Ofcom needs to ensure that there is full transparency in order that all relevant stakeholders understand the issues and the implications of any changes. Colt suggested that in order to engage industry further and to ensure that future analysis is as informed as possible it may be worthwhile to hold workshops or indeed to form an industry working group.

Ofcom's view

- 3.65 Ofcom agrees that it is important that stakeholders are aware of the potential implications of local geographic markets being defined in the forthcoming market review. As such, Ofcom will seek to engage with stakeholders to ensure that they understand Ofcom's proposals.

The relationship of the regulatory framework with other relevant frameworks

- 3.66 Colt requested that Ofcom give a clearer explanation of the relationship between the definition of geographic markets the European Regulatory Framework and the definition under general competition law e.g. the Competition Act 1998. Specifically Colt asked whether a Competition Act case would be required to define the geographic market to be the same as that defined under the European Regulatory Framework and whether the dominance finding would be the same.
- 3.67 There was also a request from Colt for the relationship with BT's Enterprise Act Undertakings to be explained and how the definition of local geographic markets would impact on those. C&W also argued that introducing geographically differentiated remedies at this time, while Openreach is becoming established will risk BT diverting its resources away from implementing its Undertakings fully. C&W also argued that other market developments, such as the establishment of TILLAPs, TILLBPs, WES A, WES B and WEES, mean that such a regulatory change is untimely.

Ofcom's view

- 3.68 The European Regulatory Framework requires that markets be defined and market power assessed consistent with competition law principles. As such, it may be expected that both market definitions and SMP findings under the European Regulatory Framework would be the same as that under general competition law. However, the former requires markets to be defined ex-ante, while the latter requires them to be defined ex-post. This is reflective of the different objectives of a market review under the European Regulatory Framework (namely to consider the need for regulatory remedies) whereas competition law is concerned with potential abuse of a dominant position or anti-competitive practices. As such, there could be legitimate reasons why market definitions and market power findings under the two regimes may not always be identical. A market determination carried out under the regime of the European Regulatory Framework is, therefore, without prejudice to any economic analysis that may be carried out in relation to any investigation or decision pursuant

to the Competition Act 1998 (relating to the application of the Chapter I or II prohibitions or Article 81 or 81 of the EC Treaty) or the Enterprise Act 2002.

- 3.69 In terms of BT's Enterprise Act Undertakings, there are certain Undertakings which apply to SMP products and these could be affected depending on if and how the market definitions change as a result of the forthcoming market review and whether BT is found to have SMP in those markets. Nevertheless, where they exist, BT will continue to be obliged to comply with its Undertakings and relevant SMP conditions.

The introduction of NGNs

- 3.70 Colt argued that the increased deployment of NGNs may affect the competitiveness of the markets considered and as such may alter the outcome of the analysis of competitive conditions. In particular, Colt raised the issue of the wholesale alternative interface markets potentially experiencing a reduction in competitiveness as BT introduces its 21CN.

Ofcom's view

- 3.71 Ofcom, in the forthcoming market review will need to take into account the deployment of NGNs in its definition of the relevant markets, assessment of market power and imposition of remedies.

Section 4

Next steps

Introduction

- 4.1 Ofcom has begun work on its next review of the various markets included in the 2004 LLMR. This includes undertaking analysis of recent market developments to understand what the impacts may be on the various product markets defined in the LLMR. Ofcom has commissioned a survey of business telecommunications customers and will also be sending information requests to operators. The data received from these work streams will be used by Ofcom to inform its analysis of the various product markets.
- 4.2 As part of the forthcoming market review, Ofcom will also undertake analysis of the geographic dimension of the markets. This will include assessing how it can refine its analytical framework to take on board comments received in response to the discussion document. This may involve the collection of detailed geographic data from operators. However, Ofcom recognises that the collection of such data used to inform the analysis included in the discussion document imposed a significant burden on operators. As such, Ofcom will seek to minimise the burden of any information request, while balancing this against the need to have available sufficient information in order to come to well informed and appropriate conclusions. Ofcom envisages requesting this data in the first months of 2007.

Industry engagement

- 4.3 Since publication of the discussion document, Ofcom has sought to engage with operators on issues relating to geographic market definition and also more widely on issues relating to recent and anticipated market developments. Ofcom has found this engagement helpful in informing its understanding of the relevant markets. In order to ensure that operators are fully aware of Ofcom's approach to the market review, Ofcom would welcome requests from operators for further meetings to discuss relevant issues. This will also help to ensure that Ofcom fully understands operators' views and can build these into its approach for the market review.