

BT's Pricing of Services for Business Customers

A statement published by Ofcom

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Section 1

Summary

Consultation on discounted service packages offered to business customers

1.1 On 29 December 2003 Ofcom assumed its powers under the Communications Act 2003 (the “Act”). References in this document to Ofcom include references to the Director General of Telecommunications and Ofcom, where appropriate.

1.2 This statement concludes the consultation exercise which was formally initiated by Ofcom on 15 October 2003 when it published a consultation document “[BT’s pricing of services for business customers](#)” (the October Consultation”).

1.3 The October Consultation considered whether British Telecommunications plc (“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 Significant Market Power (“SMP”). The document also considered whether when responding to invitations to tender, there are additional arguments for allowing BT to offer unpublished, bespoke prices.

1.4 The key proposals in the October Consultation were concerned with circumstances where, notwithstanding BT’s SMP in retail markets, BT’s competitors are able, technically and commercially, to replicate services in a market where BT has SMP. The October Consultation considered whether, in these circumstances, BT should be permitted to offer discounted bundles which include such services; such bundles have generally been considered unduly discriminatory. The consultation also considered whether Ofcom should consent to such discount schemes not being published

1.5 At the time when the October Consultation was published, BT was required to publish its prices and was prohibited from unduly discriminating in respect of virtually all electronic communications services supplied to retail business customers. Since then, there has been extensive deregulation and, in respect of retail services for business customers, only exchange lines and inland calls are subject to SMP conditions imposed under the Act following implementation of the new European regulatory framework. Ofcom has proposed that retail leased lines with a bandwidth of up to 8Mbit/s should also be subject to SMP conditions.

1.6 This major withdrawal of retail regulation is in line with the view adopted by the European Commission that retail regulation should be applied only where regulation of the upstream wholesale market is not sufficient to address market failure. Nevertheless, BT’s competitors have expressed serious concerns. While Ofcom believes that its approach is appropriate, and that reduced ex ante regulation combined with competition law should be sufficient to deal with the risk of anti competitive behaviour in markets in which regulation has now been discontinued, Ofcom considers that it would not be appropriate, at this time, to trial the uncertain effects of a more flexible approach to the application of remedies in those few remaining, tightly defined, markets where BT has recently been found to have SMP.

1.7 Ofcom has concluded that, in the circumstances of emerging competition described in paragraph 1.4 above, 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.

1.8 Ofcom is not persuaded that contracts awarded by tender can be distinguished reliably from contracts awarded by other means, and Ofcom has concluded, therefore, that the same tests should be applied in both cases. Ofcom believes there is no practical or theoretical evidence that the process of tendering is sufficiently transparent to allow the obligation to publish prices, which would apply in other situations, to be waived. Neither does Ofcom believe that the risk of foreclosure through targeting is always reduced by the nature of tendering, even where the invitation to tender is genuinely customer-driven. Given that many purchasers which invite tendered bids for a single bundle of services are receptive to part offers, Ofcom has concluded that any bundled offer which includes services from a market where BT has SMP should be required to pass an implicit price - cost test.

1.9 Many services in retail markets where BT has SMP are not currently replicable, and it is possible that the circumstances of emerging competition outlined in paragraph 1.4 above do not yet exist in any market where BT has SMP. Ofcom believes it is unlikely to be appropriate to allow any bundling of SMP and non SMP services for at least 12 months. Nevertheless, Ofcom believes the conclusions of this review should form the basis of a more flexible approach to ex ante regulation as markets move towards becoming competitive. Ofcom would expect to consult further in relation to specific services in markets which are moving towards sustainable competition to determine whether the time is right to apply ex ante regulation more flexibly as described above.

1.10 The consultation responses on the question of replicability highlight that this is an issue of considerable importance to the future of regulation. The evidence presented suggests that true replicability will be difficult to achieve as long as the wholesale products which BT offers to rival companies differ in material respects from the products which BT makes available to its own downstream retail operations. There may be ways that such differences could be addressed, either through voluntary action by BT or by regulatory intervention. The implications of this problem, and the options and choices available to address it, will be considered as part of Ofcom's strategic review of telecommunications.

Section 2

Introduction

Background

2.1 British Telecommunications plc (“BT”) has proposed from time to time that Ofcom should remove or relax regulation which applies to the supply of retail electronic communications services to large business customers. BT has variously argued that (i) Ofcom should define a market for the supply of the generality of electronic communications services to large business customers spending more than a given amount and should find that market effectively competitive, or (ii) Ofcom should further sub divide economic markets for the supply of specific service(s) to business customers by recognising distinctions between the supply of the relevant services to large business customers and other business customers, or (iii) Ofcom should loosen regulation intended to reflect the existence of market power where services within the relevant market are supplied to large business customers. Ofcom has consistently argued that it is not appropriate to define a single market for the supply of the generality of telecommunications services to large business customers as the competitive conditions will vary significantly between the services. Ofcom has also taken the view that it is not possible to identify an appropriate breakpoint between large and other business customers and, therefore, it is not appropriate to try and sub divide service -specific markets to reflect any differences between the supply to large and other business customers.

2.2 On 15 October 2003 Ofcom published a consultation document [BT's pricing of services for business customers](#) (the October Consultation) . The document considered the circumstances when 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 considered how ex ante regulation might be applied more flexibly to enable this. The document also considered whether when responding to invitations to tender, or participating in certain other formal procurement processes, there are additional arguments for allowing BT to offer unpublished, bespoke prices for bundles of services which include services from markets where BT has SMP. The overarching purpose of the exercise was to establish the most reasonable balance between delivering customer benefits today (ie lower prices for bundled services and more vigorous price competition) without increasing future scope for BT to damage competition in the relevant markets.

2.3 At the time when the October Consultation was published, BT was required, by regulation continued from the pre July 2003 telecommunications regime, to publish its prices and was prohibited from unduly discriminating in respect of virtually all retail electronic communications services supplied to business customers, including, but not limited to, analogue and digital exchange lines, all retail calls, all leased lines, IPLCs, VPN and IVPN services such as Cellstream, Framestream, BTNet and IPClear, Centrex, Featurenet, Featureline, retail broadband access, Chargecard services, and Broadcasting conveyance services such as MediaNet and TVNet.

2.4 The view of Ofcom when the October Consultation was published was that, provided competitors are able to replicate, commercially and technically, the services included within a bundle of services, or the services which may be aggregated for the purpose of calculating entitlement to a discount, and BT's prices pass appropriate implicit price – cost and net revenue tests, then BT should be permitted to offer

discounted prices for bundles of services and discount schemes based on expenditure aggregated across a range of services, even where some of the services included are from markets where BT has SMP. It was also Ofcom's view, however, that the prices of these bundles of services, and full details of the discount schemes, should be published and made available to all broadly comparable customers, and eligibility criteria should be sufficiently flexible that, in practice, the discounted bundle is available to more than just a narrowly targeted customer or group of customers.

2.5 The October Consultation also considered BT's proposition, on which Ofcom had not previously consulted, that where services from markets where BT has SMP are offered to customers through a formal process of tendering, regulatory controls should be loosened still further and, for example, normal price publication rules might cease to apply, allowing BT to offer customer-specific discounts which are neither published nor made available to any other customers. The document also considered whether, if purchasers which invite tendered bids tend to define a bundle of services which are required to be supplied as a complete package by one supplier, an obligation to pass an implicit price – cost test also might not be appropriate, as the customer himself may have ruled out the possibility of splitting his purchase between several suppliers, some of whom might not be capable of supplying the full bundle of services.

Recent developments

SMP findings in retail narrowband markets

2.6 On 28 November 2003, Ofcom published a statement entitled [Fixed Narrowband Retail Markets](#) (the "Retail Narrowband Statement"). In that statement Ofcom confirmed its initial conclusion, announced in August 2003, that BT has SMP in retail narrowband analogue and ISDN exchange line markets and in local, national and international calls markets, with the exception of Business IDD calls. Consequently, Ofcom imposed SMP conditions in these markets, including conditions which require prices to be published and which prohibit undue discrimination. At the same time, regulation in respect of these markets which had been continued from the pre July 2003 telecommunications regime, including regulation in respect of Business IDD calls, was discontinued.

2.7 Paragraph 2.7 of the Retail Narrowband Statement reiterated Ofcom's view that it is not appropriate to define a single market for the supply of the generality of telecommunications services to large business customers as the competitive conditions vary widely between services. Paragraph 2.8 of that document also reiterated that if it can be verified that competitive conditions vary between large and small business customers for specific services, but a break-point cannot readily be identified, then the appropriate and proportionate response may be to consider the scope for flexible interpretation of ex ante obligations in certain circumstances. The statement acknowledged that competitive conditions may not be completely homogenous within markets and that Ofcom was already consulting, in the October Consultation, on how such differences might be reflected in the application of the remedies which the Retail Narrowband Statement applied to markets where BT has SMP.

Withdrawal of regulation from retail broadband markets

2.8 On 13 May 2004 Ofcom published an Explanatory Statement and notification entitled [Review of the Wholesale Broadband Access Market](#) (the "May Wholesale Broadband Access Statement"). That document imposed regulation in various wholesale broadband markets, but withdrew all regulation of retail broadband

markets which had been continued from the pre July 2003 telecommunications regime.

Proposed SMP findings in retail leased lines markets

2.9 On 18 December 2003 Ofcom published an Explanatory Statement and notification entitled "[Review of the retail leased lines, symmetric broadband origination and wholesale trunk segments markets](#)". (the "December Leased Lines Statement"). In that document Ofcom set out its proposals, amongst other proposals, that BT has SMP in the retail market for leased lines up to 8Mbit/s and that SMP conditions should be imposed requiring, amongst other things, that BT should publish its prices for all services in this market and that BT should be prohibited from unduly discriminating in the supply of these services. That document also reiterated Ofcom's view that retail markets for leased lines above 8Mbit/s should not be reviewed with a view to imposing ex ante regulation but, instead, reliance should be placed on regulation of the appropriate wholesale markets. Ofcom is presently considering responses to this consultation and expects to publish a concluding statement shortly.

Discontinuation of old-regime regulation of other retail markets

2.10 On 8 April 2004, Ofcom published a statement entitled "Discontinuation of continued provision Condition 43" (the "April Condition 43 Statement"). Notices attached to that statement discontinued continued provision condition 43 in all markets except those which Ofcom was reviewing or had plans to review. Where continued provision condition 43 applies to a service, continued provisions Conditions 57 and 58 also apply, and these respectively prohibit undue discrimination and require price publication. The April Condition 43 Statement followed the publication of a similar statement and associated notices in October 2003 which discontinued continued provision condition 43 in respect of a narrower range of specified services. Continued provision condition 43, and continued provisions conditions 57 and 58, now apply only to retail leased lines and retail Broadband services which are reliant on alternative interface symmetric broadband origination. Ofcom will discontinue continued provision condition 43, and the associated continued provisions conditions 57 and 58 when it has concluded its present review of the Leased Lines markets.

Significant withdrawal from retail regulation

2.11 The cumulative effect of the actions referred to in paragraphs 2.6 to 2.10 is that BT is now obliged to publish its prices and is prohibited from unduly discriminating in respect of a much-reduced set of retail services for business customers. If Ofcom maintains the views expressed in the December Leased Lines Statement, and acts accordingly, the extent of retail markets which serve business customers where BT is subject to SMP conditions will be limited to analogue and digital exchange lines, local, national and operator assisted calls, calls to mobiles and leased lines up to 8Mbit/s.

2.12 BT's annual turnover in the retail markets which have been, or which Ofcom has proposed should be, removed from the scope of ex ante regulation since the new European regulatory framework came into force in July 2003 is difficult to assess with a high degree of accuracy. Ofcom estimates that around £2 billion of turnover in respect of retail services supplied to business customers has been deregulated in recent months. This compares with around £4 billion of retail services (calls, exchange lines and lower bandwidth leased lines) supplied to business customers

which are in markets in which it has recently been found, or proposed, that BT still has SMP.

Revenues generated by supply of business telecoms services

2.13 Ofcom has undertaken further analyses of its own in house and additional data sources to provide more precise estimates of the value in revenue terms of the supply of telecoms services to business customers.

2.14 Ofcom holds comprehensive information on the total revenues of the major providers of business telecoms services in the UK. These data suggest that total retail spend on fixed telecoms services in the year to March 2003 was £24.5bn¹. Of this £8.2bn was accounted for by residential customers leaving an estimate of total business spend of £16.3bn.

2.15 However not all data are reported on a similar basis and in particular it is difficult to produce consistent estimates of revenues from “high” spending business customers. Ofcom has thus supplemented company level data with data on spend derived from surveys of business customers. Ofcom conducts quarterly omnibus surveys of small and medium enterprises (those with less than 250 employees) which provide an estimate of average telecoms spend. Data for the financial year 2002/03 suggested that the average fixed telecoms spend (including Internet and broadband services) for SMEs was something around £350 per month which translates to a total revenue stream of some £6bn per year. Using this information with the total business spend estimate above would suggest that large businesses spend something of the order of £10bn on fixed telecoms services.

2.16 Shortly before and after publication of the October Consultation Ofcom commissioned further qualitative surveys of the purchasing behaviour of larger business customers (those with more than 250 employees). These surveys were intended to assess the degree of competition in the provision of telecommunications services to large businesses. The first survey, using a panel of large business customers was conducted between 11 September 2003 and 6 October 2003 and covered topics including overall spend of telecommunications services, the range of those services, the suppliers used, supplier switching and satisfaction with suppliers. While spend figures can be considered somewhat approximate the survey suggests an average level of spend on telecommunications services of over £1m per annum which suggests an overall spend figure of a similar order of magnitude to the £10bn figure derived above.

Market share

2.17 BT estimated that in Q2 2003/04 that 31 per cent of its total turnover was derived from the “major corporate” customer group². This is equivalent to around £5bn per annum. Notwithstanding differences in definition this would suggest that BT enjoys a share by revenue of around 50% within this sector.

2.18 Results from the first Ofcom survey are not inconsistent with the market share figure derived above and indicative that BT retains a dominant share of the supply of most services to large business customers (note that the percentage figures given have been rounded to the nearest 10 per cent). BT was named as a supplier of

¹ Source: Ofcom; Analysys (additional analysis for Ofcom). Figures exclude mobile and wholesale revenues

² <http://www.btplc.com/News/Presentations/Generalpresentations/q203slides.ppt>

specific services by more customers than were any other suppliers, ranging from 40% of buyers stating that they use BT as a VPN supplier to 80% stating that they use BT as an ISDN2 supplier. While these percentages do not directly measure market share, as some customers named more than one supplier of some services (particularly for calls) they demonstrate that BT retains a strong presence.

Single sourcing

2.19 About 60% of the group surveyed were multi site companies which use more than one supplier although whether different suppliers are allocated to different sites or to deliver a limited range of services to all sites varied from user to user. Nevertheless, the survey revealed a widespread desire (70% of large business users) to source most telecommunications services from a single company, mainly to simplify administration, rather than to benefit from discount schemes

Contracts and tendering

2.20 Ofcom conducted a second survey between 29 October 2003 and 19 November 2003 which focused, among other things, on the procurement of services including the use of tenders and customers' ability to negotiate. Summary results are reported below. As before, percentages have been rounded to the nearest 10 per cent.

2.21 The survey confirmed that tendering is widely used to place telecommunications contracts. Almost all large business customers claimed to use tendering at least some of the time, and about a quarter of those customers with an annual spend between £1 million and £4.9 million reported that their minimum value threshold for tendering was as low as (or lower than) £1,000. The survey suggested that large business users were more likely to invite tendered bids for a single service (60%) rather than for a bundle of services (40%), though larger customers were more likely than others to seek bundled offers. Meetings to clarify the tendered requirement, post-tender negotiation with a short list of suppliers and further discussion about price with the chosen supplier appear to be the norm. The award of further requirements to the chosen supplier is common. Indeed, amongst the characteristics of tendering, the practice of post-tender negotiation appears to be more widespread and more frequent even than the issue of a formal invitation to tender. Typically, about 4 possible suppliers are invited to tender, from which a short list of 2 or 3 is usually selected for further negotiation. Most large businesses (80%) report that they do not use systems integrators to supply any of their telecommunications needs, and 70% of those that do use systems integrators report that this accounts for less than 10% of their total telecoms expenditure. About 60% of large business customers which use tendering usually invite bids to supply all of their sites. Most of those who invite bids on a regional or site basis do so because they believe they will get a better deal by doing so. A minority (less than 20%) do so because they have concerns about limited geographic coverage of suppliers.

2.22 Most companies expect to benefit from price reductions when they invite tendered bids. The largest customers with national spread were more likely (40%) than large businesses with local or regional spread (30%) to expect to be able to attract a discount of greater than 10%. Those customers who named BT as their main supplier were twice as likely (40%) as other customers to report expectations of a price saving through tendering of 10% or more, which may suggest that regulation of BT's SMP services is not preventing BT from competing strongly on price in respect of a wider range of other services.

2.23 Almost all large business customers use BT to supply at least some element of their telecommunications needs. About 40% of these large business users report that they are able to negotiate contract terms with BT (the proportion is not dissimilar to the proportion reporting that they can negotiate terms with certain other suppliers). Overall satisfaction with ability to negotiate is high. However the proportion which reports that it is difficult to negotiate with BT (55%) is notably higher than figures reported in respect of other suppliers. The key reason given for it being difficult to negotiate with BT is inflexibility on price negotiation (cited by 80% of those who report that negotiation is difficult). Unsurprisingly, there is a widespread view (reported by 60% of these respondents) that regulation hampers negotiation. Negotiation on contracts for calls was most commonly cited as difficult (80% of large businesses which reported difficulty), followed by leased lines and exchange lines (each cited by about 60% of large business customers who had reported difficulty). Large telecommunications spend and multiple sites were most often cited as factors which help large businesses to negotiate with BT.

Additional data gathering from the telecommunications industry

2.24 On 3 October 2003 Ofcom requested BT and members of UKCTA to supply information about contracts with customers spending more than £1m in the year ended 31/3/03. Companies were asked to report on the volume of new and existing contracts in given value ranges, and the average number of services included in contracts in each value range. Companies were also asked to report on the number of tenders they had bid for in each value range, how many they had won, how many they had decided not to bid for and why, and the average cost of submitting a tender. Gross and net margins for tendered business and non tendered business were also requested. A total of 11 suppliers responded and, while these suppliers can be considered to account for the vast majority of supply of business telecoms services, in revenue terms the value of the contracts considered fell significantly short of the overall estimate of large business telecoms spend derived above. The results reported below can be considered indicative only. Note also that Ofcom agreed to treat all individual responses as confidential.

2.25 Although many companies were unable to supply information in the form requested, and the form in which some responses were supplied was not directly comparable with data supplied by others, it is consistent with the data for BT to have a dominant share of both new and existing contracts with a value of £5 million or more. Although this dominant share is, strictly, only a share of business reported by the 11 companies surveyed, the figure does align reasonably closely with Ofcom's estimate derived from qualitative surveys of large businesses which indicated that BT's share of supply contracts ranges between 40% and 70%, depending on the service considered.

2.26 Responses to the data request also indicated that tendering is the usual means of awarding larger contracts. Most contracts are in the value range £1 million to £4.9 million, and the majority are let by tender. Unsurprisingly, the main reasons cited for a decision not to bid were inability to offer the full range of services required by the customer or to compete on price. Many companies were unable to estimate the cost of putting together a tendered bid, but data received indicates that the cost is substantial, and increases with bid value.

2.27 Ofcom has been unable to draw any robust conclusions from the data submitted in respect of gross and net margins as very few companies provided data about both tendered and non tendered business. The limited data which was supplied did not

appear to suggest significant differences in profitability of tendered and non tendered contracts.

European requirements to publish and adhere to uniform prices

2.28 The October Consultation also set out the legal constraints on Ofcom's ability to apply SMP conditions more flexibly and, in particular, to consent to BT offering unpublished bespoke discounts. Directive 2002/22/EC of the European Parliament and of the Council of 7 March 2003 on universal service and users' rights relating to electronic communications networks and services (the "Universal Service Directive") requires NRAs to ensure that certain information, including prices, is published by undertakings with SMP in the supply of the minimum set of leased lines (defined by the Commission as leased lines with bandwidth up to and including 2Mbit/s). Although the Universal Service Directive allows a supplier with SMP to seek the NRA's agreement to a leased line within the minimum set being supplied other than under its published tariffs and supply conditions, this can be done only in response to a particular request where the SMP supplier considers it unreasonable to apply the published tariffs and supply conditions. Thus, scope to consent to BT offering unpublished prices for retail leased lines up to 2Mbit/s is very limited. While the same European constraints do not currently apply to retail leased lines above 2 Mbit/s, in practice BT no longer offers new supply of leased lines above 2 Mbit/s and up to 8Mbit/s.

2.29 Under the Universal Service Order conditions, set out in the [Statement and Notification of Designation of BT and Kingston as Universal Service Providers and the specific Universal Service conditions](#), published by Ofcom on 22 July 2003 (the "USO Statement"), BT is obliged to provide Telephony Services (single narrowband connections at a fixed location to the Public Telephone Network and/or access to Publicly Available Telephone Services) to both residential and business customers on the basis of uniform prices throughout the UK. Whilst Ofcom may consent to services not being uniformly priced, it stated in paragraph 3.17 of the USO Statement that it would only do so in exceptional circumstances. Any proposed consent would be subject to a period of notification and consultation for at least one month prior to it being made. Should Ofcom consider it appropriate to allow BT to offer bespoke prices for such services (for example, in response to invitations to tender), it would need to consult on a draft consent to such a departure from these obligations.

Section 3

Overall views of respondents to the consultation exercise

3.1 Responses were received from the Communications Managers Association (“CMA”), the UK Competitive Telecommunications Association (“UKCTA”), BT, the SSE group and Techcaliber, and from three companies which made confidential responses. Ofcom held further meetings to clarify views, after the consultation period had closed, with UKCTA, the CMA and BT.

3.2 The CMA, representing a wide cross-section of business users from SMEs to large multi-national corporations, presented a divided view, with members working for the largest multi national companies being in favour of some relaxation of regulation and others being against. On balance, the CMA concluded that this is the wrong time to make a change, particularly in view of the wider strategic review of telecommunications subsequently announced by Ofcom. CMA argued that, in any event, changes should be introduced on a time – limited trial basis so that the effects could be evaluated. Techcaliber, a US consultancy which advises business users of telecommunications, was supportive of proposals to apply regulation more flexibly, particularly in tendering exercises, provided that technical and commercial replicability is feasible and provided that appropriate controls are complied with.

3.3 BT was in favour of relaxing regulation, although BT reiterated its over-riding claim that, in any event, the supply of services to larger business customers is a distinct market in which BT does not have SMP; BT proposed that this market should be defined as contracts valued at £5 million or more. BT’s response equated “competition” with the existence of at least one other potential supplier.

3.4 BT’s competitors expressed concern about the scope for damaging anti-competitive behaviour which regulatory forbearance might present, arguing in favour of a broadening of price publication obligations even to encompass services in markets where BT does not have SMP. SSE was particularly concerned that bundling by BT would impose pressure on some competitors to compete in markets with which they were unfamiliar.

3.5 BT and its competitors presented very different views on the nature of replicability, the value of the concept and how it might be applied. BT argued that, to the extent that the concept had any value, any test should be applied at the level of the full bundle of services and, for example, where a competitor could only fulfil the customer’s requirement by reselling a particular BT retail product within that bundle, the overall bundle might still be deemed replicable if the resold element formed only a small part of the whole bundle. Whether a service was replicable by competitors using their own infrastructure, BT’s infrastructure or infrastructure supplied by another party, was not relevant to BT’s view. BT’s competitors argued that the test of whether a service in a market where BT has SMP is replicable should be based on the availability of a wholesale service from BT and, for the service to be deemed replicable, it would have to be supplied to BT’s competitors on a basis fully equivalent to that on which it was supplied to BT’s own retail arm.

3.6 A more detailed summary of responses is attached as annex 1 to this Statement.

Section 4

Ofcom's conclusions

Timing of further untested changes

4.1 The recent wide scale withdrawal of regulation from BT's retail business, referred to in paragraph 2.12 above, is in line with the strategy adopted by the European Commission, which is to impose ex ante regulation only in those markets characterised by high and non transitory entry barriers, where the emergence of effective competition is not foreseeable and where the application of ex post controls would not be sufficient to address identified market failures. Ofcom's approach also closely follows the Commission's approach which is to impose retail regulation only where regulation of the upstream wholesale market is not sufficient to address market failure.

4.2 Nevertheless, BT's competitors have expressed serious concern about the possible effects of this major withdrawal of regulation. While Ofcom believes that its approach is appropriate, and that reduced ex ante regulation combined with competition law is sufficient to deal with the risk of anti competitive behaviour, Ofcom considers that it would not be appropriate, at this time, to trial the uncertain effects of a more flexible approach to the application of remedies in those few remaining, tightly defined, markets where BT has recently been found to have SMP.

Replicability today

4.3 The key proposals in the October Consultation were concerned with circumstances where, notwithstanding BT's SMP, BT's competitors are able to replicate the supply of services in a market where BT has SMP, on a basis which is technically and commercially viable. The October Consultation considered whether, in these circumstances, BT should be permitted to offer discounted bundles which include such services; such bundles have generally been considered unduly discriminatory. The consultation also considered whether consent might be granted to such discount schemes not being published.

4.4 It is Ofcom's view, that none of those services which Ofcom has proposed should be subject to SMP conditions are currently clearly replicable, technically and commercially, by BT's competitors. Thus, even if the effects of the recent major withdrawal of retail regulation had been fully evaluated, the set of replicable services against which a more flexible approach to the application of remedies might have been tested would currently be an empty set. The nature of replicability will be assessed in more detail by Ofcom's Strategic Telecoms Review.

4.5 Ofcom reported in the October Consultation that some services in markets where BT has SMP appear to be moving towards becoming replicable. The October Consultation proposed that analogue exchange lines are likely to become replicable once analogue Wholesale Line Rental is available from BT in a fit-for-purpose form. Ofcom also proposed that ISDN exchange lines may also become replicable if BT introduces a fit-for-purpose digital Wholesale Line Rental service. Whether a fit-for-purpose Wholesale Line Rental product does enable markets to become more competitive (to an extent which warrants a more relaxed application of SMP remedies) will be considered in the light of circumstances.

4.6 The October Consultation reported that voice calls present particular problems for replicability as alternative providers which wish to compete with BT to supply calls to a customer which rents a BT exchange line will typically have to route calls in a less efficient way than BT is able to route the same calls. This is particularly relevant where the bundle of calls offered includes a large element of local calls, where the cost of the inefficient tromboning between BT's network and the competitor's network represents a much larger part of the overall cost. BT's recently announced changes to its Carrier Pre Selection (CPS) services may address these disadvantages which competitors currently face, and Ofcom will review the situation with industry as the new CPS services are rolled out.

4.7 Ofcom's review of Leased Lines markets has not yet been concluded but, as the October Consultation acknowledged, partial private circuits may eventually enable competitors to replicate some or all of the retail leased lines in markets where SMP remains. The prospects for replicability depend on improvements in processes and prices for delivery of partial private circuits.

4.8 BT's ability to offer ubiquitous coverage is also important because survey evidence confirms that a large proportion of businesses are nationally spread and would prefer to use a single supplier across all sites (about two thirds would prefer to use a single supplier), and make decisions centrally. A supplier's ability to supply all sites is considered by some three quarters of businesses when choosing a supplier. Moreover, any ability to offer discounts based on whole-company spend, including in areas where there is no infrastructure-based competitor to BT, would risk leverage to other areas in the absence of replicability. Any definition of replicability needs, therefore, to take into account competitors' ability to compete on a national basis.

4.9 It is possible that technological, financial or regulatory developments may cause some or all of the remaining services in markets where BT has SMP to become replicable by BT's competitors. This does not appear to be imminent, and the effects of the recent withdrawal of retail regulation are likely to become apparent before these circumstances arise.

Future application of SMP remedies

4.10 Notwithstanding the current absence of replicability in any SMP market, Ofcom does believe that, as markets show signs of moving towards sustainable competition and, by definition, services start to become replicable (whether reliant on wholesale services, alternative infrastructure or some other facility), ex ante remedies for SMP should be applied more flexibly to facilitate the growth of competition, even before SMP is eroded. The precise form which that flexibility might take will depend on circumstances but Ofcom has concluded that some key principles can be set out in advance. These are addressed in the paragraphs which follow.

Bundling and price publication

4.11 Responses to the October Consultation support Ofcom's view that, absent other major changes in the regulatory regime, there is some merit in allowing BT to offer published service bundles and discount schemes which include services from markets where SMP remains but is being eroded by competitors replicating those services. Ofcom believes that such an approach may stimulate competition to some extent by enabling BT to offer a wider variety of tariff options. However, Ofcom would require such tariff options to be published and made available to all broadly

comparable customers, as scope for undetected anti competitive behaviour would be unacceptably wide in the absence of such obligations.

Bespoke offers

4.12 As was explained in the October Consultation, 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. Responses to the consultation exercise generally supported this view, and Ofcom has concluded that all bundles of services which include services for markets where BT has SMP should be made available to all broadly comparable customers, and the onus would be on BT to demonstrate any objective, cost reflective reason for considering that particular groups of customers are not broadly comparable.

Net revenue tests

4.13 Ofcom would require that all discount schemes which bundle services from SMP markets must pass a net revenue test, ie the scheme can reasonably be expected to generate revenue at least equal to revenue which would have been generated by prevailing stand-alone prices. As was explained in the October Consultation, where the test is not met this would suggest anti competitive behaviour and a breach of the prohibition of undue discrimination.

Implicit price -cost test

4.14 Ofcom would also require BT to ensure that a bundle or discount scheme is capable of passing appropriate implicit price–cost tests where BT still retains SMP in respect of an element within the bundle. The implicit pricing of non SMP elements of a bundle below cost, when these elements are offered in conjunction with a service from a market where BT has SMP, would enable BT to leverage its dominance into those non SMP markets, excluding competitors from those markets. Ofcom may, where appropriate, not look at individual elements from markets where BT does not have SMP, as it may be sufficient that the implicit price - cost test is passed when applied to the non-SMP elements as a whole.

4.15 Ofcom recognises that in a situation where the purchaser has decided to procure a bundle of services and has no intention of splitting that bundle between competing providers, a requirement that the package must pass some form of implicit price – cost test when offered by BT may be superfluous. However, responses to the consultation exercise, and to the qualitative research, support Ofcom’s view that few purchasers’ minds are closed to the possibility of splitting a requirement, even when this is put out to tender. Given that most purchasers which seek offers to supply a single bundle of services appear to be receptive to part offers, Ofcom has concluded that any bundled offer which includes services from a market where BT has SMP should be required to pass an implicit price - cost test.

Saw tooth discounts

4.16 As was recognised in the October Consultation, saw tooth discounts schemes based on aggregate expenditure (where, for example, a customer spending more

than £1 million receives a discount on all expenditure, including the first £1 million) are likely to result in a discount scheme failing the appropriate implicit price–cost test and, therefore, it might be argued, as BT has argued, that a direct prohibition of saw tooth discounts is unnecessary where an implicit price – cost test must be applied. However, given the complexity of some discount schemes, and the possibility of differing applications of the implicit price–cost test, Ofcom believes there should be a presumption that saw tooth discount schemes which incorporate services from SMP markets are unduly discriminatory unless BT can substantiate the contrary in any specific instance.

Distinguishing characteristics of tenders

4.17 On balance, Ofcom is not persuaded that contracts awarded by tender can in practice reliably be distinguished from contracts awarded by other means, and Ofcom has concluded, therefore, that the same tests should be applied in both cases. Responses to the consultation exercise and to qualitative surveys commissioned by Ofcom indicated that an extended process of negotiation with more than one short listed supplier usually follows the initial evaluation of tendered bids, during which time the customer, not infrequently, may decide to place his business with more than one supplier. Contracts initially awarded through tendering are frequently extended at a later date and tenders are extensively used by purchasers of communications services to place contracts within a very wide value range.

4.18 Ofcom believes there is no practical or theoretical evidence that the process of tendering is always sufficiently transparent that the obligation to publish prices, which would apply in other situations, should be waived. Neither does Ofcom believe that the risk of foreclosure through targeting is always reduced by the nature of tendering, even where the invitation to tender is genuinely customer-driven and customer-initiated. Tendering may well be used predominantly by well-informed and sophisticated buyers, but the emergence of buyer power is also dependent on the existence of competition between suppliers and the availability of competing options

4.19 The likelihood that purchasers will invite tendered bids only where they believe more than one supplier may be capable of supplying the specified bundle is not in itself an indication that the relevant markets are competitive. Many communications services in markets where BT has SMP are capable of being supplied by more than one supplier, in one form or another. As BT stated in its response to the consultation exercise, in some cases this may be achieved simply by reselling a BT retail service. Ofcom does not accept that resale of BT retail services amounts to evidence of emerging competition.

4.20 Responses to the October Consultation also emphasised the danger that a distinctive approach to the application of SMP remedies, based on an agreed definition of business awarded by tendering, might distort the way tenders are used, providing incentives for BT to “game” the definition by persuading customers to seek tendered bids merely to enable BT to make a bespoke offer. Ofcom shares this concern, which is underlined by the absence of any core features which can be said to define the unique characteristics of tenders and which would warrant a different approach to the application of remedies.

4.21 The October Consultation considered whether any agreed definition of tendering should include a minimum value threshold. Given Ofcom’s wider conclusion that no distinction can reliably be drawn between a contract placed after tendering and contracts placed by other means, there is little merit in considering further the question of value thresholds for tenders. Qualitative data gathered from suppliers and

from large business customers, was, ultimately, inconclusive about BT's share of higher value contracts awarded by tendering compared with its share of lower value contracts awarded by tender. The data did not indicate that margins are generally higher or lower in the case of higher value tenders. Ofcom has concluded that the merit of a value threshold, applied to any form of contract which includes SMP services, probably lies in its limiting effect, reducing the number of transactions in a class to a level where a more robust audit trail can be assured. A high value requirement put out to tender may well be more likely to reach the attention of other possible suppliers than a low value tender, but the same could be said of any high value contract, however awarded.

4.22 Tendering played out against the background of a competitive market helps customers to exercise buyer power, making best use of competition by requiring suppliers to compete on terms dictated by the buyer. Played out against the background of markets where one supplier retains SMP, the process is unlikely to be capable of preventing anti-competitive behaviour by the dominant supplier and, as such, cannot be viewed as an alternative to ex ante regulation where such regulation would otherwise be deemed necessary and proportionate.

4.23 The recent extensive withdrawal of regulation from retail markets already gives BT a much greater degree of flexibility when compiling bids to be submitted in response to invitations to tender. BT proposed, in correspondence submitted after closure of the formal consultation period, that Ofcom should operate an 18 months long trial of a more relaxed approach to regulation of certain bids submitted in response to invitations to tender. Given Ofcom's conclusion that it is not possible to identify any features of tendered bids which reliably distinguish them from other types of bid, Ofcom sees little merit in operating a trial based on such a distinction.

Next steps

4.24 As was stated in paragraph 4.2 above, Ofcom does not believe that a more flexible approach to the application of remedies in SMP markets should be trialled before the impact of recent widespread withdrawal of retail regulation can be determined. Ofcom's present view is that this will take at least 12 months. The results of recent market reviews also indicate that no market where Ofcom has recently found, or proposed, that BT has SMP is likely, within those 12 months, to achieve sustainable competition.

4.25 Should it become apparent, within the next 12 months or beyond, that in a retail market where BT has SMP competitors are able to replicate the services in those markets (whether using wholesale components, alternative infrastructure or otherwise) on a basis which is commercially and technically viable, then Ofcom will consult on whether the time is right to apply ex ante regulation, in that specific market, more flexibly and as outlined in this chapter. That consultation will also consider whether it is possible to assess the impact that the wider deregulation of retail markets has had on the incidence of anti competitive behaviour.

4.26 Where, after consultation in respect of specific markets, Ofcom agrees that ex ante regulation should be applied more flexibly, Ofcom will publish a statement setting out its approach to that market.

4.27 The consultation responses on the question of replicability highlight that this is an issue of considerable importance to the future of regulation. The evidence presented suggests that true replicability will be difficult to achieve as long as the wholesale products which BT offers to rival companies differ in material respects

from the products which BT makes available to its own downstream retail operations. There may be ways that such differences could be addressed, either through voluntary action by BT or by regulatory intervention. The implications of this problem, and the options and choices available to address it, will be considered as part of the strategic review of telecommunications.

4.28 The strategic review will also consider the implications of assessing competition in geographic markets which are much narrower than the UK-wide (ex-Hull) geographic area which Ofcom has tended to utilise. Ofcom recognises that there are arguments that the level of competition differs within the UK. However, we believe that this issue needs to be subject to careful analysis, including a full understanding of the geographic reach of different network operators and service providers. In addition, Ofcom would note that it is not sufficient of itself to show that competitive conditions differ between different locations to invalidate the use of national market definitions, which may still remain the most appropriate basis on which to identify market power in certain markets.

4.29 It should be noted that the nature of ex-ante regulation may mean that different approaches are adopted to regulation than would otherwise be the case under ex-post regulation. Consequently this statement applies only to issues concerning ex-ante regulation and is without prejudice to case law and guidelines concerning the application of the Competition Act 1998 and Articles 81 and 82 of the EC Treaty.

4.30 The matters set out in this Statement cannot fetter Ofcom's discretion and the ability to depart from the position set out in this Statement where warranted is maintained.

Annex 1

Summary of responses

Question 1: Do respondents agree that, subject to appropriate tests being met, BT should be permitted to offer discounted bundles of services which include services from markets where BT has SMP?

CMA members working for the largest multi national customers were broadly in favour of some degree of relaxation which would enable them to negotiate discounts with BT. Most CMA members, however, were fearful of the anti-competitive behaviour which this might facilitate in a vertically integrated company such as BT which is not subject to structural separation. UKCTA too expressed serious concerns about the increased scope for undetected anti-competitive behaviour which this proposal would facilitate, particularly given the recent withdrawal of price publication obligations in many retail markets. BT welcomed the proposal.

Question 2: Do respondents consider that discounted bundles of services (where some of those services are from markets where BT has SMP) should be made available to other broadly comparable customers?

The CMA made no specific comment on this issue, beyond observing the advantages of being able to seek comparable bids from a range of suppliers based on a service specification defined by the buyer (rather than trying to compare unlike offers from different suppliers). Techcaliber agreed that such bundles should be made available to all broadly comparable customers and sufficient information provided to enable customers to decide whether they are interested in or able to purchase the bundle. UKCTA characterised as “essential” the proposition that BT should be prevented from targeting individual customers and expressed some concern about the apparent flexibility of the term “all broadly comparable customers”. Conversely, BT took the opportunity to welcome the term “all broadly comparable customers” as an indication that a greater degree of flexibility would be permitted when defining entitlement to a service. BT went further, however, arguing that it should be permitted to offer targeted bespoke offers to individual large business customers.

Question 3: How might Ofcom define the acceptable limits of targeting?

UKCTA was concerned to ensure that BT is not permitted to offer region-specific discount schemes which would enable it to leverage its national dominance into particular regions. UKCTA argued in favour of an obligation to advance notify changes to bundled tariffs and a prohibition of very short duration offers which, de facto, will be accepted by only a very small group of customers. UKCTA was also concerned that such bundles should not include non-replicable bespoke products. BT asserted that no limits, such as prohibitions of service specific qualifiers, should be imposed beyond a general obligation to make bundles available to all broadly comparable customers.

Question 4: Do respondents agree that prices for discounted bundles of services, which include services from markets where BT has SMP, should be published? Are there any exceptions?

UKCTA argued that BT should be obliged to publish the prices of all such bundles, and went further arguing that BT should also be obliged to publish the stand-alone price of the non-SMP elements of the bundle, including management fees and consultancy. BT took the opposite view, arguing that price publication obligations are disproportionate in the context of supply to large business customers and should be waived, at least with regard to tenders and other competitive bespoke offers of a certain size. BT also claimed that price publication encourages price following and inefficient entry. Techcaliber agreed that BT should publish non-tendered prices to provide transparency for possible anti-competitive behaviour and also to enhance buyer power.

Question 5: Do respondents agree that replicability should be one of the key criteria for deciding whether BT should be permitted to offer a service bundle which includes services from markets where BT has SMP?

UKCTA agreed that the key issue is replicability, and argued that this should also include full transactional equivalence. BT considered that bundles which mix SMP and non-SMP services may raise no competition concerns and implied that a replicability test was unnecessary. BT went on, however, to outline its view that replicability exists where competitors are able to offer a bundle with the same functionality while incurring costs which are lower than the price charged by BT for the bundle. Techcaliber agreed that replicability is essential and BT should be disqualified from supplying non-replicable elements within a bundle.

Question 6: Do respondents agree that when testing the replicability of a service, from a market where BT has SMP, the primary focus should be on the availability of a wholesale service from BT?

UKCTA agreed with this proposition, but added that the wholesale service should also be purchased on the same basis by BT's retail arm and BT's competitors. BT agreed that the availability of a BT wholesale service may be significant, but argued that BT's own costs are more significant in competitive areas and, even where there is no wholesale product available to enable delivery of a service from a market where BT has SMP, that should not mean that the replicability tests fails for the bundle as a whole. BT's view was based on a belief that replicability should be tested at the level of the bundle rather than against each SMP service within the bundle.

Question 7: Under what circumstances is it appropriate to base the replicability test on the capabilities of alternative providers' networks, rather than on the availability of appropriate wholesale inputs from BT?

UKCTA saw no merit in assessing replicability on the basis of competitor infrastructure, arguing that BT should be required to offer wholesale inputs on the same terms and conditions across the geographic region where it has been found to have SMP at the retail level. BT, as was outlined above, argued that any replicability test must be assessed against different criteria in different circumstances, and where there is a degree of network competition there is no need to rely on wholesale provision to prove replicability. Techcaliber broadly agreed that the availability of appropriate BT wholesale services is important, but recognised that in some circumstances competitors may be able to replicate a service using their own infrastructure or using a BT wholesale service (typically an access service) in combination with their own infrastructure.

Question 8: The main factors Ofcom proposes to take into account when assessing replicability are service functionality, cost, quality of service, and availability. Are there other factors that also need to be considered?

UKCTA agreed that these are the key factors but reiterated that full replicability is further dependent on transactional equivalence in the way wholesale services are procured and administered. BT took a very different view, arguing that quality of service and circuit availability should not be critical features of a replicability test as customers may be willing to accept lower quality services from BT's competitors provided that this is reflected in the price.

Question 9: Under what circumstances can market take-up of a wholesale service reduce the requirement for a detailed analysis of replicability?

UKCTA warned against setting up a "market success" threshold, which would automatically trigger a less restrictive regulatory regime, without making a detailed analysis of the underlying replicability. BT warned against relying on such a threshold to judge that a service is not replicable, though BT believed, conversely, that rapid take-up is a strong indicator of replicability.

Question 10: Ofcom has identified a number of factors that could result in an alternative provider facing a higher cost base than BT. Are there other factors that have not been identified here?

UKCTA identified bad debt, credit vetting and system design as additional costs for alternative providers, particularly the charges levied by BT through the PPP charge and PRS bad debt provision and in respect of charges for designing service provider gateways and suitable variants of wholesale services. BT cited the higher internal costs of inefficient competitors, which should not be used to justify constraints on BT. BT also cited the cost advantages of some of its competitors which have more modern networks and which do not have a USO obligation such as prevents BT from configuring its network in the most efficient way.

Question 11: Is it reasonable to assume that analogue exchange lines will be unambiguously replicable once analogue Wholesale Line Rental is available from BT in a 'fit-for-purpose' form? What other retail services, in markets where BT has SMP, are moving towards becoming unambiguously replicable?

UKCTA argued that the term "replicable" cannot be considered the equivalent of "fit for purpose" as used in the context of WLR. UKCTA pointed to differences in service functionality between the services enabled by WLR and the services offered by BT Retail. BT, conversely, stated that analogue exchange lines will by definition be "wholesale replicable" once analogue WLR is available.

Question 12: Is it reasonable to assume that the retail services listed above (ISDN2 access, Ethernet-based LAN extension services, Genus leased lines, Wavestream services) are unlikely to be replicable? What other retail services provided by BT are unlikely to be replicable?

Here again UKCTA and BT took opposite views. UKCTA claimed that such services will never become replicable until BT Retail buys the same wholesale input as its competitors. BT argued that the assumption is unreasonable as a service bundle which includes such services might, nevertheless, be replicable as a whole. More specifically, BT also argued that each of the services is moving towards being

replicable based on wholesale services which Ofcom has or proposes to require BT to supply.

Question 13: Under what circumstances are the retail services listed above (ISDN30 exchange lines, voice calls, SDH leased lines, broadband access) likely to be replicable?

UKCTA repeated its view that replicability is dependent on BT Retail buying the same wholesale inputs as its competitors. BT claimed that all of these services are likely to be replicable, with the exception of ISDN30 which will become replicable when a WLR variant is fully delivered.

Question 14: Are there any other retail services not considered above on which Ofcom ought to provide explicit guidance?

UKCTA stated that it did not believe there are any other replicable services and, indeed, cautioned Ofcom to ensure that the burden to prove replicability in respect of new services is placed on BT. UKCTA also observed, however, that where there is perfect wholesale equivalence, then replicability will be ensured. BT took a very different view, arguing, without reference to any particular services, that all other services in markets where it has SMP are either replicable or moving towards replicability.

Question 15: Which of these options do respondents believe would deliver the most reasonable balance between delivering customer benefits today (ie lower prices for bundled services and more vigorous price competition) without increasing future scope for BT to damage competition in the relevant markets?

UKCTA was strongly in favour of the full application of both tests, ie an implicit price – cost test applied at the level of each service within the bundle and a replicability test. BT was in favour of the application of each of the two tests only where the other test had been failed. Techcaliber agreed that it is not appropriate to apply the implicit price – cost test to services from markets where BT does not have SMP, but added that many buyers will readily split a tendered requirement between suppliers if this is the most cost effective approach.

Question 16: Do respondents believe saw tooth discount schemes should ever be permitted where a supplier has SMP in respect of some or all of the services to which the discount scheme relates?

UKCTA believed that saw tooth discounts should not be permitted under any circumstances at all. BT argued that such discounts should be permitted provided that other economic tests are passed, though BT believed that, in reality, saw tooth discounts are unlikely to pass the implicit price – cost test across the range of their application.

Question 17: Should BT's bundled offers be subject to a net revenue test. If so, should BT's own costs or its transfer charges be used as the relevant cost standard when applying a net revenue test to a bundle of services, some of which are from markets where BT has SMP? Would it be possible to use different standards in different circumstances and, if so, when?

UKCTA argued in favour of a net revenue test being conducted using BT's transfer charges as the relevant cost standard. BT argued that the net revenue test is not

needed where replicability has been demonstrated as, so BT understood, replicability requires that the overall price must be greater than the cost.

Question 18: What criteria should be included in the definition of a tender and how they should be specified?

UKCTA did not consider it appropriate to define a separate market for tenders and, in any event, UKCTA was not supportive of the criteria proposed by BT and reported in the October Consultation. In particular, UKCTA believed the number of pages in the tender had little meaning. UKCTA had specific concerns about how the total value of a tender might be assessed, and proposed that this should be an annualised figure to avoid creating incentives to tie in customers to longer term contracts in order to reach a “tender threshold” above which bespoke pricing is permitted. BT was supportive of the approach outlined, but took the opportunity to call for some flexibility when deciding how many of the criteria should be present in any given case. In BT’s view, where there are at least 2 bidders present, Ofcom should assume that the bundle sought by the customer is replicable and competitive. Techcaliber presented the view that the relevant criteria should be limited simply to the buyer’s issuing a document setting out its requirements and to at least two written responses being received.

Question 19: What should be the minimum contract value for “tenders”? Ofcom is seeking further information from certain suppliers on the competitiveness of tenders but would also be grateful for any further information on the value of tender contracts, the number of bidders and the BT success rate as part of this consultation.

UKCTA argued that the minimum contract value should not be less than £10 million and that this should be an annualised figure which does not include services that are not communication services (such as management fees). UKCTA reiterated its concern that BT would seek to “game” such criteria, and called for Ofcom to monitor such tendencies carefully. BT proposed a total contract value threshold (not annualised) of £5 million. Techcaliber proposed an annual contract value figure of £1 million, based on its understanding that a typical BT contract lasts for 5 years.

Question 20: Does an implicit price – cost test have any value in the context of formal tendering exercises?

The CMA was not persuaded that Ofcom has sufficient accounting data to enable it to judge whether an implicit price – cost test has been met.

UKCTA agreed that if it were possible robustly to define a separate tender market and this market was open to a greater degree of competition than other markets, then an implicit price – cost test would not be necessary. However, UKCTA argued that tenders do not form a separate market. SSE expressed concern that Ofcom’s proposals would force smaller companies such as SSE to compete in markets in which they not have the resources to compete (even if though those markets might be competitive). BT believed that the implicit price – cost test had no role in the context of tendering exercises as the customer has defined a bundle of services which he wishes to be supplied as a group. Techcaliber, however, emphasised that in its experience many purchasers split tendered requirements where this is subsequently found to be cost effective.

Question 21: Is replicability (as defined in chapter 3) an essential test in the context of formal tendering exercises?

UKCTA agreed that replicability, if equated with full transactional equivalence, is an essential test. BT argued that it is not relevant as “competitive tenders”

are themselves evidence of a competitive market, and that customers would not incur the expense of a tendering exercise if they did not believe that this would lead to competitive offers. (BT's understanding of "competitive" in this context appears to have been situations where there is at least one other potential supplier). Techcaliber agreed that replicability remains essential in the context of tendering

Question 22: Should the net revenue test be applied as described in paragraph 5.15 above?

UKCTA agreed that a net revenue test should be applied, but warned of the importance, and difficulty, of identifying the correct cost stacks. BT argued that the net revenue test is not required where the replicability test has been passed, as BT believes replicability includes "comparing prices to costs".

Question 23: Should BT be required to publish details of discounted tariffs offered in response to an invitation to tender? Are there alternative ways to ensure that BT's tendered bids comply with agreed rules such as replicability and net revenue tests?

UKCTA argued that BT should be obliged to publish such details immediately after the customer has announced the winner of the tender, and should produce, on request from Ofcom, full supporting documentation including business case. BT did not believe it should be obliged to publish prices, but offered to list for Ofcom the contracts won by tender, which include SMP services offered at non standard prices, where "after due consideration Ofcom believes there may be reasonable concern". In addition, BT offered to make available to Ofcom supporting documentation only for a period of 12 months from award of contract. Techcaliber proposed that, to ensure fair play, such prices should be made available to BT's competitors after the event, and on a confidential basis such that prices are not revealed to potential customers.

Question 24: Do respondents consider that, outside tender situations, all discount schemes based on aggregate expenditure should be published and made available to all broadly comparable customers?

UKCTA agreed that BT should be limited to offering only published national tariffs and discounts schemes. BT asserted that all "competitive" bespoke offers (ie where there is more than one potential supplier), whether tendered or otherwise, should be subject to the same level of regulation (see responses to preceding question). BT also proposed that this approach should be made subject to a minimum contract value threshold of £5 million.