



# Regulation of Business Retail Markets

## **Consultation**

Publication date: **7 September 2005**

Closing Date for Responses: **16 November 2005**



# Contents

Section	Page
1 Summary	1
2 Introduction	3
3 Research Findings	8
4 Replicability and competition concerns	18
5 Application of deregulatory initiatives across the business market	25
6 Summary of proposals and options, and next steps	27
 Annex	 Page
1 Responding to this consultation	30
2 Ofcom's consultation principles	32
3 Consultation response cover sheet	33
4 Consultation questions	35
5 Impact assessment	36
6 Retail markets in which BT has SMP and where Ofcom proposes to grant conditional consent to departures from the published price list	39
7 SMP conditions which presently apply to BT in the markets listed in annex 640	

## Section 1

# Summary

- 1.1 In its Statement dated 23 June 2005 about the Strategic Review of Telecommunications, Ofcom reported that it would look again at scope for deregulation of services supplied to business customers where replicability provides the ability for rivals to replicate BT's own retail offerings.
- 1.2 This document considers whether, if BT's retail business exchange line services and business inland call services are now capable of being replicated by competitors using BT's Wholesale Line Rental and Carrier Pre-Selection services, BT should be permitted to compete by offering unpublished bespoke prices. Currently, BT is prohibited from departing from its published prices. While this consultation document focuses exclusively on BT, it is likely that the same principles should be applied to Kingston, which is subject to similar conditions in business retail markets. The replicability of Kingston's retail services in the Hull area has not, however, been assessed.
- 1.3 Where an SMP supplier, such as BT, is not obliged to offer uniform prices to all broadly comparable customers, it may selectively cut the prices which it offers to customers for which it faces a degree of competition, while maintaining high prices in areas of weak or non-existent competition. Smaller competitors may find it very difficult to compete and market entry may be foreclosed. Acceptance of this outcome is unlikely to be consistent with Ofcom's statutory duty to promote competition. Ex ante conditions can address this concern by prohibiting the dominant provider from offering targeted prices.
- 1.4 If, however, competitors are able to replicate BT's retail services in all or most parts of a market, by relying on the use of BT's wholesale services, then the scope for BT to target selective price cuts in a way which would damage competition may be much reduced. This is because attempts to raise prices in order to recover a high proportion of costs in areas of low or non-existent competition, while reducing prices in areas of stronger competition, could be matched by other operators using fit-for-purpose wholesale products. In these circumstances it may no longer be necessary to prohibit BT from offering bespoke retail prices, as the competition enabled by replicability may be sufficient to prevent excessive variations in prices which could foreclose market entry. Customers would then benefit from BT's ability to offer bespoke prices and services in response to specific needs, and from competitors' renewed vigour in competing with BT in an environment where the level of any bid which may be offered by BT is more difficult to predict.
- 1.5 In these circumstances, it might be open to Ofcom to conclude either (i) that retail regulation is no longer justified as it is sufficient to rely on upstream wholesale regulation and/or competition law or (ii) that ex ante retail regulation should be retained in a modified form which reflects the ameliorating effects of replicability but which enables Ofcom to promote competition by ensuring that competition is allowed to become more robustly established before removing ex ante regulation. Under the second approach Ofcom might consent to BT departing from published prices, but only where BT observes specified price floors. Either of these approaches might be applied to the entire business retail sector or might be limited to a subset, such as a defined group of high spending business users.

- 1.6 On 20 July 2005 Ofcom published a consultation document "[The replicability of BT's regulated retail business services](#)" in which it considered whether the Carrier Pre Selection, Wholesale Line Rental and Partial Private Circuits wholesale services offered by BT are now fit for purpose and enable business inland calls, business exchange lines and low bandwidth leased lines respectively to be replicated by BT's competitors. That document also stated that, if and when business calls and exchange lines become replicable then, as had been concluded in the May 2004 statement "[BT's pricing of services for business customers](#)", BT should be permitted to offer discounted bundles which include these services, provided that prices for these bundles are published and made available to all broadly comparable customers, and provided that the bundle price meets certain economic tests. Ofcom has invited interested parties to comment by 30 September 2005 on whether business inland calls, business exchange lines and low bandwidth leased lines are now replicable.
- 1.7 The present consultation document should be read in the light of the detailed consideration of replicability contained in the July 2005 consultation referred to in the preceding paragraph, and is intended to establish an appropriate strategy for phased withdrawal from ex ante regulation of retail business markets (beyond any decision to allow BT to offer published discounts for service bundles which include services from markets where BT has SMP). This document does not consider allowing BT to offer unpublished bespoke prices for low bandwidth leased lines, as Ofcom is required by the Universal Service Directive to impose certain conditions in this market for as long as BT retains SMP.
- 1.8 This document sets out Ofcom's preliminary view as follows:
- Where replicability is feasible, BT should be permitted to offer bespoke prices not necessarily available to all comparable customers
  - Bespoke prices should not fall below a price floor which covers transfer charges for network components plus fully allocated retail costs.
  - BT should not be obliged to publish bespoke prices, as this may mute competition by making it easier for competitors to predict BT's sales strategy.
  - BT would be expected to assess each bespoke price for compliance with the Competition Act and any ex ante safeguard tests, and to demonstrate that it has adequate management systems to ensure such compliance.
  - These principles can equally be applied to prices offered to larger and smaller businesses but, as a precautionary measure, should initially be limited to prices offered to customers spending more than £1m per year with BT, until BT's management systems have been adequately tested.
- 1.9 Interested parties are invited to comment on the proposals in this consultation document by 16 November 2005.

## Section 2

# Introduction

- 2.1 The Universal Service Directive provides for National Regulatory Authorities (“NRAs”) such as Ofcom to impose ex ante conditions on providers with Significant Market Power (“SMP”) in retail markets, but only where the NRA is unable to achieve the objectives set out in Article 8 of the Framework Directive by setting access-related conditions or SMP conditions in wholesale markets. These Article 8 duties include the promotion of competition and the promotion of the interest of citizens. As a competitive market will produce a more efficient outcome than a regulated market, the promotion of competition is central to Ofcom’s goal of securing the best deal for the consumer in terms of quality, choice and value for money. For these legal and strategic reasons, Ofcom is obliged to pay close attention to whether existing regulation of retail markets remains appropriate, irrespective of whether, for example, market shares might strongly suggest that one or more provider still has SMP.
- 2.2 Article 18 of the Universal Service Directive, as implemented by Section 92 of the Communications Act 2003 (“the Act”), however, imposes additional duties on NRAs in respect of “the minimum set of leased lines”. The minimum set was defined in Commission Decision 2003/548/EC dated 24 July 2003 as digital leased lines of bandwidth 64 Kbit/s and 2Mbit/s and certain 2 and 4 wire analogue leased lines. Where an NRA has concluded that a provider has SMP in respect of the supply of any part of the minimum set, it is obliged to impose conditions in accordance with Annex VII to the Directive. These conditions include provisions relating to discrimination, cost orientation, transparency and tariffs. The obligation to impose these conditions is not subject to a test of whether by setting conditions in upstream wholesale markets alone the NRA can meet its duties under Article 8 of the Framework Directive, as implemented by Section 4 of the Act, such as the duties to promote competition or the interests of citizens. Ofcom is currently constrained, therefore, in its ability to withdraw from, or significantly lighten, regulation in respect of retail low bandwidth leased lines while BT retains SMP.
- 2.3 It should be noted that even if BT is permitted to offer unpublished bespoke prices, it would remain obliged, under Condition 10 of the General Conditions of Entitlement which apply to all providers, to publish its standard prices for all Publicly Available Telephone Services, which services include business retail exchange lines and inland calls (but not retail leased lines). The general obligation to publish prices explicitly excludes bespoke prices and individual prices and tariffs.

## Regulation of BT today

- 2.4 BT has been designated as having SMP in the retail markets for the supply of exchange line service (analogue, ISDN2 and ISDN30) and inland calls to business users (and also in the markets for the supply of low bandwidth leased lines). A full list of these markets is contained in Annex 6.
- 2.5 In the markets for business exchange lines and business inland calls BT is presently subject to SMP conditions relating to price publication and undue discrimination. It is obliged to publish its charges, terms and conditions, and publish and notify to Ofcom any amendment within 24 hours of that amendment coming into force. BT is explicitly prohibited from departing from those published prices. The conditions relating to undue discrimination prohibit BT from unduly discriminating against particular

persons or classes of person in relation to the services offered. These conditions are attached at Annex 7.

- 2.6 Additional conditions apply to the retail leased lines market, reflecting the obligations imposed on NRAs by the Universal Service Directive to impose specific conditions.

### **The objective of this consultation document**

- 2.7 This consultation document considers whether, where competitors are able to replicate, technically and commercially, services in a business retail market where BT has been designated as having SMP, Ofcom should grant consent to BT to offering unpublished bespoke prices. The document considers the markets for supply of exchange line services and inland calls. It does not consider whether it should make similar changes to the conditions which relate to leased lines, as Ofcom does not have the power to withdraw or significantly amend the texts of these conditions or the way in which they are applied, without conducting a market review and finding that BT no longer has SMP. Ofcom will be consulting separately on the question of whether, in respect of retail leased lines, there is evidence that there are material variations in the strength of competitive in different geographical areas and, if so, whether Ofcom should conduct a market review.
- 2.8 Replicability will continue to be important, and any failure on BT's part to maintain the replicability of retail products would lead to the bundling of SMP products again being presumed by Ofcom to be unduly discriminatory.

### **Replicability**

- 2.9 Where a supplier with SMP, such as BT, is not obliged to offer uniform prices to all broadly comparable customers, it may selectively offer price cuts where it faces a degree of competition, while keeping prices high elsewhere. In these circumstances smaller competitors may find it very difficult to compete and market entry may be foreclosed as these competitors cannot offer selective price cuts in this way. Acceptance of this outcome is unlikely to be consistent with Ofcom's statutory duty to promote competition.
- 2.10 The electronic communications sector often faces very high common costs relative to incremental costs and, where competition is unevenly spread across a market, provides particularly powerful opportunities for a dominant player to recover those common costs disproportionately in areas of least competition. Ex ante conditions may be imposed to address this concern by prohibiting the dominant provider from offering targeted prices.
- 2.11 If, however, competitors are able to replicate BT's retail services in all or most parts of a market, by relying on the use of BT's wholesale services, then the scope for BT to recover a high proportion of common costs in areas of low or non existent competition, while reducing prices to incremental cost in areas of stronger competition, may be much reduced. This is because such replicability enables competitive pressure to be spread more evenly, making it more likely that competitors will be able to match BT's pricing behaviour. In these circumstances it may no longer be necessary to prohibit BT from offering bespoke retail prices, as the competition enabled by replicability may be sufficient to prevent excessive variations in prices which could foreclose market entry. Customers may then benefit from BT's ability to offer bespoke prices and services in response to specific needs.

- 2.12 On 20 July 2005 Ofcom published a consultation document “[The replicability of BT's regulated retail business services](#)” (the “Replicability Consultation”) in which it considered whether the Carrier Pre Selection, Wholesale Line Rental and Partial Private Circuits wholesale services offered by BT are now fit for purpose and enable business inland calls, business exchange lines and low bandwidth leased lines respectively to be replicated by BT's competitors. Ofcom has invited interested parties to comment by 30 September 2005 on whether business inland calls, business exchange line and low bandwidth leased lines are now replicable.

### **Possible reasons for changes to retail regulation**

#### **Reliance on wholesale regulation**

- 2.13 In addition to the requirements of European Directives to place reliance where possible on regulation of wholesale rather than retail markets, Ofcom's statement dated 23 June 2005 on its Telecoms Strategic Review also placed strong emphasis on the delivery of wholesale services which are intended to enable competition to develop in retail markets, and looked forward to a progressive loosening of the current complex and intrusive mesh of regulation as competition becomes increasingly effective.

#### **Pressure from business customers**

- 2.14 Furthermore, for several years, some of the UK's largest businesses, have lobbied Ofcom, and Oftel before it, to remove regulation which prevents BT from engaging with them to negotiate the price and other aspects of services in markets where BT has SMP. To an extent the situation was eased when the UK implemented the new European Directives in July 2003. One of the outcomes of the process to identify and review markets afresh was a significant narrowing of the scope of retail regulation to the core exchange lines, inland calls and low bandwidth leased lines services; under the old regime BT had been obliged to publish and adhere to standard prices for almost all telecommunications services. Nevertheless, regulation still prevents these customers from negotiating with BT in respect of exchange lines, inland calls and low bandwidth leased lines.

#### **Risk of regulation muting competition**

- 2.15 It has been claimed by BT that obligations to publish and adhere to standard prices may enable a degree of price following by competitors, resulting in a muting of competition. Ofcom recognises that greater uncertainty about the prices which a large competitor may offer is likely to stimulate other suppliers to compete more vigorously when bidding for business. This outcome would be advantageous to customers (provided that it did not result in failure of alternative providers, such that BT ceases to face effective competitive pressures).

#### **Changes to the way in which telecommunications services are purchased**

- 2.16 There is strong anecdotal evidence that telecommunications services are increasingly being purchased by larger businesses as part of a much wider IT requirement within which the telecommunications component, particularly that part which relates to legacy PSTN services, may be relatively small. Where BT, and other UK telecoms suppliers, are facing retail competition from large IT systems integrators at home and abroad, ex ante regulation which requires adherence to a standard published price list may have little value for customers or competitors and may serve only to impose a layer of bureaucracy on the way in which certain prices within the overall package are presented.



## Previous consideration of bespoke pricing

- 2.17 On 15 October 2003, Oftel published a consultation document "[BT's pricing of services for business customers](#)", ("Oftel's 2003 consultation") which considered possible changes to the regulatory constraints on BT's freedom to vary prices in business retail markets where it has SMP. The document was concerned with circumstances where, notwithstanding BT's SMP, competitors are able, technically and commercially, to replicate the services in that market. The document considered whether in these circumstances BT should be permitted to offer discounted prices (relative to published stand-alone prices) for bundles of business services where bundles include some services which are from markets where BT has SMP. The document also considered whether when responding to invitations to tender, there are additional arguments for allowing BT to offer unpublished, bespoke prices.
- 2.18 Ofcom concluded in the Statement [BT's Pricing of Services for Business Customers](#) published in May 2004 ("the May 2004 Statement") that, where retail services are replicable, BT should be permitted to offer discounted bundles of services which include services from markets where BT still has SMP, provided that prices for these bundles are published and made available to all broadly comparable customers. Such bundles would be required to pass a net revenue test and also an implicit price – cost test (under which non-SMP services would be treated as a single unit) to prevent anti competitive leverage of power from SMP to non SMP markets, and there would be a presumption, unless proved otherwise in each specific case, that saw tooth discounts are anti competitive. The document noted, however, that European Directives currently limit Ofcom's discretion to remove retail regulation in respect of the minimum set of leased lines, where SMP remains.
- 2.19 The May 2004 statement also concluded that contracts awarded after tendering could not reliably be distinguished from contracts awarded by other means, and, therefore, that regulation should not be applied in a way which relies on such a distinction: BT had proposed that regulation should be lightened where contracts are awarded after a process of tendering.
- 2.20 As is explained in paragraph 2.12 above, Ofcom is presently consulting on whether Wholesale Line Rental, Carrier Pre Selection and Partial Private Circuits enable BT's business exchange lines, business inland calls and low bandwidth leased line services to be replicated. That document explains that if these services are now replicable, Ofcom would no longer presume that the bundling of business exchange lines and inland calls with other services is unduly discriminatory, provided that certain tests are met.
- 2.21 BT has argued over the course of the last few years that Oftel/Ofcom should permit bespoke pricing in respect of services offered to large business customers, and should achieve this outcome either by defining an economic market for the supply of the generality of telecommunications services to business customers which spend in excess of a given amount per year (and by finding that market competitive), or by defining sub markets for the supply of specific services, such as calls or exchange lines, to larger business customers (and by finding those markets competitive). In its reviews of the relevant markets, concluded on 28 November 2003, Oftel decided that it was not appropriate at that time to define markets on either of those bases.

## Options for change

- 2.22 If Ofcom concludes that, in the presence of replicability, it should consent to BT offering some or all business customers unpublished bespoke prices for inland calls and exchange line services, Ofcom would need to consider four further issues:
- Firstly, whether BT should be required to respect particular price floors and whether other pricing parameters should be set to ensure that the ability to offer bespoke prices is not used to damage prospects for competition.
  - Secondly whether this facility should be limited to prices offered to particular classes of business customer or under particular circumstances
  - Thirdly, how the changes should be implemented; for example, by granting consent under the existing price publication condition or by amending or withdrawing the relevant condition(s).
  - Fourthly, what compliance and monitoring procedures should be implemented.
- 2.23 These questions, and the wider question about whether BT should be permitted to offer unpublished bespoke prices, are considered in sections 4 and 5 of this consultation document.

## Section 3

# Research Findings

## Background

- 3.1 As was explained in Section 2 above, BT has claimed, for several years, that competition to meet the telecoms needs of large business customers is markedly more intense than competition to supply medium size and small businesses. The term “large business” has not been defined, but has generally referred to the largest customers with multi-million pound annual telecoms expenditure. BT has also claimed that competition to supply certain industry segments, such as the financial services sector, is markedly more intense than competition to supply other segments. On this basis, BT has argued that Ofcom should remove, or lighten, regulation in respect of these parts of the various retail markets where BT still has SMP, more swiftly than in others parts.
- 3.2 The availability of wholesale services which enable BT's competitors to replicate BT's retail services is intended to improve prospects for retail competition to emerge; that is the subject of this consultation exercise. If competition to supply certain segments of the business markets is already markedly more intense than competition to supply other segments, it might be expected that replicability would further intensify that level of competition, and strengthen any arguments in favour of removing, or lightening regulation, in those segments. For these reasons, Ofcom has researched the views and behaviour of business customers with the objective of identifying differences between larger and smaller business users of telecoms services. Ofcom has also gathered data from BT and its competitors with a view to understanding whether competitive conditions to supply larger and smaller business customers are different.
- 3.3 If this research had found that competitive conditions do vary markedly between definable segments, it might have been appropriate to remove or lighten regulation in some segments more swiftly, or more slowly, than would otherwise be the case. However, the surveys of business users and the data gathered from suppliers do not indicate marked differences in market conditions or customer expectations between the supply of communications service to large businesses and smaller businesses.

## Data gathering

- 3.4 During April and May 2005, Ofcom conducted a formal information gathering exercise with BT and its competitors to attempt to understand whether there are significant differences in the strength of competition to supply services to different segments of the business community, be they larger or smaller companies, higher or lower spenders on telecoms services or companies which operate in a particular industry or service sector. Data gathered related to the volume and value of services supplied to different categories of business users, the value of business bid for and/or won through a process of tendering, and the overall value of all telecoms services supplied to business customer. The data requested was intended also to enable time-series analysis. Ofcom is unable to publish full details of the results of that exercise as almost all of the data was provided on a confidential basis.
- 3.5 Ofcom also gathered data from the following surveys of business users:

- 113 online interviews with telecoms decision makers in UK large businesses (251+ employees) via Ofcom's online panel, conducted by Continental Research;
  - 500 telephone interviews with telecoms decision makers within medium size businesses (51-250 employees), conducted by Continental Research;
  - 200 telephone interviews with telecoms decision makers/influencers in member companies of the Communications Management Association (CMA), conducted by Recom. 31% of respondents to the CMA survey work in organisations with more than 2500 employees.
- 3.6 The first two of these surveys contained questions about respondents' purchasing of telecommunications services, their use of different suppliers, the extent to which they use BT, the key criteria when selecting a supplier, switching, their experience and ability to negotiate with BT, and their views on the value of retail regulation. The purpose of these surveys was to attempt to detect any indications of variations between the behaviour of large and medium size business users in their purchasing of services from markets where BT has SMP. The third survey amplifies an annual survey of the CMA's membership and was intended to complement the first two surveys. The findings of these 3 surveys are summarised more fully in an Ofcom report available at <http://www.ofcom.org.uk/research/telecoms/reports/pricing.pdf>.

### **Basis of Ofcom's analysis**

- 3.7 In the following analyses which are intended to consider whether there is evidence of material differences between competitive conditions to supply larger and smaller business customers, Ofcom has grouped businesses as follows;
- Data supplied by communications providers and classified by customer spend threshold -
    - £1m+ per annum telecoms spend - "large" businesses;
    - under £1m per annum telecoms spend- other businesses.
  - Data supplied by business telecoms users is divided into the following categories by Ofcom:
    - "medium" size business users (51-250 employees); and
    - "large" businesses users (251+ employees).
- 3.8 These two approaches to defining "large" businesses are not directly comparable, in that an annual telecoms spend of £1m would typically be reported by the largest organisations with more than 5000 employees, rather than by those with around 250 employees (though, clearly, this will vary according to the nature of the business). Within the group of businesses with more than 250 employees, which were surveyed as representatives of the "large business" community, a small number reported total annual telecoms spend in excess of £1m. This subset was, indeed, strongly skewed towards companies with more than 5000 employees and annual turnover in excess of £500m. In other words these tended to be amongst the UK's biggest companies. This sample is too small to allow reliable analysis of the views and behaviour of this group. The market research analysis which follows is, therefore, limited to a comparison of the views and behaviour reported, on the one hand, by respondents to the survey of medium size businesses and, on the other hand, by respondents to the survey of large businesses (ie those with more than 250 employees).

## **Data gathering from providers of communications services to business users**

3.9 BT and 17 of its competitors were asked to supply Ofcom with market share data (by volume and value) relating to the following retail business products:

- exchange lines (analogue and digital);
- low bandwidth leased lines.
- inland calls

The data supplied was to be capable of being classified according to the customer's total annual telecoms spend with that supplier:

- <£100K;
- £100k - £500k;
- £500k to 1m;
- £1m to £5m;
- £5m to £10m; and
- >£10m.

and was also to be capable of analysis according to the industry sector in which the customer fell. Suppliers were also asked to report, broken down into the same categories by spend, on total billed revenue for telecoms services. Data was requested in respect of each of the 12-months periods ending between 1 January 2003 and 1 January 2005 (6-months periods in respect of total telecoms revenue).

3.10 Suppliers were also asked to report on the number of contracts bid for through a process of competitive tendering, and the proportion of these bids which resulted in the award of a contract. Suppliers were asked to provide this information broken down by industry sector of the prospective customer and the total value of business being bid for.

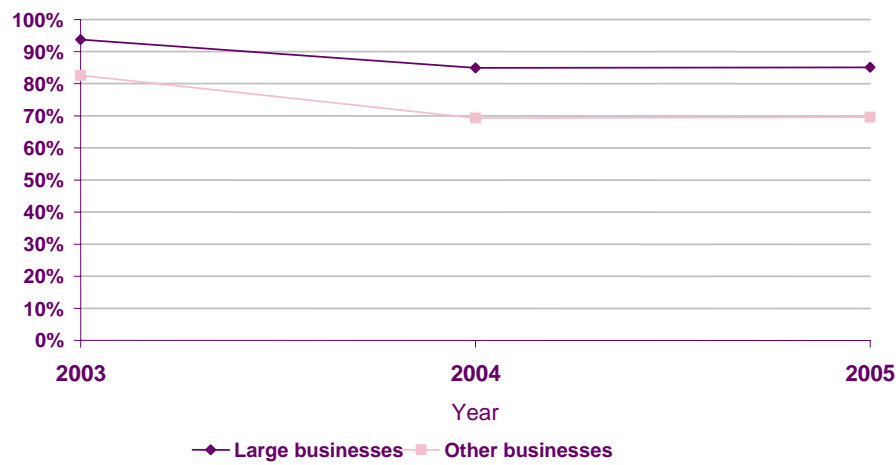
3.11 Some data was provided on a more consistent and comparable basis than other data. In particular, providers were more able to supply volume data than they were able to supply revenue data (many of BT's unregulated competitors were unable to apportion a specific value to particular services being supplied within a service bundle), and analysis according to the customer's total spend threshold tended to be more consistent than analysis based on the customer's industry sector (as suppliers do not all use the same sector classifications). Many suppliers also found it impossible to provide granular data about the nature of the customers supplied with inland calls. It was also clear that suppliers took very varied views of what constituted a tendered bid. Some providers were unable to provide full time-series analysis for the past 3 years.

3.12 All data provided by BT and its competitors was supplied on a confidential basis and Ofcom is not able to publish individual responses or aggregated data where this might enable any data relating to specific respondents to be identified.

## Market shares – exchange lines

3.13 The data supplied to Ofcom suggested that BT's share of the total volume of exchange lines supplied to businesses was approximately 75% at the end of 2004/05 (This data appears slightly to understate BT's share compared with routine data gathering by Ofcom's Market Intelligence team which does not attempt to disaggregate according to customer spend or industry sector; that data suggests a market share in excess of 80%). The Chart below divides this statistic over time, split into supply to large businesses and supply to other businesses, as defined by Ofcom and as outlined above.

BT's % share of exchanges lines (number of lines)



3.14 The chart above suggests that:

- BT's share of the total volume (number of lines) of exchange lines supplied to large business customers has declined, and is currently equal to about 85%; and
- BT's share of the total volume (number of lines) of exchange lines supplied to medium business customers has similarly declined in recent years, and is currently equal to about 70%;

3.15 Taken on its own, this data does not appear to support the contention that the supply of these products to the largest business customers is more competitive than supply to smaller business customers – in fact, BT's share of supply to large businesses appears to be somewhat higher than the average, and the rate of decline similar to that in respect of the rest.

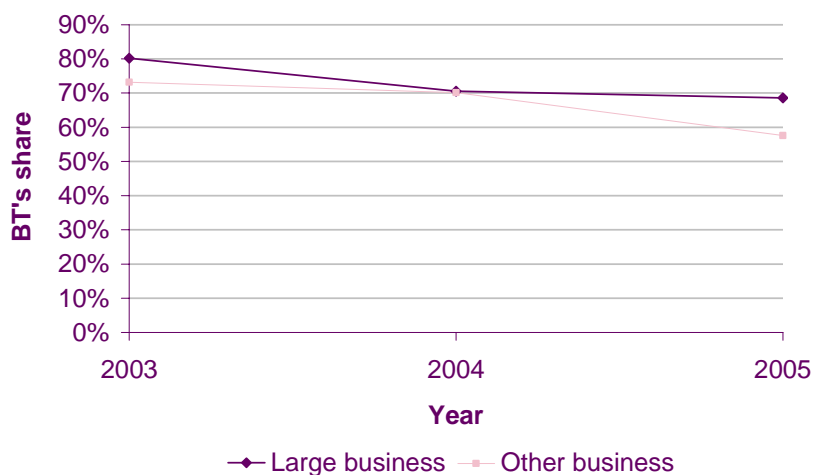
## Market shares – Inland calls

3.16 Many of BT's competitors for the supply of inland calls to business customers, particularly the larger and longer established competitors, were unable to provide granular data indicating the nature of the customers supplied with such calls, and

Ofcom is unable to assess whether BT's share is greater or smaller in respect of higher spending customers. Routine data collected by Ofcom's Market Intelligence team, which is not disaggregated according to customer type, indicates that BT's share of the overall market for supply of inland calls to business customers is just under 50%. Confidential data supplied by BT for the present consultation exercise fails to show marked differences in the speed or direction of change in the volume of inland call minutes supplied by BT to larger and smaller business customers. Of the three spending groups in excess of £1m per year which were defined by Ofcom in the data request (£1m to £5m, £5m to £10m, and over £10m), two showed little change over the 3 years analysed, and one showed a declining trend. The trend in respect of lower spending customers was generally down. Analysis by industry sector, similarly failed to show marked differences in trends.

### Market shares – low bandwidth leased lines

- 3.17 Although, as was explained in paragraph 2.7 above, this document does not consider whether Ofcom should allow BT to offer unpublished bespoke prices in respect of leased lines, for completeness Ofcom has gathered data about BT's share of this market. The industry data supplied to Ofcom specifically for this consultation exercise suggests that BT's share of the total volume (number of lines) of low bandwidth retail leased lines (at all such bandwidths) supplied to businesses was approximately 63% at the end of 2004/05. (This data appears to understate BT's share compared with routine data gathering by Ofcom's Market Intelligence team which does not attempt to disaggregate according to customer spend or industry sector; that data suggests a market share in excess of 70%). The Chart below presents this statistic over time, split into lines supplied to large businesses (£1m+ per annum spend on telecoms) and to other businesses (under £1m per annum spend on telecoms) as outlined above.



- 3.18 The chart above indicates that:

- BT's share of the total volume (number of lines) of low bandwidth leased lines supplied to large business customers has declined, and is currently a little under 70%, and
- BT's share of the total volume (number of lines) of low bandwidth leased lines supplied to other business customers has also declined, and is currently equal to just under 60%;



- 3.19 Taken on its own, this data too does not appear to support the contention that the supply of low bandwidth leased lines to the largest business customers is more competitive than the supply to other business customer; in fact, BT's share of the supply to large businesses appears to be somewhat higher than the average, and the rate of decline in respect of leased lines supplied to large business customers a little slower than that in respect of supply to other businesses. This data is not inconsistent with the market research data which suggests that 56% of large businesses and 51% of medium businesses use BT for at least some of their leased lines.

## **Tendering**

- 3.20 Data supplied by BT and its competitors in respect of invitations to tender which had been bid for and/or won has not proved useable. It has not been possible to draw any conclusions about the success rate reported by BT and by its competitors, as reported overall volumes of contracts bid for varied so widely that it was impossible to assume that there had been a common pool of invitations to tender, which even a core of major suppliers had bid for in competition with each other. The same difficulty was encountered even in respect of small subsets of, for example, high value tenders. Furthermore, the high success rate reported by many respondents was not consistent with the premise that this group was reporting in respect of a common pool of invitations to tender. Confidential data supplied by BT to inform this consultation exercise did not indicate that BT's own success rates varied markedly or consistently with the total value of the prospective contract.

## **Customer segments**

- 3.21 While there were some common features in the customer segments used by BT and its competitors in their account management, overlaps were insufficient to enable market share analysis on this basis. Confidential data supplied by BT for this exercise did not indicate that the rate or direction of change in the volume or value of services supplied to the financial services segment, the segment cited by BT as being subject to particularly strong competition, was any worse than the average.

## **Survey data - large and medium business users**

### **BT's share of individual businesses telecoms spend**

- 3.22 Business users provided the following mean average estimates of the proportion of their overall telecoms spend that was allocated to BT:
- large businesses - 40%;
  - medium businesses - 55%.
  - CMA members - 50%
- 3.23 The data may tentatively suggest that larger businesses, compared with medium size businesses, spend a slightly smaller proportion of their overall telecoms budget with BT. It should be emphasised, however, that the figures relate to total telecoms spend rather than spend on services in markets where BT has SMP. On that basis, this data may not be inconsistent with data supplied by communications providers (referred to in paragraph 3.9 above) which indicated that BT's market share of low bandwidth leased lines and exchange lines supplied to large businesses is somewhat higher than its share of these services supplied to other businesses. Larger businesses were significantly more likely to report that they purchased, in addition to traditional



PSTN services and low bandwidth leased lines, a wide range of services including more advanced services in more competitive unregulated markets.

### **The likelihood of individual businesses using BT for some services**

- 3.24 Large businesses were more likely than medium size businesses to use BT at least in part for some services:
- 85% of large businesses said they used BT for some PSTN exchange lines, whereas the corresponding figure for medium size businesses was 63%;
  - 67% of large businesses said that they used BT for some inland calls, whereas the corresponding figure for medium size businesses was 48%)
- 3.25 This may reflect the fact that many large businesses have more diverse needs (and are more geographically dispersed) than smaller businesses and are therefore reliant on BT for the supply of at least some services in some areas. It may also reflect the fact that many large businesses use more than one supplier as a means of improving network resilience. Ofcom's market research suggests around six in ten large businesses use multiple suppliers for some services, generally either for resilience or different sites.

### **Changing supplier**

- 3.26 Large businesses were more likely to have either switched or considered switching the supplier they used for telecoms services. Ofcom collected this data across a range of services (see below), and, broadly speaking:
- between about 60% and 80% of large businesses (depending on the service concerned) said that they had either considered changing or changed supplier for various services; whereas
  - between about 40% and 60% of medium-size businesses said that they had either considered changing or changed supplier for various services.
- 3.27 This may support the commonly held view that larger business users, with dedicated communications and procurement specialists are more likely than medium size businesses to review their sourcing options. It is interesting to note, however, that the proportion of business users which had actually switched supplier, rather than merely considered doing so, varied much less between large and medium size businesses.

### **Key criteria for choosing telecoms supplier**

- 3.28 Ofcom asked large and medium-size businesses for an explanation of the key criteria that they took into account when choosing a telecoms supplier. Ofcom was interested to understand whether large and medium size businesses might have different concerns and priorities which could have a bearing on the way markets operate in respect of these two groups.
- 3.29 Perhaps unsurprisingly, reliability and resilience of the service were most often cited as "very important" factors, with good customer service/ account management following at some distance in second place. Getting the lowest price was much less often cited as a "very important" factor, but a very high proportion of respondents cited this as "fairly important". The picture presented by the CMA membership was broadly similar with resilience and reliability generally being afforded the highest priority, although price was said to be particularly important when selecting a supplier of calls and digital leased lines. Those CMA members who had a view on the level of BT's prices relative to prices offered by others generally believed that BT was more

expensive; this view was held most firmly and most widely in respect of inland calls. Overall responses from large and medium size businesses about the importance of price were very similar, and provided no indication that one or other group was more determined than the other to exert pressure on price.

- 3.30 The supplier's ability to service all of the customer's sites and to supply the complete range of services which the purchaser required were significant factors for both medium and large business users, but there was little difference in the views expressed by these two groups. BT's ability to meet CMA members' needs on a national level was cited as the key reason, along with reliability, for preferring BT. The concept of replicability is, of course, intended to enable competitors to compete across all parts of a market.

### Ease of negotiation with BT

- 3.31 Despite BT's regulatory obligation to adhere to published prices, a surprisingly high proportion (between 40%-60% depending on the service) of medium and large business users reported that they had engaged in negotiation with BT over the price of exchanges lines, inland calls or low bandwidth leased lines. These figures were broadly replicated by the CMA membership. The reported incidence of price negotiation by medium size businesses, rather than large businesses, was relatively high and difficult to explain. It may be that many respondents were in fact reporting negotiation based on BT's standard published discount structures, or it may be that the way the question was framed caused some confusion amongst respondents. Ofcom does not believe that the limited evidence of these surveys alone should be taken to indicate widespread breach of BT's obligation to adhere to published prices. Nevertheless, it may suggest that in practice regulation is not hindering BT from engaging in a semblance, at least, of normal commercial negotiation.
- 3.32 When asked about ease of negotiation, large businesses were no more likely than medium size businesses to report that negotiation with BT was easy:
- Around a fifth of large businesses reported that negotiation was easy; and
  - The result for medium size businesses was broadly similar (22%).
- 3.33 Whether this suggests that larger business do not, as previously thought, have more buyer power than medium size business, or merely that larger businesses have higher expectations of the process of negotiation, is not clear. Responses from those who had not negotiated were fairly evenly split between those saying BT would not negotiate for various reasons and those saying they themselves saw no reason to negotiate. CMA members more often stated that they saw no reason to negotiate (BT refusal was less often cited).
- 3.34 A consistently low proportion of medium size businesses and CMA members (generally below 10% in respect of each service) reported being tied to long term contracts ie having some form of longstanding deal or pre-agreed price with BT. However, nearly a quarter of the large businesses surveyed reported that they had not negotiated as they had some form of long standing deal or pre-agreed price with BT. Respondents to the CMA survey confirmed that telecoms procurement contracts are renewed fairly frequently, with more than 40% reporting that contracts for inland calls and analogue exchange lines are renewed at least annually, with contracts for leased lines being renewed somewhat less often (only about 30% annually).

### Views on current regulation on BT

- 3.35 Large businesses were more likely than medium size businesses to report that they thought BT was unfairly disadvantaged by current regulation:
- A very high proportion (81%) of large businesses reported that BT is unfairly disadvantaged by regulation which prevents BT from offering bespoke prices for inland calls, exchange lines and low bandwidth leased lines
  - the corresponding figure for medium size businesses was about 58%.
  - 61% of CMA members reported a belief that BT is unfairly disadvantaged by regulation, although more than half of respondents in rural areas did not share that view.
- 3.36 The survey of CMA members explored these perceptions of the impact of retail regulation in more detail. Nearly half (48%) of CMA members were strongly of the view that BT should be allowed to offer bespoke prices in areas where there is significant competition, and more than half (58%) were strongly of the view that BT should continue to be regulated in areas where there is no other competition (few disagreed with either proposition). About 70% of CMA members strongly agreed or tended to agree that greater flexibility for BT to negotiate on price would lead to increased price competition, and almost as many believed that this would result in increased service competition, although nearly half (47%) were concerned that this might give BT an unfair competitive advantage.

### Overall conclusions

- 3.37 As summarised in paragraph 3.3 above, the surveys of business users and the data gathered from suppliers do not indicate marked differences in market conditions or customer expectations between the supply of communications service to large businesses and smaller businesses.
- 3.38 The data does indicate that BT may be losing some market share in respect of exchange lines, calls and low bandwidth leased lines supplied to business customers, but the rate of loss does not appear to be significantly greater in respect of the supply to large business customers and, if any statistically significant conclusions can be drawn, BT's remaining market shares appear to be somewhat higher in respect of the supply of exchange lines and leased lines to larger business customers.
- 3.39 There is some evidence that larger business customers may allocate a smaller proportion of their total telecoms spend to BT, but this may be a reflection of the different mix of services required by larger business customers, many of which are new generation services in markets where BT does not have SMP.
- 3.40 The reported extent of negotiation with BT in respect of regulated services is surprising, but there is little difference between the reported experience of large and medium size businesses. Furthermore, where negotiation has not taken place with BT, the reasons given are as likely to have to do with the purchaser's satisfaction with the offer or unwillingness to devote resources to negotiation as they are to have to do with BT's refusal as a result of regulatory constraints or general unwillingness. These results, albeit from small-scale surveys, do not indicate strong customer pressure for BT to be permitted to negotiate more freely. Nevertheless there appears to be a widely held view, particularly prominent amongst larger business customers (though less so amongst rural based CMA members) that BT is unfairly constrained by regulation which prevents it from offering bespoke prices.

- 3.41 Ofcom does not believe that the data gathered for the purpose of this consultation exercise, by itself, supports the view that Ofcom should take different approaches to regulation of retail markets serving larger and smaller business customers, or that regulation should vary between services offered to different industry sectors, although Ofcom believes that, for reasons set out in para 4.29, it may be appropriate to restrict increased pricing flexibility to larger businesses, at least initially.

## Section 4

# Replicability and competition concerns

## Bespoke pricing and competition concerns

- 4.1 The reasons why bespoke pricing can give rise to competition concerns were discussed in Oftel's October 2003 consultation on pricing of services for retail business customers. Paragraphs 2.10 explained that:

Where a dominant supplier faces varying degrees of competition, customers and competitors may benefit if that dominant supplier is obliged to offer uniform prices to all broadly comparable customers. Under these obligations, customers in areas of relatively weak, or non-existent, competition will be offered services at the same price as broadly comparable customers in areas of relatively strong competition and where competition may already have started to have an impact on prices. Competitors too may be able to compete more effectively if the dominant supplier is obliged to offer all price packages to all broadly comparable customers as, under these obligations, the dominant supplier would not be able to reduce his prices in response to the direct threat of competition while maintaining high prices and generating high profits elsewhere. Where a dominant supplier is not obliged to offer uniform prices to all broadly comparable customers, he may choose to recover all common costs from customers in areas of non-existent competition while pricing down to incremental cost where he is faced with competition. In these circumstances, competitors will find it very difficult to compete. The electronic communications sector, which often faces very high common costs relative to incremental costs, provides particularly powerful opportunities for this kind of behaviour.

- 4.2 This text describes a generic situation in which, subject to compliance with the Competition Act, BT would have the ability and incentives to target aggressive discounts on those areas where it faces most competition. These areas could be one, or a combination, of any of the following:
- specific geographic areas where competitors have the greatest presence;
  - specific customer segments (for example, the supply of services to large business customers) where BT faces most competition; or
  - the particular customers of BT's competitors.

- 4.3 The simple numeric example below takes a situation where there are two areas or segments in which the incremental cost of servicing each is 5, and where there are also common costs of 5 between the two areas (assume that the average/fully allocated cost of each service is 7.5). If a dominant provider faces competition in Area A and has a monopoly in Area B, it may selectively offer a discounted price equal to incremental cost (5) in Area A, and recover its common costs by pricing at standalone cost (10) in Area B. If it does so, it will be difficult for a non-dominant provider to compete using his own infrastructure in the potentially competitive Area A.

	Area A (competitive)	Area B (monopoly)
Incremental costs	5	5
Common costs	5	

- 4.4 This simple model assumes that non dominant competitors are able to compete only in Area A, and therefore have to recover all common costs here.
- 4.5 For this reason Ofcom, and Oftel before it, has tended to presume that differential pricing, where not justified by varying costs, would have a material adverse effect on competition and, therefore, would be in breach of ex ante conditions which prohibit undue discrimination. Ofcom is currently consulting on how it will investigate potential contraventions on competition grounds of requirements not to unduly discriminate imposed on SMP providers; see the consultation “[Undue discrimination by SMP providers](#)” published by Ofcom on 30 June 2005. If Ofcom was to decide, following responses to the present consultation document, that BT should be permitted to depart from its published price list, the question of whether any particular price is unduly discriminatory would be considered on its merits with reference to the undue discrimination guidelines.

### The impact of replicability on competition

- 4.6 Replicability goes some way to addressing the problem of targeted price cuts by enabling competition to be more uniform. The availability of wholesale services, on terms which are comparable to those offered to BT Retail, which enable retail services to be replicated in all areas or market segments where infrastructure-based competition is not feasible or is limited to few small players, could be expected to reduce the scope for BT to discount prices in areas of competition while heavily loading common retail costs, or the common costs of any other unregulated components, onto prices in areas of weak or non existent competition, as replicability should mean that there is a degree of competition in all areas and market segments. For this reason, Ofcom is considering whether retail regulation which prevents targeted pricing remains appropriate in respect of services which are replicable.

### Limitations of wholesale services

- 4.7 In some cases, however, the availability of particular wholesale products does not enable entrants to compete with BT on a genuinely equal footing.

### The nature of the wholesale services

- 4.8 For BT's retail services to be replicable, a number of conditions relating to the wholesale services must be satisfied, including:
- service functionality;
  - cost;
  - quality of service; and
  - availability.

- 4.9 While conditions of this sort remain unsatisfied, it is clear that remedies at the wholesale level will not be sufficient to bring the benefits of competition to consumers. Ofcom is presently consulting (in the Replicability Consultation) on whether these conditions have now been met in respect of Wholesale Line Rental, Carrier Pre Selection and Partial Private Circuits.

### **Economies of scale/scope**

- 4.10 Retail competition will not immediately become fully effective even when enabled by the availability of wholesale services in all areas and market segments. There may therefore still be scope for common costs to be loaded onto prices of services in areas of weak or non-existent competition. The outcome may still be that smaller competitors without comparable economies of scope are unable to compete. This problem will be exacerbated if there are also economies of scale at the retail level so that on average BT's retail costs are actually lower than those of its competitors. One possible solution to these concerns, while permitting BT to offer bespoke prices in response to competitive pressure, would be to require BT to ensure that any bespoke prices are above a price floor, such as for example a floor equal to the non-discriminatory transfer charge for network elements plus fully allocated retail costs. An FAC floor goes some way to addressing this concern by in effect requiring at least a minimum level of common costs to be recovered in all areas.

### **Existing customer base/barriers to switching**

- 4.11 Take-up of many of the key wholesale products made available by BT, such as Wholesale Line Rental, remains limited. In order to win customers from BT, competitors will have to overcome any barriers to switching that might be caused by BT's contractual terms with existing customers, the practical risks inherent in switching supplier or customer inertia.

### **Geographic variations in competitors' costs**

- 4.12 Even where wholesale services generally enable BT's retail services to be replicated across the whole market, geographic variations in competitors' costs may still remain.

### **Other factors**

- 4.13 Other factors which may also make it difficult for smaller competitors and new entrants to compete may be more complex for a sector regulator to address, but should not be over-looked. These include;
- access to capital markets – BT's size and good credit rating may mean that, relative to most of its competitors, it faces a lower cost of raising both debt and equity capital;
  - mature/declining markets – it will be easier for competitors to gain a foothold in a market that is expanding quickly than in a more mature one, such as the PSTN services considered in this document, that are not expanding; and
  - other miscellaneous – e.g. brand image/ lack of competition on non-price factors.
- 4.14 BT's share of the remaining regulated business retail markets is likely to remain above a level traditionally associated with a position of dominance, and these advantages are likely to remain. For this reason, and for the reasons explored in paragraphs 4.10 to 4.13 above, it may be prudent not to remove ex ante conditions in their entirety until the relevant retail markets have been reviewed.



### **Regulatory implications arising from replicability**

- 4.15 As has been discussed in the preceding paragraphs, the availability of wholesale services which enable competitors to replicate BT retail services from markets where BT has SMP, should, nevertheless, significantly improve the effectiveness of Ofcom's wholesale remedies in the business sector, ensuring that competitors have access to the full range and functionality of wholesale inputs that is available to BT, at prices equivalent to those faced by BT Retail.
- 4.16 It is Ofcom's present view, on which it is seeking comments, that replicability, when it becomes a reality, will have an impact on the operation of retail markets such that a change will be required to the way in which retail markets are regulated.

### **Possible outcome of market reviews in the presence of replicability**

- 4.17 Following a finding that the services can be replicated, there are perhaps three possible outcomes to any subsequent retail market review, namely:
- the retail market (or, perhaps, a subset) is declared competitive, and all ex ante regulation is removed;
  - BT retains a position of SMP in the markets, but Ofcom concludes that no ex ante regulation should be imposed as Ofcom can achieve the objectives set out in Article 8 of the Framework Directive by relying on wholesale regulation; or
  - BT retains a position of SMP in the markets and some ex ante regulation remains appropriate.
- 4.18 The first of these outcomes - that the retail markets, or an identifiable subset, are now effectively competitive - seems unlikely to be delivered during the near term. BT's high market shares when the business inland calls and exchange line markets were last reviewed in 2003, the results of Ofcom's recent survey of telecoms suppliers and the extent to which market shares may vary between different customer segments, the factors outlined under the headings above and the limited time, if any, during which the wholesale remedies (Wholesale Line Rental and Carrier Pre Selection) have been available in a fit for purpose state, all suggest that reviews of the business calls and exchange line retail markets, if conducted today, are unlikely to find these markets competitive. Ofcom expects to conduct further market reviews at some time during the next 18 months when conditions in the retail markets may have altered.
- 4.19 Alternatively, it is conceivable, if wholesale remedies do now enable competition to take place, that a market review might conclude that ex ante retail regulation should be removed and reliance placed instead on wholesale remedies and competition law. However, there is a risk therefore that premature removal of retail regulation would markedly reduce the prospects for competition becoming effective. This outcome is unlikely to be consistent with Ofcom's duties to promote competition and the interests of citizens. It may therefore be necessary to retain some ex ante regulation, albeit in a modified form, which limits BT's ability to target aggressive discounts on those areas where it faces most competition.

### **Options for regulatory change based on consent under existing conditions**

- 4.20 As was discussed earlier in this document, regulation of business retail markets is now limited to obligations to publish and adhere to published prices plus a general prohibition of undue discrimination. The availability of fit for purpose wholesale



services on terms which do not unduly discriminate between BT Retail and its competitors does have the capacity to mitigate some, if not all, of the competition concerns arising from bespoke pricing and non adherence to published prices, by enabling competition to be more uniform. It may therefore be appropriate to grant consent to BT departing from its published price list, although it may be prudent and proportionate to limit the scope of any such consent.

### Price floors

- 4.21 A first order test for anti-competitive pricing is whether the price for the service in question is below the additional costs incurred in supplying that service. In the telecoms sector, these additional costs are normally measured by long-run incremental costs (LRIC), see for example The Competition Act 1998: the application in the telecoms sector. Under this standard approach, any price for a service, from a market where BT has SMP, which fails to allow full recovery (on a contract by contract basis) of the transfer charges which BT Retail is liable to pay BT's relevant wholesale division for the network components of the services would be viewed as unduly discriminatory and anti competitive. In addition, it would be expected to cover at least the incremental retail costs of provision. Ofcom believes, however, that, if BT is to offer bespoke prices, the relevant "price floor" should instead be based on fully allocated costs (FAC). The reasons for applying this higher cost standard to bespoke prices are set out below.
- 4.22 Although replicability should prevent BT from engaging in extreme targeting of discounts, BT still enjoys large economies of scale and other advantages arising from its legacy presence (including customer inertia), and some degree of unevenness in competitive conditions will remain. BT's retail economies of scale and the other advantages offered by its dominance in retail markets, suggest to Ofcom that any consent to BT offering unpublished bespoke prices for services from markets where BT has SMP should be limited to prices which allow recovery of retail costs on a fully allocated basis plus non-discriminatory wholesale charges, at least until the effects of consent to bespoke unpublished prices have been fully assessed. Such a price floor would promote competition by limiting BT's ability to engage in extreme targeting of discounts, while still enabling BT to flex its retail prices, and terms and conditions, in response to customer demand and competitive pressure.

### Implicit price – cost test in respect of service bundles

- 4.23 The outstanding Replicability Consultation takes the view adopted by Ofcom in the May 2004 Statement that, where SMP services are included within a service bundle, the prices of the services in that bundle should be required to pass an implicit price - cost test. The test considers whether a competitor which is unable to supply all the SMP elements of the bundle still stands a reasonable chance of winning a contract to supply a subset of the bundle elements alone. For this to be feasible, the total cost of purchasing (i) any one or more of the SMP elements at standard (non bundled) prices from the dominant supplier plus (ii) all other elements from the smaller competitor (at a price no lower than incremental cost) must be no higher than the cost of buying the complete bundle from the dominant supplier at the discounted price. Therefore the implicit price – cost test assesses whether, if the total discount represented by the entire service bundle (relative to standalone prices) is applied to each element individually (with the exception of non SMP element which are taken as a single entity), the resultant discounted price for each element is above cost. If the cost is greater than the price discounted in this way, the test is failed.

- 4.24 Given the concerns expressed in paragraph 4.22 above, if it was concluded that an implicit price - cost test is appropriate, in the case of bespoke pricing it might be proportionate to assess the cost of SMP elements of the bundle on a FAC basis and non SMP elements on a LRIC basis.
- 4.25 However, as was explained above, the purpose of the implicit price – cost test is to ensure that it remains feasible for suppliers which cannot offer all the SMP elements of the bundle to compete for a subset of the bundle elements. It could be argued that where it is possible for competitors to replicate the SMP elements (and one assumes that, by definition, non SMP elements can be sourced competitively) then the implicit price-cost test for each service is no longer required and that any comparison of prices and costs should take place at the level of the bundle as a whole. In the case of bespoke offers, the cost of the bundle would be assessed using the retail FAC of SMP services. Ofcom is inviting stakeholders to comment on this issue, both in the context of bespoke unpublished bundles (the subject of this consultation) and also in the context of published service bundles which are made available to all broadly comparable customers (the issue addressed in the May 2004 Statement).
- 4.26 The implication of not requiring the prices of individual services within bundles to pass an implicit-price cost test is that, in effect, competitors will be expected to compete to provide all the services in a bundle. Operators who only wish to compete to supply a subset of the services may be unable to do so. This is not necessarily unreasonable, since the point of replicability is that it enables competitors to provide SMP services on the same basis as BT. However, it may be that some competitors do not wish to provide all the services within a bundle, where some of these are outside their normal line of business and area of expertise. In addition it is possible that services within a bundle could have different contract renewal dates. In these circumstances there may be opportunities for BT to exploit the freedom to offer bundled discounts to the detriment of competition. However, the proportionate response may not be to impose detailed regulation such as implicit price-cost tests but, rather, is likely to be to consider any complaints and review the need for regulation and the prospects for further deregulation as appropriate.

### **Variations in market conditions for supply to different types of business user**

- 4.27 BT has claimed that competition to supply telecommunications services to large businesses is more intense than competition to supply smaller businesses. BT has also claimed that competition to supply certain industry segments, such as the financial services sector, is particularly intense. On this basis, BT has argued that Ofcom should either define separate markets for the supply of services to such groups or should apply regulation in a way which reflects the claimed differences in the strength of competition. As was summarised in section 3 above, the data recently gathered by Ofcom does not support the contention that competition to supply exchange line services, inland calls and leased lines (the services in the remaining markets in which BT still has SMP) is markedly more intense in the larger business segment compared with other segments. Comparative data from different suppliers in respect of the supply to different industry segments is not sufficiently robust to allow analysis of BT's market share, as different suppliers classify different customers in different ways. Nevertheless, BT's own time series-data does not indicate that BT is losing volumes of business more swiftly in the financial services segment than elsewhere.
- 4.28 In short, there currently appears to be insufficient evidence before Ofcom to cause it to change its earlier view that it is not appropriate to define economic markets on the

basis of customer spend thresholds or industry segment. Ofcom will review this situation once again when it next conducts a review of the relevant markets.

- 4.29 Given the finding referred to in the preceding paragraph, Ofcom might be expected to conclude that any regulatory changes required as a consequence of business retail services becoming replicable should be applied to all segments of the relevant business market. However, a change allowing BT to offer bespoke prices would represent a significant change to the way the retail markets operate, and there may be merit in a more cautious phased approach which allows competitors to adjust and BT to ensure that it has management systems in place sufficient to manage bespoke pricing within competition law and any remaining ex ante constraints. The larger business segment is already subject to closer and more bespoke account management than smaller businesses, and the survey data in section 3 above does indicate that larger businesses are more likely to report that regulation today unfairly constrains BT. Larger business are also more likely to have full time professional IT/telecoms teams and negotiators who are engaged in purchasing a wide range of IT and telecoms services, much of it lying beyond the bounds of SMP markets. In these cases, regulation of the retail markets where BT has SMP may have little relevance. It is conceivable that initial consent to departures from published prices could be limited to bids offered to customers spending more than, for example, £1m per year with BT on IT and telecoms related goods and services.

### **Ofcom's preliminary view of bespoke pricing**

- 4.30 Ofcom's current view is that, where services from markets where BT has SMP can be replicated, BT should be permitted to offer unpublished bespoke prices which are not necessarily available to the generality of customers. However Ofcom currently believes that such prices should not be permitted to fall below a level which allows recovery of transfer charges for all network components plus fully allocated retail costs.
- 4.31 However, Ofcom believes, on balance, that where it can reasonably be demonstrated that all elements of a bundle are genuinely replicable, it would not be appropriate to make compliance with an implicit price – cost test an explicit condition of a consent to offer service bundles which mix SMP and non SMP services. The relevance of any implicit price – cost test, when judging concerns about possible undue discrimination, would be decided on a case by case basis.

## Section 5

# Application of deregulatory initiatives across the business market

- 5.1 If Ofcom concludes that, in the presence of replicability, it would be proportionate to allow BT to offer some or all business customers bespoke prices for inland calls and exchange line services (whether or not subject to ex ante price floors or other constraints), Ofcom would need to consider whether it should require publication of those bespoke prices.

## Price publication and price audits

- 5.2 In appropriate circumstances, it would be feasible for Ofcom to allow BT to offer bespoke prices to individual customers but to require that these personalised prices are published after the event (for example, as at present, within 24 hours). Ofcom's present view, on which it is seeking to comments from stakeholders, is that publication at large would significantly reduce the advantages of introducing bespoke pricing, by exposing to competitors' eye the prices which BT is willing to offer specific customers. Publication would also tend to result in those bespoke prices which are visible to end users becoming the new de facto standard prices, and knowledge of that risk might inhibit BT's willingness to respond to the demands of particular customers. In view of these concerns, Ofcom currently sees little merit in making regulatory changes which enable bespoke pricing if the obligation to publish those prices at large, even after the event, is to remain in place.
- 5.3 It would be feasible, alternatively, to require BT to notify all bespoke prices to Ofcom so that compliance with price floors and any other tests could be checked. This approach would offer the advantage that these prices would not fall into the public domain where they might affect the behaviour of competitors or the expectations of purchasers. It is Ofcom's present view, however, that, if the risks of anti competitive behaviour presented by bespoke pricing are such that it is necessary to audit each such bespoke price, then there must be a strong presumption that it is not appropriate to allow BT to depart from its price list.
- 5.4 In any event, BT would need to implement robust management systems to ensure that any bespoke prices comply with relevant price floors or other economic tests, and that authority to offer such prices is given at an appropriate management level. Ofcom would expect such pricing and costing analyses to be capable of audit in the event of claims that BT was failing to comply with such tests and price floors. This documentation may be sufficient to meet compliance needs.
- 5.5 Ofcom will welcome views on the merits of these, and any other, price publication or audit requirements.

## Regulatory mechanisms for implementing changes

- 5.6 In the markets for business exchange lines and business calls BT is presently subject to SMP conditions relating to price publication and undue discrimination. Under the price publication condition, it is obliged to publish its charges terms and conditions, and publish and notify to Ofcom any amendment within 24 hours of that amendment coming into force. BT is explicitly prohibited from departing from those published

prices. The condition relating to undue discrimination prohibits BT from unduly discriminating against particular persons or classes of person in relation to the services offered. These conditions are set out in annex 7 to this consultation document.

### **Consent to non publication of prices**

- 5.7 The price publication condition D3 contains provision for Ofcom to consent to BT not publishing charges, terms and conditions or otherwise not acting in accordance with the provisions of that condition. The statement “Fixed Narrowband Retail Services Markets” published by Oftel on 28 November 2003, which accompanied the notification which set this condition, explained that the power to disapply the condition by consent would “allow such disapplication where, for example, the Director’s view is that publication should not be required in the case of supply to business customers under certain conditions”. If it was decided that BT should be permitted to offer unpublished bespoke prices, consent could be granted in respect of all business customers or a defined sub group. Consent could also be made conditional on BT observing certain cost floors. Ofcom would need to consult on the specific form of any such consent.
- 5.8 Section 49 of the Act requires Ofcom to ensure that any consent given under an SMP condition must be objectively justifiable, not unduly discriminatory, proportionate and transparent. When it has assessed responses to the present consultation exercise, Ofcom will consider whether consent under the price publication condition would meet these statutory requirements.

### **Prohibition of undue discrimination**

- 5.9 Ofcom is currently consulting on how it will investigate potential contraventions on competition grounds of requirements not to unduly discriminate imposed on SMP providers; see the consultation “Undue discrimination by SMP providers” published by Ofcom on 30 June 2005. Responses to that document have been requested by 8 September 2005. The document proposes that in such cases Ofcom should first consider whether any differences in transaction conditions reflect relevant differences in the customers’ circumstances and whether any relevant similarities in customers’ circumstances are reflected in transaction conditions offered to two customers. If such differences and similarities are not so reflected, Ofcom would then consider the capability that the behaviour had, has or will have to harm competition.
- 5.10 If Ofcom was to decide, following responses to the present consultation document, that BT should be permitted to depart from its published price list, the question of whether any particular price is unduly discriminatory would be considered on its merits with reference to undue discrimination guidelines which Ofcom will publish when it concludes its consultation “Undue discrimination by SMP providers”. Compliance with any conditions attached to the consent to depart from published prices (such as an obligation to observe a particular price floor) cannot guarantee that the price will not be found to be in breach of condition D2 which prohibits undue discrimination or that BT may be in breach of the Competition Act. In particular, consent to depart from published prices, provided that prices comply with a specified price floor or other economic test, should not be viewed as express permission to offer prices at or above the specified floor as envisaged by condition D2.2.
- 5.11 Ofcom’s preferred approach is set out in section 6 below.

## Section 6

# Summary of proposals and options, and next steps

## Proposals and questions

- 6.1 Ofcom is proposing that when competitors are able to replicate, technically and commercially, the exchange line and inland call services supplied to business retail customers, Ofcom should grant consent under the terms of BT's SMP condition D3 "Requirement to publish charges", permitting BT to depart from its published prices by offering bespoke and individual prices and tariffs.

*Question 1. Do you agree with the proposal to consent to BT departing from its published prices where services are replicable?*

- 6.2 Such consent would apply only to bespoke prices which allow recovery of all transfer charges for network costs plus fully allocated retail costs.
- 6.3 The Replicability Consultation proposes that where service bundles include services from markets where BT has SMP, each SMP service and the aggregate of non SMP services should pass an implicit price – cost test, and that Ofcom should presume that such service bundles which do not pass such a test are unduly discriminatory. However, Ofcom now wishes to reconsider whether this is appropriate where it is possible for competitors to replicate the SMP elements of a bundle (and it is assumed that, by definition, non SMP elements can be sourced competitively). It may be the case that Ofcom should not presume that prices are unduly discriminatory provided that they at least equal the relevant level of costs applied at the level of the bundle as a whole (and, in the case of bundles offered at large, a net revenue test). The relevance of an implicit price – cost test would instead be considered on a case by case basis where concerns about undue discrimination arise.

*Question 2. Do you agree that consent to BT departing from its published prices should be limited to prices above a floor defined by fully allocated costs? Would the application of such a price floor adequately address any concerns which you have about the general proposal to consent to departures from the published price list? Do you agree that Ofcom should not presume that service bundles which fail an implicit price – cost test at the individual service level are unduly discriminatory?*

- 6.4 As was discussed in section 5 above, Ofcom does not believe that publication of bespoke prices after the event would be consistent with the operation of a more flexible retail market, and neither would this be consistent with the approach taken in the General Conditions of Entitlement which specifically exclude bespoke and individual prices and tariffs from the obligation to publish prices for publicly available telephone services. Ofcom therefore believes that BT should not be obliged to publish or notify to Ofcom details of bespoke prices which it offers to business customers (provided that any conditions limiting the consent to offer bespoke prices are complied with).



*Question 3. Do you agree that BT should not be obliged to notify bespoke prices to Ofcom or publish bespoke prices after the event?*

- 6.5 The data gathered from business customers and telecoms suppliers, as summarised in section 3 above, does not indicate marked differences in the views and behaviour of large and medium size businesses, neither does it indicate that there are marked differences in the strength of competition to supply large or medium size businesses. Section 4 above explored the possibility, however, that any consent to bespoke pricing should, initially, be limited to a subset of the relevant business markets to enable competitors to adjust to the new market conditions which bespoke pricing may bring about and to ensure that BT is able to put in place adequate management systems to control the extent of bespoke pricing. For the reasons given in paragraph 4.29 above, Ofcom proposes that consent to departures from published prices should initially be limited to prices offered to customers whose annual spend with BT is already in excess of £1m.

*Question 4. Do you agree that any consent to BT departing from its published prices should initially be limited to prices offered to customers already spending in excess of £1m per year with BT?*

- 6.6 Ofcom currently believes that the measure of whether replicability has been achieved sufficient to warrant departures from the published price list for the business inland calls and business exchange lines services listed in annex 4 of the Replicability Consultation should be the same measure as was detailed in the Replicability Consultation, which is considering whether service bundles which include SMP services should be permitted.

*Question 5. Do you agree that where business inland calls and business exchange lines are considered replicable for the purpose of allowing service bundles which include these products, then business inland calls and business exchange lines should also be considered replicable for the purpose of allowing unpublished bespoke prices?*

## Next steps

- 6.7 After considering responses to the present consultation exercise, Ofcom will publish a statement summarising its conclusions as to whether, when services become replicable, it should grant consent to departures from BT's published price list. When the relevant retail services have been found to be replicable, Ofcom will then consult on the precise form of any consent. It is possible that Ofcom may decide that replicability has been achieved before Ofcom publishes a statement on the principle of permitting BT to offer unpublished bespoke prices. If that happens, Ofcom will publish a statement on the principle of deregulation flowing from replicability and will simultaneously consult on the precise form of the consent(s).
- 6.8 If consent to the offering of bespoke unpublished prices is initially limited to a subset of business customers for the reasons given in paragraph 6.5 above, Ofcom would expect to initiate a reassessment of the impact of this consent within 12 months of consent being granted, with a view to removing the limitation and extending the consent to the rest of the business market. In taking that decision, Ofcom would place much weight on the adequacy of BT's management systems for ensuring compliance with its regulatory and legal duties.

- 6.9 In any event, Ofcom currently expects to review the retail markets for business inland calls and business exchange and leased lines within the next 18 months, with a view to establishing whether market definitions remain appropriate and whether BT has SMP in those markets. If these markets are found to be competitive, or if Ofcom decides that it can meet its duties under the Framework Directive by relying on wholesale remedies, Ofcom will remove all SMP conditions, including any conditions associated with consents to depart from the published price list.



## Annex 1

# Responding to this consultation

## How to respond

Ofcom invites written views and comments on the issues raised in this document, to be made by **5pm on 16 November 2005**

Ofcom strongly prefers to receive responses as e-mail attachments, in Microsoft Word format, as this helps us to process the responses quickly and efficiently. We would also be grateful if you could assist us by completing a response cover sheet (see Annex 2), among other things to indicate whether or not there are confidentiality issues. The cover sheet can be downloaded from the 'Consultations' section of our website.

Please can you send your response to [michael.richardson@ofcom.org.uk](mailto:michael.richardson@ofcom.org.uk).

Responses may alternatively be posted or faxed to the address below, marked with the title of the consultation.

Michael Richardson  
Competition and Markets  
Ofcom  
Riverside House  
2A Southwark Bridge Road  
London SE1 9HA

Note that we do not need a hard copy in addition to an electronic version. Also note that Ofcom will not routinely acknowledge receipt of responses.

It would be helpful if your response could include direct answers to the questions asked in this document, which are listed together at Annex 3. It would also help if you can explain why you hold your views, and how Ofcom's proposals would impact on you.

## Further information

If you have any want to discuss the issues and questions raised in this consultation, or need advice on the appropriate form of response, please contact Michael Richardson on 020 7783 4157 or at <mailto:michael.richardson@ofcom.org.uk>.

## Confidentiality

Ofcom thinks it is important for everyone interested in an issue to see the views expressed by consultation respondents. We will therefore usually publish all responses on our website, [www.ofcom.org.uk](http://www.ofcom.org.uk), ideally on receipt (when respondents confirm on their response cover sheer that this is acceptable).

All comments will be treated as non-confidential unless respondents specify that part or all of the response is confidential and should not be disclosed. Please place any confidential parts of a response in a separate annex, so that non-confidential parts may be published along with the respondent's identity.

Ofcom reserves its power to disclose any information it receives where this is required to carry out its legal requirements. Ofcom will exercise due regard to the confidentiality of information supplied.

Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use, to meet its legal requirements. Ofcom's approach on intellectual property rights is explained further on its website, at [www.ofcom.org.uk/about\\_ofcom/gov\\_accountability/disclaimer](http://www.ofcom.org.uk/about_ofcom/gov_accountability/disclaimer).

### **Next steps**

Following the end of the consultation period, Ofcom intends to publish a statement within approximately 2 months of the end of the consultation period.

Please note that you can register to get automatic notifications of when Ofcom documents are published, at [http://www.ofcom.org.uk/static/subscribe/select\\_list.htm](http://www.ofcom.org.uk/static/subscribe/select_list.htm).

### **Ofcom's consultation processes**

Ofcom is keen to make responding to consultations easy, and has published some consultation principles (see Annex 2) which it seeks to follow, including on the length of consultations.

If you have any comments or suggestions on how Ofcom conducts its consultations, please call our consultation helpdesk on 020 7981 3003 or e-mail us at [consult@ofcom.org.uk](mailto:consult@ofcom.org.uk). We would particularly welcome thoughts on how Ofcom could more effectively seek the views of those groups or individuals, such as small businesses or particular types of residential consumers, whose views are less likely to be obtained in a formal consultation.

If you would like to discuss these issues, or Ofcom's consultation processes more generally, you can alternatively contact Vicki Nash, Director, External Relations, who is Ofcom's consultation champion:

Vicki Nash  
Ofcom Scotland  
Sutherland House  
149 St Vincent St  
Glasgow G2 5NW  
Tel: 0141 229 7401  
Fax: 0141 229 7433  
E-mail: [Vicki.Nash@ofcom.org.uk](mailto:Vicki.Nash@ofcom.org.uk)

## Annex 2

# Ofcom's consultation principles

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

### Before the consultation

- A2.1 Where possible, we will hold informal talks with people and organisations before announcing a big consultation to find out whether we are thinking in the right direction. If we do not have enough time to do this, we will hold an open meeting to explain our proposals shortly after announcing the consultation.

### During the consultation

- A2.2 We will be clear about who we are consulting, why, on what questions and for how long.
- A2.3 We will make the consultation document as short and simple as possible with a summary of no more than two pages. We will try to make it as easy as possible to give us a written response. If the consultation is complicated, we may provide a shortened version for smaller organisations or individuals who would otherwise not be able to spare the time to share their views.
- A2.4 We will normally allow ten weeks for responses to consultations on issues of general interest.
- A2.5 There will be a person within Ofcom who will be in charge of making sure we follow our own guidelines and reach out to the largest number of people and organisations interested in the outcome of our decisions. This individual (who we call the consultation champion) will also be the main person to contact with views on the way we run our consultations.
- A2.6 If we are not able to follow one of these principles, we will explain why. This may be because a particular issue is urgent. If we need to reduce the amount of time we have set aside for a consultation, we will let those concerned know beforehand that this is a 'red flag consultation' which needs their urgent attention.

### After the consultation

- A2.7 We will look at each response carefully and with an open mind. We will give reasons for our decisions and will give an account of how the views of those concerned helped shape those decisions.

## Annex 3

# Consultation response cover sheet

- A3.1 In the interests of transparency, we will publish all consultation responses in full on our website, [www.ofcom.org.uk/](http://www.ofcom.org.uk/), unless a respondent specifies that all or part of their response is confidential. We will also refer to the contents of a response when explaining our decision, without disclosing the specific information that you wish to remain confidential.
- A3.2 We have produced a cover sheet for responses (see below) and would be very grateful if you could send one with your response. This will speed up our processing of responses, and help to maintain confidentiality by allowing you to state very clearly what you don't want to be published. We will keep your completed cover sheets confidential.
- A3.3 The quality of consultation can be enhanced by publishing responses before the consultation period closes. In particular, this can help those individuals and organisations with limited resources or familiarity with the issues to respond in a more informed way. Therefore Ofcom would encourage respondents to complete their cover sheet in a way that allows Ofcom to publish their responses upon receipt, rather than waiting until the consultation period has ended.
- A3.4 We strongly prefer to receive responses in the form of a Microsoft Word attachment to an email. Our website therefore includes an electronic copy of this cover sheet, which you can download from the 'Consultations' section of our website.
- A3.5 Please put any confidential parts of your response in a separate annex to your response, so that they are clearly identified. This can include information such as your personal background and experience. If you want your name, address, other contact details, or job title to remain confidential, please provide them in your cover sheet only so that we don't have to edit your response.

## Cover sheet for response to an Ofcom consultation

### BASIC DETAILS

Consultation title: Regulation of Business Retail Markets

To (Ofcom contact): Michael Richardson

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

### CONFIDENTIALITY

What do you want Ofcom to keep confidential?

Nothing

☐

Name/contact details/job title

☐

Whole response

☐

Organisation

☐

Part of the response

☐

If there is no separate annex, which parts?

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

### DECLARATION

I confirm that the correspondence supplied with this cover sheet is a formal consultation response. It can be published in full on Ofcom's website, unless otherwise specified on this cover sheet, and I authorise Ofcom to make use of the information in this response to meet its legal requirements. If I have sent my response by email, Ofcom can disregard any standard e-mail text about not disclosing email contents and attachments.

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

☐

Name

Signed (if hard copy)

**Annex 4**

## Consultation questions

*Question 1. Do you agree with the proposal to consent to BT departing from its published prices where services are replicable?*

*Question 2. Do you agree that consent to BT departing from its published prices should be limited to prices above a floor defined by fully allocated costs? Would the application of such a price floor adequately address any concerns which you have about the general proposal to consent to departures from the published price list? Do you agree that Ofcom should not presume that service bundles which fail an implicit price – cost test at the individual service level are unduly discriminatory?*

*Question 3. Do you agree that BT should not be obliged to notify bespoke prices to Ofcom or publish bespoke prices after the event?*

*Question 4. Do you agree that any consent to BT departing from its published prices should initially be limited to prices offered to customers already spending in excess of £1m per year with BT?*

*Question 5. Do you agree that where business inland calls and business exchange lines are considered replicable for the purpose of allowing service bundles which include these products, then business inland calls and business exchange lines should also be considered replicable for the purpose of allowing unpublished bespoke prices?*

## Annex 5

# Impact assessment

- A5.1 The analysis presented in this section of this document, when read in conjunction with the rest of this document, represents an Impact Assessment ("IA"), as defined by section 7 of the 2003 Act.
- A5.2 IAs provide a valuable way of assessing different options for regulation and showing why the preferred option was chosen. They form part of best practice policy-making and are commonly used by other regulators. This is reflected in section 7 of the 2003 Act, which means that generally we have to carry out IAs where our proposals would be likely to have a significant effect on businesses or the general public, or when there is a major change in Ofcom's activities. In accordance with section 7 of the Act, in producing the IA in this document Ofcom has had regard to such general guidance as it considers appropriate, including related Cabinet Office guidance and Ofcom's own draft guidance entitled Better Policy Making: Ofcom's approach to Impact Assessments.  
[http://www.ofcom.org.uk/consult/condocs/ia\\_guidelines/?a=87101](http://www.ofcom.org.uk/consult/condocs/ia_guidelines/?a=87101)

## Aim of the proposal

- A5.3 Ofcom's principal duty in carrying out its functions, as set out in Section 3(1) of the Act, is to further the interests of citizens in relation to communications matters, and to further the interests of consumers in relevant markets, where appropriate by promoting competition. Section 4 of the Act sets out Ofcom's duties for the purposes of fulfilling Community obligations. In regard to Ofcom's proposal outlined in the present document, to permit BT to depart from its published prices by offering bespoke and individual prices and tariffs, Ofcom has considered all the requirements in those sections, in particular furthering the interests of consumers in relevant markets, where appropriate by promoting competition; the desirability of promoting competition, the desirability of encouraging investment and innovation; and promoting efficient and sustainable competition in the provision of electronic communications networks and services.

## Summary of the issues

- A5.4 As explained in paragraph 2.7 above, this consultation document considers whether, where competitors are able to replicate technically and commercially services in business retail markets where BT has been designated as having SMP, Ofcom should consent to BT offering unpublished bespoke prices. At present, as is explained in paragraph 2.5, BT must adhere to published prices.
- A5.5 The advantages of requiring providers with SMP to adhere to standard published prices were explained in section 4 above. These have to do with a belief that where a dominant supplier faces varying degrees of competition, customers and competitors may benefit if that dominant supplier is obliged to offer uniform prices to all broadly comparable customers. Under those obligations, customers in areas of relatively weak, or non-existent, competition will be offered services at the same price as customers in areas of relatively strong competition and where competition may already have started to have an impact on prices. Competitors too may be able to compete more effectively if the dominant supplier is obliged to offer all price packages to all broadly comparable customers as, under these obligations, the dominant supplier would not be able to reduce his prices in response to the direct

threat of competition while maintaining high prices and generating high profits elsewhere.

- A5.6 Section 4 above also assessed the likely impact of replicability on the need to constrain a dominant provider's ability to target aggressive discounts on those areas where it faces most competition. Paragraph 4.6 observed that replicability goes some way to addressing the problem of targeted price cuts by enabling competition to be more uniform.
- A5.7 Section 2 above (paragraphs 2.13 to 2.16) considered the disadvantages of regulation which requires BT to adhere to its published price list. These included concern by large purchasers that regulation prevents them from exercising buyer power, and concern by BT, and Ofcom, that price list adherence obligations can mute competition by enabling a degree of price-following by competitors.

### Options considered

- A5.8 Ofcom has considered 3 main options for regulatory action when BT's business exchange lines and inland calls are found to be replicable:

- Option 1 Do nothing
- Option 2 Conduct market reviews
- Option 3 Grant consent to bespoke pricing

### Option 1

- A5.9 Under section 6 of the Communications Act, Ofcom has a duty to ensure that it does not impose or maintain unnecessary regulatory burdens. Furthermore, as was explained in paragraph 2.1 above, while the Universal Service Directive provides for NRAs such as Ofcom to impose ex ante conditions on providers with SMP in retail markets, this provision applies only where the NRA is unable to achieve the objectives set out in Article 8 of the Framework Directive by setting access-related conditions or SMP conditions in wholesale markets. For these reasons, Ofcom is obliged to pay close attention to whether existing regulation of retail markets remains appropriate irrespective of whether, for example, market shares might strongly suggest that one or more provider has SMP. Given the expected impact of replicability, referred to in Section 4 above, Ofcom has concluded that it would not be proportionate to do nothing when replicability is delivered, as a continuing prohibition on the offering of bespoke unpublished prices would mute competition to supply these services and prevent business customers from negotiating bespoke prices, terms and conditions to suit their particular circumstances.

### Option 2

- A5.10 The most recent review of the retail markets for inland calls and exchange lines was concluded in December 2003, and Ofcom's Strategic Review of Telecommunications gave further consideration to these markets during 2005. Given the conclusions of those reviews and the limited time, if any, during which the wholesale remedies (Wholesale Line Rental and Carrier Pre Selection) have been available in a fit for purpose state, suggest that reviews of the business calls and exchange line markets, if conducted today, are unlikely to find these markets competitive. As such, Ofcom believes it may be more productive to delay market reviews for some months until market conditions have shown some signs of having



altered. In the meantime Ofcom will continue to monitor closely all market developments.

### Option 3

- A5.11 As explained in section 4 above, it is Ofcom's preliminary view that the availability of fit for purpose wholesale services, on terms which enable BT's retail services to be replicated by competitors, does go some way to addressing the problem of targeted price cuts by enabling competition to be more uniform. In Ofcom's preliminary view, the impact of replicability requires a proportionate change in regulation which will enable BT to offer targeted price cuts in response to competitive pressure.
- A5.12 BT's economies of scales and scope, its large existing customer base, and the other factors considered in section 4 above do continue, however, to afford BT material competitive advantages. For this reason, Ofcom currently believes that it would be prudent to control BT's ability to target aggressive price cuts by limiting consent to the offering of bespoke unpublished prices to prices which observe a price floor based on BT's fully allocated costs. Where retail services can be replicated by BT's competitors, Ofcom does not currently believe that it would be proportionate to require bespoke service bundles, which include services from markets where BT has SMP, to pass an implicit price – cost test, as such tests are intended primarily to address concerns about the inability of non dominant providers to offer complete service bundles in competition with a dominant provider. The basis of this view were explained in paragraph 4.23 to 4.26 above.
- A5.13 Ofcom has considered the merits of requiring BT to publish, or notify to Ofcom, all bespoke prices offered to particular customers but, as was explained in paragraphs 5.2 to 5.4, has reached an initial conclusion that this would not be a proportionate response to the remaining competition concerns.
- A5.14 Ofcom has also considered whether a different approach to regulation should be taken in respect of services offered to larger and smaller business customers. As was summarised in Section 3 above, Ofcom conducted quantitative and qualitative research to investigate whether different regulatory strategies are warranted. Although Ofcom found no evidence to support distinct regulation in respect of larger and smaller business customers, Ofcom does currently believe that the impact of allowing BT to offer bespoke unpublished prices may be sufficiently powerful that it warrants Ofcom adopting a cautious approach and, initially, limiting consent to a defined subset of business customers. For the reasons explained in paragraph 4.29 above, Ofcom believes it would be prudent to limit consent to the offering of bespoke unpublished prices to offers made to customers already spending in excess of £1 million per year with BT.
- A5.15 In reaching these preliminary conclusions, Ofcom believes it has achieved an appropriate balance between ensuring the continued development of competition in the presence of SMP while enabling BT to respond to the needs of individual consumers.

## Annex 6

# Retail markets in which BT has SMP and where Ofcom proposes to grant conditional consent to departures from the published price list

### **In the United Kingdom excluding the Hull area-**

- Business analogue exchange line services;
- Business ISDN2 exchange line services;
- Business ISDN30 exchange line services;
- Business local calls;
- Business national calls;
- Business calls to mobiles;
- Business operator assisted calls

## **Annex 7**

# **SMP conditions which presently apply to BT in the markets listed in annex 6**

### **Condition D2 – Requirement not to unduly discriminate**

D2.1 The Dominant Provider shall not unduly discriminate against particular persons or a particular description of persons in relation to services offered.

D2.2 Nothing done in any manner by the Dominant Provider shall be regarded as undue discrimination under this Condition if and to the extent that the Dominant Provider is required or expressly permitted to do such thing in that manner by or under any condition set under section 45 of the Act which applies to the Dominant Provider.

### **Condition D3 – Requirement to publish charges**

D3.1 Except in so far as the Director may otherwise consent in writing, the Dominant Provider shall publish charges, terms and conditions and act in the manner set out below.

D3.2 The Dominant Provider shall publish charges, terms and conditions, including bundled charges, terms and conditions (whether or not those bundles include charges, terms and conditions for services supplied in markets to which this Condition does not apply).

D3.3 The Dominant Provider shall publish any amendments to the charges, terms and conditions published under paragraph D3.2, including charges, terms and conditions for any new services, within 24 hours of the time that the amendment comes into effect.

D3.4 Publication referred to in paragraphs D3.2 and D3.3 shall be effected by placing a copy of the information on any relevant website operated or controlled by the Dominant Provider.

D3.5 The Dominant Provider shall send to the Director a written notice of any amendment to the charges, terms and conditions published under paragraph D3.2 (including charges, terms and conditions for any new services) within 24 hours of the time that the amendment comes into effect and shall send a copy of the notice to any person who may reasonably request such a copy.

D3.6 Where it would be impractical for the Dominant Provider to publish under paragraphs D3.2, D3.3 or D3.5 any charge or amended charge, the Dominant Provider shall instead publish the method to be adopted for determining that charge or amended charge.

D3.7 The Dominant Provider shall provide services at the charges, terms and conditions published under this Condition, and shall not depart there from either directly or indirectly.