



BT's response to Ofcom's consultation document  
*"Review of Wholesale Broadband Access Markets"*  
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**NON-CONFIDENTIAL VERSION**

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## 1. Executive Summary

- 1.1. The UK has one of the most competitive and dynamic telecoms markets in the world currently ranking 7<sup>th</sup> on the EC's 2017 Digital Economy and Society Index. This is ahead of any other large Member State and market developments have been supported by Ofcom's focus on promoting competitive entry based on LLU and VULA investment.
- 1.2. Ofcom's analysis shows that now customers in at least 98% of the country have the choice of at least two of the three major broadband providers as well as BT. Against this backdrop, Ofcom must ensure that regulation is applied in a fair and balanced way and avoid regulation distorting competition between BT and rival network operators. The time is right for Ofcom to consider whether SMP regulation is necessary at all, or whether lighter, less intrusive remedies could be used to address any outstanding consumer concerns.
- 1.3. BT agrees with Ofcom's assessment that the size of the geographic area where consumers have limited choice of providers has shrunk dramatically. In particular BT welcomes Ofcom's recognition of the impact of fibre-based services in its geographic analysis in this review.
- 1.4. BT also suggests several further adjustments to improve the accuracy of Ofcom's geographic model so it better reflects the expansion of competition into rural areas. These include adding FTTP rollout and planned fibre build by other operators and moving to an agreed list of distribution points to avoid a systematic underestimate of fibre coverage.
- 1.5. Once Ofcom's model is updated with the latest available data and to reflect the above adjustments, BT believes the size of any proposed Market A will fall to below 1%. At this level, BT questions Ofcom's conclusion that relevant economic market exists in which BT has SMP requiring remedies to protect existing competition.
- 1.6. Ofcom's proposal to remove charge controls from Market A is consistent with a more proportionate approach which is required in light of the changes to market boundaries. BT agrees that these have served their purpose well and are no longer needed to protect consumers. However Ofcom has not gone far enough.
- 1.7. Markets A and B are inextricably linked: at the retail level by indirect constraints from BT's national pricing and at the wholesale level by having the same underlying network serving both markets. This means Ofcom's focus on protecting competitors in Market A is likely to have negative consequences for competition, investment and innovation in the much larger Market B.
- 1.8. The cost of compliance with the proposed regulation, added to the competitive disadvantage that BT faces in Market B as compared to other principal operators, will continue to stifle BT's ability to innovate and provide effective competition at the retail level in Market B to the detriment of consumers. Specifically, price and non-price outcomes will be worse than in the absence of regulation, and these costs are likely to outweigh the very limited (if any) benefits that result from the ongoing protection of a few competitors in Market A.
- 1.9. While regulation may have been justified when Market A still accounted for a significant share of the UK, this cannot be the case for a market BT believes now comprises no more than 1% of UK households. For example it is no longer acceptable that competition in Market B is distorted

by BT having to publish details of any and all changes to its network in advance as a result of remedies imposed in Market A.

1.10. In BT's view Ofcom has not demonstrated that its proposed set of remedies are appropriate, necessary and the least onerous option available and do not produce disproportionate adverse effects as required by its duties under the Communications Act 2003. Ofcom's proposed remedies are also inconsistent with Ofcom's strategic aims in the DCR to deregulate and simplify whilst protecting consumers and promoting competition.

1.11. Nonetheless, if remedies are to be imposed then at the very least Ofcom should:

- should continue to disapply remedies for fibre services in Market A where these are delivered via handover points in Market B;
- remove the obligation to provide services in Market A on an EOI basis in favour of the less onerous 'no undue discrimination' requirement;
- refine the notification obligations to allow for speedier flow through of changes to underlying input products; and
- not increase the level of financial reporting, especially given the reduction in the size of Market A.

## 2. Introduction

2.1. Ofcom's approach to regulating the WBA markets on a geographic basis since 2008 has succeeded in promoting competitive entry on the basis of LLU investment and VULA access. Now only a very small fraction of UK premises remain outside of competitive LLU, cable and VULA footprints. We believe that it is likely when Ofcom updates its model with the latest available data, Market A will cover less than 1% of households.<sup>1</sup>

### Market context

2.2. The market context in which Ofcom is conducting its review of the WBA market does not suggest that there is any further role to play for ex ante regulation at the WBA market layer.

Three key factors are:

- The successful and on-going roll-out and take up of fibre network access at the Openreach level has extended the scope for competition at the WBA layer significantly, and this trend is set to continue. It has so far passed over 26 million homes. The goal is to help the UK government to reach 95% superfast coverage by the end of 2017, and the aim is to use the "gain-share" dividend from the BDUK process to enable further fibre rollout.
- In the Digital Communications Review (DCR) Ofcom laid down its visions and objectives for the telecoms markets over the coming years, expressing a desire to incentivise the building of competitive network infrastructure while committing to deregulation and simplification wherever this was appropriate.
- In 2016 the Government announced its goal of ensuring all consumers receive a guaranteed minimum broadband speed of 10Mbps. It is currently considering an offer made by BT (the Universal Broadband Commitment)<sup>2</sup> to provide a minimum speed of 10Mbps to all premises on a commercial basis (i.e. without recourse to government subsidies). The UBC would address poor broadband speeds and benefit a large share of consumers in Market A. BT believes the UBC, if it goes ahead, is likely to address many of Ofcom's ongoing concerns about broadband provision in Market A in a more targeted and effective way than continued SMP regulation.

### Ex ante regulation of WBA no longer serves any purpose

2.3. Ofcom should consider carefully what concerns it is seeking to address in this residual market. We consider that remedies at the WBA level are no longer warranted in light of the following:

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<sup>1</sup> BT estimates that Market A will be circa 1% when the data is updated in the Ofcom model and would fall to circa 0.7% of UK premises if Ofcom take into account a forward look concerning CP presence at fibre handover points. We believe Sky and Talk Talk Group (TTG) will inexorably extend their reach to all fibre handover points.

<sup>2</sup> DCMS Press Release - Universal broadband to reach every part of the UK:

<https://www.gov.uk/government/news/universal-broadband-to-reach-every-part-of-the-uk>

- Ofcom recognises that further LLU rollout is unlikely and accepts that any regulation of Market A would be unlikely to incentivise additional retail competition.<sup>3</sup> Regulation is not required, therefore, to stimulate additional market entry at any level.
- At the same time, Ofcom acknowledges that BT’s national pricing policy at the retail level protects consumers in Market A from excessive pricing and that BT has no commercial incentives to change this policy for less than 2% of its market.<sup>4</sup>
- Regulation in Market A therefore has the sole purpose of protecting existing choice and competition in Market A, which Ofcom itself admits is comparatively limited.<sup>5</sup>
- Further, as mentioned above, our view is that the UBC is a more appropriate means of securing the improvements Ofcom is seeking for consumers in Market A than further SMP regulation. Ofcom should consider how any such network enhancement (and the resulting enhancement to retail competition) within the review period (i.e. 2018 to 2021) would affect its assessment.

## Document Structure

2.4. The remainder of this response is structured as follows:

- Section 3 deals with Ofcom’s market definition and SMP analysis
- Section 4 comments on Ofcom’s proposed remedies
- Section 5 provides BT’s comments on Ofcom’s proposed financial reporting and cost accounting changes

2.5. This document also includes the following annexes in support of our response:

- Annex 1 provides BT’s comments on Ofcom’s product market definition
- Annex 2 addresses the question of whether the proposed Market A is a relevant economic market that warrants ex ante regulation
- Annex 3 sets out BT’s detailed comments on Ofcom’s geographic analysis
- Annex 4 details BT’s concerns with Ofcom’s proposed Equivalence of Inputs (EOI) remedy

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<sup>3</sup> See paragraph 4.44 of the WBA MR - <https://www.ofcom.org.uk/consultations-and-statements/category-1/wholesale-broadband-access-market-review>

<sup>4</sup> See paragraph 1.16 of the WBA MR.

<sup>5</sup> See paragraph 1.13 of the WBA MR.

2.6. Much of Ofcom's market analysis is set out in Ofcom's 2017 WLA consultation.<sup>6</sup> Therefore rather than repeat in detail BT's comments we have referred to BT's response to the WLA where relevant.<sup>7</sup>

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<sup>6</sup> See paragraph 3.10 of the WLA MR - [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0033/99636/Vol1-Market-review.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0033/99636/Vol1-Market-review.pdf)

<sup>7</sup> See the BT response to Ofcom WLA MR - [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0008/105011/BT.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0008/105011/BT.pdf)

## 3. Market Definition and SMP Analysis

### Introduction

- 3.1. In this section we provide comments on Ofcom's proposed product and geographic market definitions and market power analysis as set out in Sections 3, 4 and 5 of the Consultation.
- 3.2. We broadly support Ofcom's approach to market definition and especially the inclusion of BT fibre-based services in the definition of geographic market boundaries. Fibre and copper-based services are substitutes at the retail layer and fibre has become an important basis for retail broadband competition (albeit still constrained by copper-based services). Fibre has further facilitated third party entry by virtue of that fact that there are far fewer fibre handover points (around 1100) that serve a larger number of premises each than the number of unbundled LLU exchanges (around 3000).
- 3.3. We set out a number of proposals to improve the accuracy of Ofcom's geographic modelling. These are examined in detail in Annex 3. We understand that Ofcom intends to update its analysis to reflect the latest available data, which we believe will show that around 1% of UK premises remain where retail competition relies predominantly on BT's WBA services.
- 3.4. The strength and extent of effective competition in broadband markets is reflected by the now de minimis size of Ofcom's proposed Market A (around 1% of UK premises based on BT's updated analysis), and the steady decline in the size of this market over time. One of the key drivers of this is the rollout of wholesale fibre access services (VULA) by Openreach. This allows CPs to circumvent copper bitstream access products and in due course, when SoGEA<sup>8</sup> is launched in 2018, also copper voice access services.
- 3.5. Ofcom has not fully explored the implications of such a small Market A on market dynamics and BT's behaviour within that market. Even if fibre may not be available to all by the end of this market review period, BT's ability and incentive to exercise market power at the wholesale bitstream layer in any geographic area have now been effectively eliminated, for the following reasons set out below. These are discussed in further detail in Annex 2:
  - BT's largest wholesale customer (BT Consumer) and EE set their retail residential prices at a national level. As Ofcom recognises, BT Consumer is unlikely to increase retail prices only in Market A,<sup>9</sup> so consumers are effectively protected from the risk of excessive pricing in Market A.
  - ✂
  - In the absence of regulation, maintaining geographically differentiated WBA terms, conditions and prices for Market A areas, which are geographically remote and segregated, would incur disproportionate systems and sales costs.

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<sup>8</sup> Openreach's Single Order Generic Ethernet Access product will allow CPs to provide fibre based broadband services using a single fibre access product. Today CPs have to purchase two products GEA to provide fibre access plus MPF or WLA to provide the underlying copper access capability.

<sup>9</sup> See paragraph 6.31 of the WBA MR: Ofcom cites: the fact that BT Consumer never changed this policy, even when Market A constituted a significantly greater share of the national market; the sales and marketing costs it would incur to offer geographically differentiated prices; and the risk to BT's brand reputation.

- Finally, BT would likely face reputational damage to its brand were it to deteriorate in any way the terms, conditions or prices it offers to non-BT CPs in Market A areas, which would outweigh any notional benefits from such a strategy. Further, BT's UBC offer indicates that in fact BT stands ready to improve broadband services in relevant areas, many of which are in Market A.
- 3.6. As a consequence, it would be proportionate, at this juncture, to deregulate Market A, either by concluding that there is no separate Market A, or by significantly reducing regulation to no more than a reporting obligation in relation to in a separate Market A, recognising that there is virtually no risk of consumer detriment in Market A.
- 3.7. In this section we provide comments on how Ofcom's approach to incorporating fibre-based competitive presence should be improved further in its geographic market definition, before discussing in more depth why Market A is no longer a relevant separate economic market. We have limited comments on Ofcom's product market definition (Question 3.1), which are set out in Annex 1.
- 3.8. Before examining the core market boundaries issues, however, we first provide a brief factual summary of the history of WBA regulation. It illustrates the success of increasing the deregulated footprint over time, leading up to this consultation in which Ofcom must consider if continued regulation in a vanishingly small part of the market still serves any purpose, and whether it may actually result in negative outcomes.

### The Evolution of the WBA market

- 3.9. Since 2008 Ofcom has identified different geographic markets based on the presence of competing LLU and cable-based competition (known as Principal Operators (POs)). Table 1 below summarises how, over successive market reviews, Ofcom has found competition to be effective in more and more of the UK, thereby reducing the size of the geographic area subject to SMP regulation.

**Table 1: Evolution of Geographic Markets, Coverage and SMP Remedies\***

Review	Markets (SMP/No SMP)	Coverage of SMP market(s)	Remedies in SMP Markets**
2008	Markets 1 & 2 – split between 1) BT only exchanges 2) exchanges with 1 or 2 Principle Operators (POs) Market 3 – exchanges with BT + at least 3 POs	30%	<ul style="list-style-type: none"> <li>• Obligation to supply on fair and reasonable terms</li> <li>• Obligation not to unduly discriminate</li> </ul>
2010	Markets 1 & 2 – split between 1) BT only exchanges 2) exchanges with 1 PO or 2 POs where BT's market share > 50% Market 3 – exchanges with BT + at least 3 POs or 2 POs where BT's market share <50%	21%	<ul style="list-style-type: none"> <li>• Obligation to supply on fair and reasonable terms</li> <li>• Obligation not to unduly discriminate</li> <li>• Charge control in Market 1; Cost Orientation in Market 2</li> </ul>
2014	Markets A – exchanges with BT and up to 1 PO Market B – exchanges with BT + at least 2 POs	10%	<ul style="list-style-type: none"> <li>• Obligation to supply on fair and reasonable terms</li> <li>• Obligation to supply on an EOI basis</li> <li>• Charge control in Market A</li> </ul>
2017	Markets A – exchanges with BT and up to 1 PO Market B – exchanges with BT + at least 2 POs	2%	<ul style="list-style-type: none"> <li>• Obligation to supply on fair and reasonable terms</li> <li>• Obligation not to unduly discriminate</li> <li>• Obligation to supply on an EOI basis</li> <li>• No charge control in Market A</li> </ul>

*\*In each review Ofcom also defined a separate market, The Hull Area, covering 0.7% of UK premises in which KCOM has been designated as having SMP*

*\*\* In all SMP markets Ofcom also imposed requirements to publish a reference offer and notify changes to terms and condition (28 days) and technical information (90 days)*

3.10. In 2008, Ofcom recognised Market 1 as the market with the least prospect of competition; Market 3 as effectively competitive and Market 2 as having potential for further LLU rollout going forward. Ofcom regulated Markets 1 and 2, but it did not impose a charge control in light of voluntary price ceiling and floor commitments given by BT.

3.11. The boundaries of Markets 1, 2 and 3 were revised by Ofcom in 2010 to i) reflect further LLU and cable rollout and ii) deregulate exchanges with at least 3 POs (including BT) where BT's market share was less than 50%. Following the expiry of BT's pricing commitments Ofcom also introduced a charge control in Market 1. As Ofcom expected Market 2 to see further LLU rollout it did not impose a charge control in Market 2.

3.12. In 2014 most of Market 2 was deregulated when Ofcom defined only two Markets, A (SMP) and B (no SMP). By then LLU rollout had already slowed down. CPs began to take up new fibre based access products and the economics of rolling out LLU to ever smaller exchange areas became more challenging. It has since slowed down even further. Market A in 2014 comprised just under 10% of UK premises, typically remote areas where the economics of rolling out competing broadband infrastructure were more challenging.

- 3.13. Ofcom considered the purpose and proportionality of remedies applied in such a small geographic market, given that consumers in Market A were already afforded protection through a combination of factors. These included BT's national pricing policy at the retail level, so consumers living in Market A areas benefitted from competitive retail prices set in the context of effective retail competition in Market B, and general competition law. In 2014, Ofcom found that the national pricing policy did not afford sufficient protection as BT was free to change its policy at any time if it were in its commercial interest. Ofcom also recognised that it was unlikely that much further LLU or cable based competition was likely to arise in Market A areas.
- 3.14. Since 2014, as expected, further LLU-rollout has been limited. Ofcom accepts that this is likely to be a feature of the investment economics in the remaining Market A areas, where a sparse and remote population drives up the unit costs per customer.<sup>10</sup> However, as foreshadowed by Ofcom in its 2014 decision, fibre-based wholesale access (VULA) has evolved into a larger source of competitive pressure to BT's WBA access products.<sup>11</sup> In its current proposals Ofcom recognises this in its geographic market definition, reducing the size of Market A from 6.5% (based only on copper and cable-based competitive presence) to less than 2%. Ofcom further recognises that in light of BT's enduring national pricing policy at the retail level, and the small size of Market A, imposing a charge control is both unnecessary and disproportionate.
- 3.15. Ofcom is therefore – rightly – continuing the historical trend towards further deregulation of the WBA market, which has allowed broadband competition to develop and flourish. The proposed reduction of Market A to less than 2% of the UK and the removal of the charge control are critical milestones, reflecting Ofcom's DCR commitment to deregulate and simplify wherever feasible.
- 3.16. As set out in this and the following sections, BT is of the view that Ofcom could go even further and define a single national geographic market (excluding Hull) in which no undertaking has SMP in the WBA market. At least Ofcom should reduce regulation to the bare minimum necessary (particularly by removing EOI, but ideally with no more than an ongoing reporting obligation). This would avoid the imposition of disproportionate and unjustified costs on BT and the wider market.

## Product Market Definition

- 3.17. Ofcom proposes to retain the product market definition from 2014 which includes residential and business services, and copper, fibre and cable networks:

*“Asymmetric broadband access and any backhaul as necessary to allow interconnection with other telecoms providers, which provides an always-on capability and allows both voice and data services to be used simultaneously.”<sup>12</sup>*

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<sup>10</sup> See paragraph 5.21 of the WBA MR.

<sup>11</sup> See paragraph 1.17 of the WBA MR

<sup>12</sup> See paragraph 3.3 of the WBA MR.

3.18. Ofcom repeats its findings from the retail market analysis set out in the parallel WLA Consultation.<sup>13</sup> BT agrees with Ofcom’s finding that fibre, copper and cable based services should all be included in the relevant product market, as retail services based on all three technologies are regarded by consumers as substitutes. BT provided more detail on Ofcom’s retail market analysis in its response to the WLA consultation.<sup>14</sup>

3.19. As in 2014, Ofcom proposes to exclude from the relevant retail product market definition service provided using alternative networks, namely mobile, fixed wireless and satellite networks.<sup>15</sup> Retail services provided using alternative networks such as mobile or fixed wireless may, however, then be directly viable alternatives for products in the relevant market (typically lower speed products). Whether or not this constraint satisfies the test for these services to be included in the relevant product market, this pressure should be recognised as part of Ofcom’s market analysis. We provide some further commentary on these matters in Annex 1.

## Geographic Market Definition

*Question 4.1: Do you agree with Ofcom’s proposed geographic market definition? Please provide reasons and evidence in support of your views*

*Question 5.1: Do you agree with Ofcom’s proposal that BT holds SMP in Market A? If not, please provide reasons and evidence in support of your views.*

3.20. In this section we provide BT’s comments on Ofcom’s approach to assessing different competitive conditions across the UK, in particular the inclusion of fibre into Ofcom’s model. As a result of this exercise, Ofcom has arrived at a “non-competitive” market covering at most 2% of UK premises.

3.21. First we explain why fibre based competition has a larger geographic reach than copper. We then set out our views as to why the 65% threshold for the recognition of fibre is highly conservative and could be as low as 50% (if not lower). This is followed by a summary of the improvements we consider are necessary to improve the accuracy of Ofcom’s geographic model, which are set out in more detail in Annex 3. We then turn to the broader question of whether Market A is now so small that it no longer constitutes a relevant economic market that warrants ex ante regulation.

3.22. Finally we discuss why in any case a Market A thus defined no longer meets the threshold of a relevant separate economic market in which BT can be said to hold SMP. We explain why the linkages between the competitive Market B and the uncompetitive Market A remove any incentive for BT to exercise any market power in Market A, with further detail set out in Annex 2.

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<sup>13</sup> See the BT response to the WLA MR. - [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0033/99636/Vol1-Market-review.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0033/99636/Vol1-Market-review.pdf)

<sup>14</sup> See the BT response to Ofcom WLA MR - [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0008/105011/BT.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0008/105011/BT.pdf)

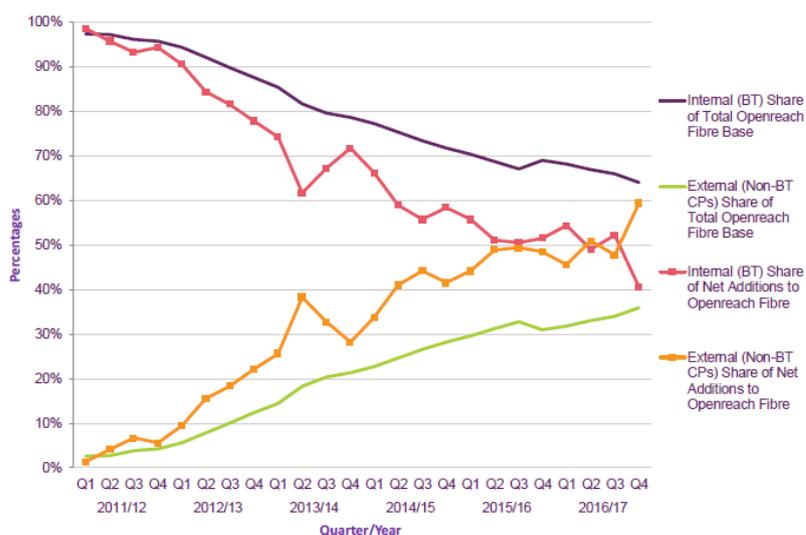
<sup>15</sup> See paragraph 3.4 of the WBA MR.

## Accounting for Fibre

3.23. Of particular relevance to the WBA market review is Ofcom’s finding that fibre is a viable substitute for copper and should be considered in assessing the geographic market boundaries. Figure 1 (Figure 4.3 reproduced below<sup>16</sup>) illustrates clearly the growing relevance of fibre-based broadband competition. External CPs now add the same, if not more, new fibre-based broadband lines as internal (BT Group) CPs. As a result, the total share of Openreach fibre lines taken by external (non-BT) CPs has been steadily growing, and forecasts suggest this trend will continue.

**Figure1: Share of Openreach fibre connections**

**Figure 4.3: Share of Openreach fibre connections**



Source: BT KPIs Q4, 2016/17, <http://www.btplc.com/Sharesandperformance/Quarterlyresults/>.

3.24. We welcome Ofcom’s recognition that it is appropriate to augment the approach employed in 2014 and that it is now time also to consider competitive presence on the basis of virtual unbundled local access (VULA).

3.25. As recognised by Ofcom,<sup>17</sup> there is no longer any uncertainty about the competitive impact of fibre. Fibre from Openreach is available to 26.8 million UK premises, and nearly 95% of UK premises can access superfast services from any network (Openreach, Virgin or other, smaller network providers).<sup>18</sup> On the Openreach network, c.38% of connections are now based on fibre.<sup>19</sup> In the WLA consultation, Ofcom forecasts that fibre take up on the Openreach network will continue to grow significantly over the next three years.<sup>20</sup>

3.26. The way in which fibre is provided gives additional scope for competition in broadband services using Openreach’s input products as it reaches larger geographical areas from fewer

<sup>16</sup> See page 36 of the WBA MR.

<sup>17</sup> See paragraph 4.53 of the WBA MR.

<sup>18</sup> See paragraph 2.8 of the BT response to the WLA MR.

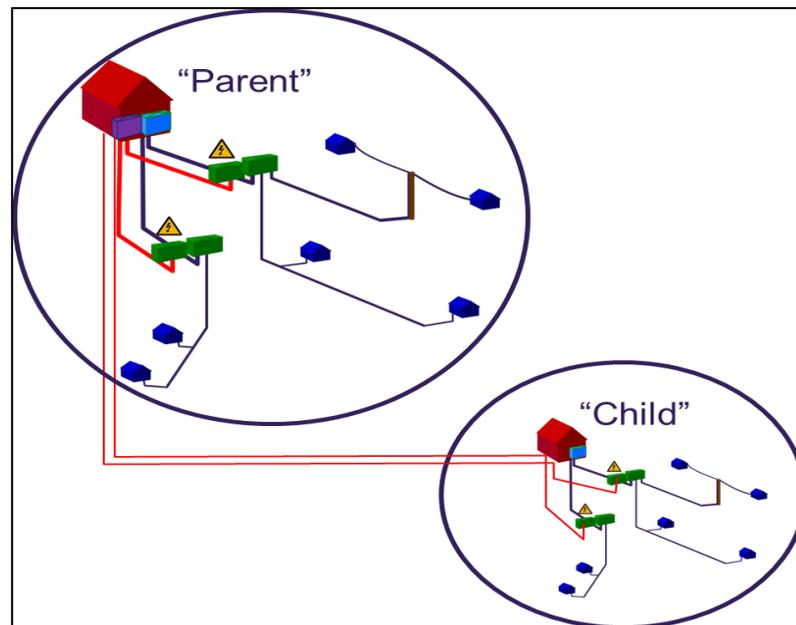
<sup>19</sup> See paragraph 4.53 of the WBA MR.

<sup>20</sup> BT notes that while it agrees with Ofcom that the share of fibre based lines will increase, it believes that Ofcom’s forecasts have been exaggerated. This has been discussed in detail in Openreach’s response to the WLA consultation, volume 2, in response to question 4.2 and annex 4.

handover points. Inherent in Openreach’s network design is its desire to provide sufficient coverage from each NGA handover point such that it is economically viable for multiple CPs to be present. CPs only need to be present in around 1100 fibre handover points to offer service to all NGA connected customers. This contrasts with having to unbundle around 5500 exchanges to access all copper-based customers.

3.27. As Ofcom acknowledges, it is therefore possible for CPs to compete using fibre broadband services in areas where they have not invested in equipment in the copper exchange.<sup>21</sup> Figure 2 below shows the way in which GEA unlocks access to greater geographic areas from fewer points of handover.

**Figure 2 – Fibre provision from “Parent” exchange area to cabinets in “Child” exchange areas**



3.28. Points of handover are located in “Parent” exchanges, which are typically in Market B areas. In other words they are in exchanges where POs already have an LLU presence. It therefore requires little additional investment for these POs to access GEA lines at those points.<sup>22</sup> Access to GEA also allows POs to supply customers that are located in “Child” exchanges, which may be in Market A and which are connected to the “Parent”. This means that POs can use Openreach GEA services to provide broadband services reaching beyond their own LLU footprint.

3.29. Further fibre rollout combined with other technological changes means that nearly the entire country can be provided with fibre broadband by POs using Openreach services:

- Openreach has announced plans to launch Single-Order-GEA (SOGEA) in April 2018. This will allow POs to purchase only a fibre connection and provide both data and voice services over that connection, obviating the need to purchase a copper connection alongside a FTTC connection; thereby the presence of Openreach fibre will always be considered on-

<sup>21</sup> See page 32, footnote 75 of the WBA MR.

<sup>22</sup> S&C.

net. It is unlikely that POs would have to incur significant investments to switch to a SOGEA-based service.

- 3.30. While TalkTalk Group (TTG) and Sky may no longer supply retail residential broadband services in “off-net” areas (i.e. outside of their LLU footprints),<sup>23</sup> fibre access, along with additional rollout under BT’s UBC, may over time overcome this geographic constraint and enable further competition outside of POs’ LLU footprints. By way of example, ✂ .<sup>24</sup> ✂.
- 3.31. BT agrees with Ofcom’s proposals to include fibre rollout in the geographic market definition and whilst we have some comments about the details of Ofcom’s methodology we are broadly supportive of the approach.

### Fibre threshold

- 3.32. Ofcom accepts its proposal to set the threshold at 65% is a judgment, in the absence of robust evidence.<sup>25</sup> It argues that fibre-based competitive presence in many ways acts in a similar manner as cable. Therefore, and because 65% meant that fibre-based providers could address “a clear majority”,<sup>26</sup> Ofcom proposed 65% as the appropriate threshold.
- 3.33. While we welcome Ofcom’s decision to take account of fibre, we believe that the proposed threshold of 65% is conservative. In previous market reviews BT put forward evidence showing that BT’s service shares were similar in exchange areas with 2 LLU operators to exchange areas with 1 LLU operator and Virgin presence in 30-65% of the exchange area.<sup>27</sup> Choosing 65% as the threshold was therefore a conservative approach.
- 3.34. While no data is yet available for a sufficiently long time period to conduct similar analysis for fibre presence, BT believes that 65% is, even more than in the case of cable, a conservative threshold. This is because unlike in the case of cable, more than one CP can enter the market on the basis of fibre. In the case of cable, only one company could address the 65%+ of the exchange area. Where fibre is present, the number of POs that can take fibre is usually two or more. Therefore the competitive threat on the basis of fibre presence is greater than in the case of cable presence. It follows that in case of fibre presence a lower share of the exchange area needs to be covered to constrain BT than in the case of cable presence.
- 3.35. Furthermore, Ofcom’s analysis of PO presence at fibre handover points does not appear to include forecasts of future expansion of PO presence to further fibre handover points. In Annex 3 we discuss how there are limited barriers to entry to connect to additional handover exchanges on a forward looking basis. Therefore, unless Ofcom removes the restriction that a PO needs to be present at a handover site today for them to be counted, adopting a 65% threshold only on today’s PO presence is highly likely to miss many exchanges that over the course of the market review period will pass the 65% threshold.
- 3.36. Given the absence of robust data gathered by Ofcom to date, we believe it is right for Ofcom to take full account of the information we have submitted about how it should decide when a competitive presence has become “too large to ignore”. Given the above points of principle

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<sup>23</sup> See paragraph 4.14 of the WBA MR.

<sup>24</sup> ✂

<sup>25</sup> See paragraphs 4.61/62 of the WBA MR.

<sup>26</sup> Paragraph 4.62 of the WBA MR.

<sup>27</sup> See for example Ofcom’s discussion of BT’s arguments in paragraphs 4.63-65 of the 2014 WBA statement.

and the detailed points set out below, BT is of the view that the threshold must necessarily be lower than in the case of cable presence. Therefore BT believes that 50% would be a more appropriate threshold.

### Improving the accuracy of Ofcom's Geographic model

3.37. BT also has several suggestions on how to improve the accuracy of Ofcom's geographic modelling and ensure it is based on the best available data. These are set out in detail in Annex 3 and cover the following key points:

- Ofcom must ensure their analysis is updated so it is based on **the best available data**. The data currently used by Ofcom was collected between October 2015 and November 2016.
- There is no justification for Ofcom's model to include FTTC but exclude **FTTP rollout** or planned fibre build by other operators.
- Ofcom's **network overlap coverage threshold** is too high
- Improvements to Ofcom's **calculation of the number of UK premises**
- Ofcom has underestimated fibre coverage in an area in its **network overlap calculation**. This can be rectified by moving to an agreed list of broadband distribution points.
- BT can provide updated data to help reduce the 33,000 **mismatched postcodes** Ofcom found when matching OS postcodes to BT data
- To calculate the **size of each exchange** Ofcom has used postcodes to allocate DPs to each exchange. BT can provide additional data to address issues in Ofcom's data where postcodes are served by multiple exchanges.

### Market A is now so small that it no longer constitutes a relevant separate economic market in which BT could exert market power.

3.38. Notwithstanding BT's comments above, BT broadly agrees with Ofcom's approach to market definition and particularly supports the inclusion of fibre-based presence in the assessment geographic market boundaries. However, Ofcom did not step back at the end of the process to ask what BT could realistically do with its notional SMP in the now tiny separate Market A.

3.39. If defined as a separate market, inevitably BT would be found to have SMP in Ofcom's proposed Market A on the basis of market share alone. This would presume that BT can, in an area that consists of less than 2% of UK premises spread across a number often remote and separate very small exchange areas,<sup>28</sup> act "*to an appreciable extent independently of competitors, customers and ultimately consumers*".<sup>29</sup> This appears to be an unlikely premise,

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<sup>28</sup> The average number of premises served by a Market A exchange is 517, as opposed to just under 7,000 in Market B. See paragraph 5.21 of the WBA MR.

<sup>29</sup> See article 70 of the European Commission, Commission Guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services (2002/C 165/03), July 2002.

and as such, further analysis is necessary to assess whether the area thus defined still qualifies as a separate relevant economic market.

3.40. BT's analysis is set out in detail in Annex 2, and it concludes that BT's ability and incentive to exert market power in the proposed Market A area are severely constrained by a number of factors, namely:

- BT largest wholesale customer (BT Consumer) and EE set their retail residential prices at a national level. As Ofcom recognised, it was unlikely for BT Consumer to increase retail prices only in Market A,<sup>30</sup> so consumers are effectively protected from the risk of excessive pricing in Market A.
- All of BT customers buy WBA services both in Markets A and B, with the lion's share of the business typically in Market B. Attempting to impose unfair terms, conditions or prices in Market A (2%) would carry the risk of customers withdrawing business, or demand deeper discounts, in Market B (98%) in exchange. BT would not incur that risk in 98% of its market for the benefit of only 2% of its market.
- In absence of regulation, maintaining geographically differentiated WBA terms, conditions and prices for Market A areas, which are geographically remote and segregated, would incur disproportionate systems and sales costs.

3.41. Finally, BT would likely face reputational damage to its brand were it to deteriorate in any way the terms, conditions or prices it offers to non-BT CPs in Market A areas, which would outweigh any notional benefits from such a strategy.

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<sup>30</sup> See paragraph 6.31 of the WBA MR: Ofcom cites the fact that BT Consumer had never changed in policy even when Market A constituted a significantly greater share of the national market; the sales and marketing costs it would incur to offer geographically differentiated prices; and the risk to BT's brand reputation.

## 4. Ofcom's Proposed Remedies

4.1. In this section we set out our comments on Ofcom's proposed remedies, as set out in Section 6 of the consultation, and our response to Question 6.1.

*Question 6.1: Do you agree with the remedies that we propose for BT in Market A? If not please set out what alternative remedies should be implemented and provide your reasons and supporting evidence.*

- 4.2. Given BT's views on Ofcom's proposed market definition and SMP analysis set out in Section 3 above, BT contends that consumers are sufficiently protected such that the proposed suite of remedies in Market A would be disproportionate.
- 4.3. We first address the issue of why almost all of the proposed remedies are not needed even if, as Ofcom proposes, Market A is a relevant economic market in which BT has SMP. We then set out why BT views the proposed remedies as inconsistent with Ofcom's duties under the Communication Act to ensure its regulatory activities are proportionate and targeted only at cases in which action is needed.
- 4.4. Finally, we provide BT's comments and concerns in relation to the following four specific areas:
- (a) The extension of remedies for fibre services
  - (b) Equivalence of Input
  - (c) Notification requirements
  - (d) The removal of charge controls
- 4.5. BT's comments on Ofcom's proposals on regulatory reporting and cost accounting are dealt with in Section 5

### If Market A is a Relevant Economic Market and BT has SMP does it follow that more than light-touch regulation is needed?

#### Regulation is no longer necessary

- 4.6. Even if a separate Market A in which BT had SMP persisted as a notional finding, Ofcom needs to assess whether any regulation would benefit consumers in Market A areas sufficiently so as to justify the costs of continued regulation.
- 4.7. Ofcom accepts that any regulation of Market A would be unlikely to incentivise additional retail competition. Regulation in Market A therefore has the sole purpose of protecting existing choice and competition in Market A,<sup>31</sup> which Ofcom itself admits is very limited.
- 4.8. it is unlikely that continued WBA regulation in the small Market A would have any noticeable benefits, for the following reasons:
- In previous market reviews regulation was expected to promote further LLU rollout. Further LLU rollout is now increasingly unlikely<sup>32</sup> given the unfavourable economics of

<sup>31</sup> See paragraph 6.5 of the WBA MR.

<sup>32</sup> See paragraph 6.5 of the WBA MR.

rolling out to Market A exchanges which serve on average only 517 premises, as opposed to Market B exchanges serving on average just under 7,000 premises.<sup>33</sup>

- Ofcom was told by major CPs that they intended to withdraw, or have already withdrawn, from offering retail services that are outside of their own LLU footprints.<sup>34</sup> It is unlikely that a tougher regulation of WBA services in Market A would make a difference to these strategic commercial decisions.
- BT Consumers' and EE's national pricing policy at the retail level ensures consumers in market A have access to competitive broadband offers.

4.9. To demonstrate how consumers in Market A are protected, BT and EE offer customers in Market A the same acquisition offers advertised on their websites as customers living in Market B areas (subject to network availability). BT's and EE's retail prices are set by reference to effective competition in 98% of the UK, and both offer prices that are competitive to prices available by other competitors in Market B:

- EE offers unlimited broadband with a speed of up to 17Mb for £21/month for an 18 month contract, including weekend calls to landlines.
- BT offers unlimited broadband with a speed of up to 17Mb for £24.99/month for a 12 month contract, including UK weekend calls, 100GB Cloud storage, Virus protection for 2 devices and free BT sport for 12 months.
- Both Sky and TTG offer unlimited broadband with a speed of up to 17Mb on their networks for £20/month (£19.95 for TTG), not including any free calls.

4.10. While undeniably fewer of the major CPs have chosen to offer services in Market A, the quality and value for money of the offers by the providers that do offer services do not suffer as a result.

4.11. Furthermore, not only would regulation no longer serve any purpose, heavy handed regulation would in fact be harmful to consumer outcomes, not only in Market A but also in Market B. In particular the imposition of EOI has in the past led to suboptimal market outcomes both in Markets A and B, which we discuss in more detail below and in Annex 4. To the extent that Ofcom feels compelled to continue with any regulation, it should be no more than a light touch reporting obligation.

4.12. In summary, Ofcom can be confident that by reducing regulation in Market A to a very light touch regime consumers and competition will not be adversely affected. At least, some impediments to effective competition and innovation arising from current regulation should be avoided by lessening the regulatory hurdles.

4.13. Ofcom sets out its potential competition concerns and concludes that in the absence of regulation in Market A, BT would have the incentive and the ability to:

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<sup>33</sup> See paragraph 5.21 of the WBA MR.

<sup>34</sup> See paragraph 4.14 of the WBA MR.

- Refuse to provide network access to other providers, which could restrict competition in the provision of retail services to the detriment of consumers;
- Discriminate in favour of its downstream retail businesses to the detriment of competition in retail broadband services (including by price and/or non-price discrimination), and ultimately to the detriment of consumers; and
- Fix and maintain some or all of its WBA prices at an excessively high level or engage in a price squeeze.<sup>35</sup>

We deal with each of these concerns in turn below.

4.14. **Refusal to supply.** BT does not have any incentive to refuse wholesale services to CPs in Market A as the loss of goodwill would threaten losses in Market B far greater than any potential gains at the retail level in Market A.<sup>36</sup> This is quite apart from the likely customer reaction at being deprived of choice which would damage the BT brand.

4.15. **Incentive to discriminate.** The incentive to discriminate in such a small residual market is very weak, even when assuming that a BT retail business would gain all services on a like for like basis. The risk of CPs withdrawing business in Market B in retaliation and the reputational damage to the BT brand more than outweigh this risk. Furthermore, it's highly unlikely that all consumers in Market A would take service from a BT retail business if in the past they have consciously switched away from BT. A share of these customers may turn to mobile, for example, or use other access technologies for fixed broadband should that be needed.

4.16. **Margin squeeze.** Ofcom acknowledged that a margin squeeze would be unlikely to be effected through a decrease of the retail price, given BT sets its retail prices on a national level.<sup>37</sup> Given the size of Market A, it would never be profitable for BT to lower its national prices simply for the purpose of a margin squeeze in less than 2% of the UK. However, Ofcom did not recognise that the imposition of a margin squeeze through higher wholesale prices is equally implausible, for the same reasons as given above: CPs withdrawing services in Market B from BT in retaliation for higher wholesale prices in Market A would be more costly than any hypothetical gains BT could hope for from a margin squeeze in Market A.

### Regulation will not incentivise entry to expand choice at any level

4.17. Consumers in Market A would benefit the most from more investment in infrastructure to improve the quality of broadband received in remote and rural areas. The proposed regulation is not designed to achieve this, as acknowledged by Ofcom itself, and it is hard to conceive of any SMP regulation that could incentivise businesses to invest in areas where it is difficult to any commercially viable investment plan work.

4.18. Programmes separate from the SMP ex ante regulatory framework, namely BT's UBC offer and BDUK initiatives by Government are specifically focused on this issue. The former is aimed at ensuring that all households have access to a minimum broadband speed of 10Mbps and the

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<sup>35</sup> See paragraph 6.5 of the WBA MR.

<sup>36</sup> See also Annex 2 to this response, subsection on Countervailing buyer power.

<sup>37</sup> See paragraph 6.27 of the WBA MR.

latter is aimed at supporting fibre rollout in remote areas where commercial investment is unviable.

4.19. It is unlikely that regulation could change BT's retail competitors' commercial decision on whether to offer services in what are predominantly remote and sparsely populated areas:

- If Ofcom wanted to incentivise network investment, wholesale charges would have to be kept high. However, given the economics of these areas, in order to entice competitive network entry prices would have to be so high that they would be detrimental to consumers' interests.
- If Ofcom wanted to incentivise higher take up of BT's WBA services in order to stimulate more retail competition, prices in Market A would have to be kept artificially low. Aside from the fact that very low Market A charge controls would not allow BT a fair return on their investments in those parts of the market where unit costs of providing services tend to be higher, it would still be unlikely that such a move would change major competitors' incentives to increase their use of WBA services in order to compete in Market A areas. They would not only face the direct cost for the WBA service but would have to maintain separate systems for services provided over their own network and those provided over BT's WBA services. Sky and TTG have retreated from serving retail residential customers that are outside of their LLU footprints, and it appears highly unlikely that they would change their strategy following a price reduction in Market A.

4.20. In short, therefore, ex ante regulation is an ineffective tool by which to address the key concerns of speed and availability affecting consumers in Market A. In the meantime, consumers in Market A indirectly benefit from competitive pressures that extend into Market A from effective competition in Market B, not least, as recognised by Ofcom, through BT's (and EE's) national pricing policy. The pricing examples provided earlier in this section illustrate that consumers in Market A had access to the same competitive and value for money offers from those providers that chose to offer services in these areas.

### Ofcom's proposed remedies, especially EOI, are inconsistent with its duties under the Communications Act.

4.21. BT's detailed examination Ofcom's proposal to continue to impose an EOI obligation on BT is set out in Annex 4. BT views Ofcom's proposals, especially the continued imposition of EOI, as inconsistent with Ofcom's legal duties under the Act, in particular Ofcom's duties to ensure remedies are proportionate.

4.22. For a measure to be proportionate Ofcom must show it is appropriate, necessary, the least onerous option available and not produce disproportionate adverse effects. In order to decide whether regulation is imposed, and if so what remedy, Ofcom must carry out a balancing exercise on this basis properly considering the relevant risks, hazards they pose, benefits of alternatives available and detriment of imposing any particular regulation.

4.23. We have not seen evidence of this exercise in the consultation beyond brief references to the proportionality of individual remedies. There are serious questions as to whether continued regulation of Market A is appropriate in the context of these proportionality issues and Ofcom's wider duties in respect of the principles of regulatory best practice.

4.24. In this context, while BT can see how continued regulation may be one way to achieve Ofcom's narrow goal of protecting competitors in Market A, it is difficult to see how strict EOI, notification, reporting and accounting obligations can be said to be no more onerous than is required to achieve this aim. We deal with our specific concerns regarding each of these remedies below in turn. Indeed, we have shown that the natural competitive constraints imposed by Market B would be sufficient to achieve this.

### BT's comments on specific remedies proposed by Ofcom

4.25. BT has a number of specific comments and concerns with Ofcom's proposed remedies in relation to the areas listed below. The remainder of this section deals with these.. BT's comments on regulatory reporting and cost accounting are provided in Section 5.

- (a) The extension of remedies for fibre services
- (b) Equivalence of Input
- (c) Notification requirements
- (d) The removal of charge controls

#### (a) The extension of remedies for fibre services

4.26. BT strongly supports Ofcom's proposals to include fibre rollout in the geographic market definition and whilst we have some comments about the details of Ofcom's methodology we are broadly supportive of the approach. However, we believe that Ofcom's proposals inadvertently for the first time introduce remedies on fibre services in Market A child exchanges where the handover point is in Market B.

4.27. In the last two market reviews<sup>38</sup> Ofcom disapplied remedies in Market A child exchanges parented on Market B handover points as they recognised that competitive conditions differed in this circumstance. We can see no reason why Ofcom should change its position in this review.

4.28. We believe that it is not Ofcom's intention<sup>39</sup> to regulate traffic that is recognised as competitive in nature and therefore we recommend that Ofcom should continue to disapply SMP remedies whenever fibre circuits are handed over in a Market B area, irrespective of whether the local exchange is listed as Market A or Market B.

4.29. Furthermore, our systems and processes have been built based on whether the handover point is in Market A or Market B. To implement Ofcom's proposed remedies would require BT to reconfigure its network to separate traffic at this point in the network by geographic markets. This is clearly disproportionate and could not be justified as proportionate as required by Ofcom's duties under the Communications Act.

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<sup>38</sup> See paragraph 6.54 of the WBA MR Statement 2014.

<sup>39</sup> See paragraph 6.38 of the WBA MR. Ofcom states that "*In practice these requirements will largely apply to copper WBA products as there are limited handover points for fibre services within Market A*".

## (b) No undue discrimination/EOI

- 4.30. Ofcom proposes to continue the current remedy of EOI in all cases (existing and new products) except in cases where products have been provided on a non-EOI basis, where it proposes to continue to apply a NUD remedy.<sup>40</sup>
- 4.31. Ofcom argues a form of non-discrimination remedy is necessary to protect existing competition and choice for consumers in Market A.<sup>41</sup> Its proposal to maintain EOI for existing products currently provided on an EOI basis and for new products relies on the following rationale:
- EOI is the “most effective” non-discrimination remedy as it has better incentive properties for the dominant undertaking to be transparent and improve its products, and it gives more certainty to wholesale customers<sup>42</sup>
  - It does not impose significant costs as BT has already been doing this.<sup>43</sup>
- 4.32. Ofcom’s analysis of the proportionality of an EOI remedy is fairly high level and omits some critical aspects which, if given due consideration, would not justify the imposition of a strict EOI remedy – at most a more flexible NUD remedy would be justifiable.

### *EOI in Market A adversely affects effective competition in Market B and BT’s investment and innovation incentives in Market A*

- 4.33. Ofcom’s assessment entirely ignores the most relevant impacts of the EOI remedy in terms of costs. These not only those fall directly on BT but also affect the market and consumers more widely, as a result of restrictions on BT’s flexibility to tailor its offerings to individual customers’ needs.
- 4.34. In particular Ofcom did not consider the interdependencies between Markets A and B that arise from BT running a single network serving both markets. EOI imposed on Market A also affects BT’s flexibility in Market B where BT competes predominantly with other POs, namely Sky, TTG, Virgin, and increasingly Vodafone, each of which benefits from some degree of vertical integration. This adversely affects effective competition in Market B and reduces BT’s incentives to extend innovations and investments for Market B into Market A. Ofcom has not taken account of these costs to consumers and competition.

### *EOI imposes disproportionate costs*

- 4.35. Ofcom’s assertion that EOI does not impose significant costs on BT starts from the flawed premise, that the continuation of an existing remedy is costless. There is no indication in its consultation that Ofcom has gathered evidence to support this assertion, and BT would be happy to work with Ofcom to give more detail about the day-to-day costs of complying with EOI. More generally, its assessment does not seem to weigh up fairly the costs imposed against the limited benefits of a strict EOI benefitting a market comprising less than 2% of UK premises.

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<sup>40</sup> See paragraph 6.64 of the WBA MR.

<sup>41</sup> See paragraph 6.58 of the WBA MR.

<sup>42</sup> See paragraph 6.59 of the WBA MR.

<sup>43</sup> See paragraph 6.60-6.61 of the WBA MR.

- 4.36. It is incorrect to consider a regulatory cost as “proportionate” simply because it is in place already. As a point of principle, the appropriate counterfactual against which the costs of a remedy should be considered is a scenario in which the remedy is disapplied, rather than the status quo.
- 4.37. From a legal perspective, Ofcom is under a duty to impose the least onerous remedy necessary to achieve its objectives. As discussed in Section 3 and above, imposing extensive remedies on BT in a notional or de minimis Market A in which BT would be found to have SMP is unlikely to be proportionate. It follows that any remedies Ofcom may consider must be very “light touch” in nature to avoid imposing undue costs on BT and the market as a whole for very small discernible benefits in a market covering less than 2% of UK premises. Ofcom recognises that No Undue Discrimination (NUD) may allow for more flexibility<sup>44</sup> and therefore by definition is less costly for the regulated company than a rigid EOI rule.

#### *Impact of removing the Undertakings*

- 4.38. Finally, applying EOI as an SMP remedy in Market A in the future, when the Undertakings are removed, may perversely lead to much stricter constraints on BT if the provisions set out in the Undertakings to allow for vertical information sharing in order to ensure smooth operation and maintenance of the network fall away. Indeed, Ofcom’s introduction of EOI as a remedy in the last WBA Market Review was at least partly based on its assessment that BT would face limited additional cost as it was already complying with EOI via the Undertakings.
- 4.39. Ofcom has assumed a “business as usual” approach in that the current SMP EOI remedies would remain unchanged. However, given the impending removal of the Undertakings following Ofcom’s Digital Communications Review, SMP EOI remedies can no longer rely on the rules and systems on information sharing established in the Undertakings.
- 4.40. The Undertakings allow BT a smooth operation of its networks across the supply chain, without being in breach of its EOI obligations<sup>45</sup>. BT would have to replicate the current systems supporting the Undertakings solely for the benefit of Market A or risk imposing a significantly more onerous regulatory obligation.

#### *Conclusion*

- 4.41. If all these factors are fully taken into account it becomes clear that EOI is no longer a proportionate remedy and in fact has more adverse consequences for consumers, competition and innovation than benefits. BT therefore urges Ofcom to review its proposal to maintain EOI and at the very least move to a lighter touch NUD type remedy.

#### *(c) Notification*

- 4.42. Ofcom proposes to continue to have two separate SMP notification remedies:
- A requirement to notify changes to charges, terms and conditions at least 28 days in advance (Condition 5);<sup>46</sup> and

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<sup>44</sup> See paragraph 6.56 of the WBA MR.

<sup>45</sup> In this context it is important to note that Market A is the sole market outside of Openreach in which Ofcom has imposed an EOI remedy.

<sup>46</sup> See page 111 of the WBA MR.

- A requirement to notify changes to technical information at least 90 days in advance (Condition 6).<sup>47</sup>

4.43. We set out below why the application of both these remedies is disproportionate and:

- can result in unintended adverse consequences for BT's wholesale customers where price changes are the result of changes to Openreach input prices ; and
- Distorts competition in Market B by for example requiring BT to notify forthcoming network changes to its competitors in Market B by virtue of having the same underlying network supporting both markets.

### Condition 5: Notification of changes to charges, terms and conditions

4.44. BT's wholesale broadband contracts require BT to provide 28 days' notice to changes to terms and conditions. This is common industry practice and is in place irrespective of whether a CP purchases services in Market A or B. As the SMP and contractual obligations align, one could argue that the SMP requirement does not impose any additional burden on BT. However, in practice it does act to constrain BT's flexibility in situations where it would unambiguously be in CPs interest to introduce a change in fewer than 28 days.

4.45. Indeed, there are occasions where Condition 5 puts CPs purchasing WBA services from BT at a disadvantage to those buying from other Wholesale providers. This can be the result of Ofcom also imposing a 28 notification obligation on Openreach's WLA services which are an underlying input to BT's WBA products.

4.46. For example, in late 2016 BT only narrowly succeeded in passing on the benefits of an Openreach special offer to its customers whilst meeting the 28 day notification obligation. In this instance Openreach announced a special offer on 28 November 2016 for all fibre orders received from 1 January to 31 March 2017. In order for CPs purchasing WBA services to benefit from this offer from 1 January, BT had to be able to develop its offering and notify customers by 5 December (i.e. 28 days prior to 1 January). In this case it was fortuitous that Openreach provided more than 28 days' notice of its changes. This would not have been possible had Openreach only provided the minimum 28 days notification of its changes.

4.47. Other competing LLU networks do not face this issue. This has the potential to distort competition for broadband services on a national level and demonstrates the disproportionate nature of Condition 5 on BT. It was only due to a quirk of timing that meant BT was able narrowly avert a problem.

4.48. We question whether there is any need to have an SMP remedy such as Condition 5 as it adds little value over and above the standard contract obligations that CPs rely upon.

### Condition 6: Notification of technical changes

4.49. Furthermore a similar issue of the disproportionate nature of Condition 6 (90 day notification) arises. As we have indicated above, the same underlying broadband network

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<sup>47</sup> See page 113 of the WBA MR.

supports services in Markets A and B. This means any fundamental changes to the broadband product set will impact both markets. So the 90 day notification requirement impacts the regulated Market B as well as Market A. This seems disproportionate with such a tiny Market A.

- 4.50. Indeed, the requirement to notify technical changes is often dictated by changes to Openreach fibre or copper products which are subject to a separate EOI obligation in the WLA market. Therefore all of industry are made aware of the product changes at the same time. It is disproportionate that BT broadband services require an additional 90 days formal notification compared to those launched on other broadband networks who can launch services much earlier.
- 4.51. Furthermore, the BT process of launching product changes through a well-established systems release programme often aligns and overlaps with the 90 day SMP obligation in practice. However, without Condition 6 BT would be able to bring advantageous changes to CPs in fewer than 90 days. This would allow BT to compete with the LLU networks who do not have a requirement to notify changes 90 days in advance.

#### (d) Removal of Charge Controls in Market A

- 4.52. BT strongly supports Ofcom's proposal to remove charge controls from Market A. BT agrees that these have served their purpose well but are no longer needed to protect consumers in light of BT having maintained a national retail price for BT branded services. As demonstrated above, BT's and EE's retail offers available to consumers in both Markets A and B offer consumers in Market A no less value than consumers in Market B. Even though some major CPs have chosen not to supply broadband outside of their LLU footprint, the offers available from those that do choose to supply are identical to those available in competitive Market B.
- 4.53. Given BT's longstanding approach not to differentiate prices even when up to a third of UK premises were subject to pricing remedies, it is inconceivable that BT would seek to disaggregate prices in the proposed Market A. The marketing and sales costs and risk to BT's brand reputation would more than outweigh any hypothetical benefits of doing so.
- 4.54. If the relevant regulatory barriers were removed (namely the charge control and EOI), BT and its customers may (and would) negotiate national charges applying across the entire BT network. In consequence, retailers who currently offer differentiated retail prices in Market A and B (e.g. Plusnet) may also be encouraged to move to a national pricing approach, thereby extending further the benefits of a competitive Market B to Market A consumers.
- 4.55. Furthermore, the imposition of a charge control would require Ofcom to be able to reliably identify costs and profitability in the proposed Market A. The available accounting information would require a series of adjustments before it could be used even to provide an indicative measure of profitability. Ofcom acknowledges this in its discussion of pricing and profitability.<sup>48</sup> Specifically:
- BT agrees with Ofcom that the return on capital employed as published in the Regulatory Financial Statements (RFS) is a poor indicator of the economic returns in the WBA market.

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<sup>48</sup> See paragraphs 5.13-5.17 of the WBA MR.

The published returns were lower in the 2016/17 RFS, whilst on an adjusted basis the returns are similar in 2016/17 to the adjusted returns published in 2015/16.<sup>49</sup>

- There are a large number of different factors that need to be considered when assessing the likely economic returns in a newly defined Market A following the market review. These include: the effect of smaller average number of customers served by BT exchanges;<sup>50</sup> potentially more remote exchanges meaning longer backhaul distances; the investment required to improve bandwidth speeds in these smaller exchanges; and the impact of a migration between the IPstream and WBC technologies. The investment in WBC, designed to improve rural broadband speeds in the short term, may be complicated further by fibre progressively replacing copper broadband, which may cut short asset lives of the WBC investment. Any economic assessment would then need to factor into the calculations the impact of stranded assets. This could increase annual costs as the existing asset lives might need to be shortened.
- When the size of Market A was last changed as a result of the 2014 WBA market review, it was not a trivial exercise to evaluate how the change in the geographic market would affect unit costs. We consider that these challenges will remain especially given the added complexities of the roll-out of fibre meaning there may be three different technologies interacting with each other across some common shared costs.

4.56. In short, continuation of a charge control would serve no purpose, be very costly and intrusive and may be more harmful to consumer interests than beneficial.

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<sup>49</sup> The 2016/17 return on capital employed for WBA Market A was 55% (compared with 70% in the 2015/16 published RFS) whilst the adjusted returns were 25% compared with a figure of 26% originally published in the 2015/16 RFS.

<sup>50</sup> The average exchange size in Market A has reduced by nearly 40% from 891 premises using the 2014 market definition to 517 premises now (See paragraph 5.21 of the WBA MR)

## 5. Financial Reporting and Cost Accounting

### Introduction

5.1. In this section we provide BT's detailed comments of Ofcom's financial reporting and cost accounting proposals and response to Question 7.1.

**Question 7.1:** *Do you agree with our proposals for BT's Regulatory Financial Reporting, including in particular the proposed Direction modifying requirements relating to the preparation, audit, delivery and publication of the RFS, and Direction modifying requirements relating to the form and content of the RFS? If not, what alternative would you propose and why?*

5.2. In line with our response in Section 8 and Annex A of Openreach's response to Ofcom's NBMR Consultation 24 March 2017,<sup>51</sup> Ofcom should reflect the proposed changes in pricing remedies in the reporting requirements. However, despite the move from a cost-based charge control to a fair and reasonable charges obligation, Ofcom is not proposing any significant changes to our reporting requirements and it proposes to maintain the requirement for us to publish fully allocated cost (FAC). We recommend that Ofcom should adapt the reporting requirements in line with the proposed changes to the regulation of prices. We consider that such association between pricing remedies and reporting remedies could be best achieved via an overall framework for regulatory financial reporting.

5.3. We welcome Ofcom's proposal for BT to provide certain information to Ofcom separately. However, we consider the additional level of private information Ofcom proposes to be provided in the Data File with regard to the WBA market, is excessive in light of the other remedies.

5.4. BT's detailed response to Ofcom's proposals and on our proposed framework for regulatory financial reporting is set out below.

### BT's comments on Ofcom's financial reporting and cost accounting proposals

#### Summary of Ofcom's proposals

5.5. We welcome Ofcom's proposal not to give directions specifying requirements for consistency with regulatory decisions or for reporting on our adjusted financial performance.<sup>52</sup> We interpret the proposal to mean, that the WBA market will be included in the 'Adjusted Performance Summary' in the 2017/2018 RFS, and will be removed from 2018/2019 onwards.

5.6. We welcome Ofcom's proposal to consider whether it should make changes to the requirements relating to the reconciliation report, and whether it can be simplified as part of a wider regulatory financial reporting consultation that will be published later this year, following a request from BT.<sup>53</sup>

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<sup>51</sup> See Openreach response to the Narrowband Market Review Consultation dated 24 March 2017 - [https://www.ofcom.org.uk/data/assets/pdf\\_file/0018/101637/Openreach.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0018/101637/Openreach.pdf)

<sup>52</sup> See paragraph 7.10 of the WBA MR.

<sup>53</sup> See paragraph 7.12 of the WBA MR.

- 5.7. We welcome this further consultation, and propose that it includes additional areas, in particular a proposed framework for regulatory financial reporting.<sup>54</sup>
- 5.8. Such a framework should be relevant in the context of all market reviews, providing a clear and proportionate association between pricing remedies and reporting remedies, giving stakeholders clarity and certainty over the information required to be disclosed. In addition to ensuring that stakeholder needs are consistently met, such a framework should lead to a reduction in the complexity and volume of regulatory financial reporting. Specifically, removing the obligation to provide stakeholders with information which adds little or no value, or relates to items which are not material, will improve transparency for stakeholders and reduce the cost of compliance, to the benefit of all stakeholders.
- 5.9. In this forthcoming consultation Ofcom also proposes to update the list of network components as part of their work relating to Duct and Pole Access (DPA).<sup>55</sup> We propose to continue to work with Ofcom on this. However, we would be grateful for a clarification of why the wider financial reporting consultation is linked to the consultation on DPA products.<sup>56</sup>

### The preparation, delivery, publication, form and content of the RFS

- 5.10. Ofcom considers that to preserve the integrity and consistency of the RFS, as a matter of principle all markets should be subject to appropriate reporting requirements, and that whether to include such requirements and their scope is a matter to be considered and determined in each market review.<sup>57</sup>
- 5.11. As we set out in our response to Ofcom's NBMR Consultation of 24 March 2017,<sup>58</sup> we consider such consistency would be best achieved through an appropriate framework.

### Form and Content of the RFS

#### Proposed requirements for public information in the RFS

##### *Market level information*

- 5.12. We agree with Ofcom's proposal that BT must publish the revenue, operating costs, capital employed and returns for Market A in the 'performance summary by market' schedule in the RFS. However, the requirement for publishing the 'attribution of wholesale current costs' and 'attribution of wholesale current cost mean capital employed' schedules, is disproportionate to the size of the market. These schedules do not aid the understanding and demonstration of the overall reliability and robustness of the RFS. We believe the 'performance summary by market' schedule is sufficient to provide stakeholders with the confidence that costs have been allocated consistently and appropriately.<sup>59</sup> This should be reflected e.g. in paragraph 13(v) and

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<sup>54</sup> See Section 8 and Annex A of the Openreach response to the Narrowband Market Review Consultation dated 24 March 2017

<sup>55</sup> See paragraph 7.12 of the WBA MR.

<sup>56</sup> See paragraphs 7.29-7.34 of the WBA MR.

<sup>57</sup> See paragraph 7.35 of the WBA MR.

<sup>58</sup> See Openreach response to the Narrowband Market Review Consultation dated 24 March 2017

<sup>59</sup> See paragraphs 7.49-7.50 of the WBA MR.

(vi) of the proposed Direction<sup>60</sup> on page 165 and the schedules<sup>61</sup> of the Consultation, which should not be required for this market.

*Service level information*

5.13. Ofcom proposes to require BT to disclose revenue, volume, average price and total FAC information for the main WBA services CPs purchase within Market A. This is despite the move from a cost-based charge control to a fair and reasonable charges obligation.<sup>62</sup>

5.14. Whilst we welcome the removal of the requirement for separate disclosure of relatively low volume services, we disagree with the proposal to publish service level information where we are subject to fair and reasonable charges obligation, in line with our proposed framework. This should be reflected e.g. in paragraph 13(vii) of the proposed Direction<sup>63</sup> and the schedules<sup>64</sup> of the Consultation.

5.15. On page 27 (paragraph 101) of Openreach’s response to Ofcom’s NBMR Consultation 24 March 2017,<sup>65</sup> Openreach set out the following proposed approach (see table 2 below), which makes a clear link between any pricing remedy imposed and the information BT is required to publish.

**Table 2 – Reporting Obligations**

Pricing remedy	Reporting obligation			
	Performance summary	Adjusted performance schedule	Market summary	FAC by service and component
No remedy	None	None	None	None
Fair and reasonable	Published	As appropriate	None	None
Bottom up charge control	None	None	None (revenues and volumes in a compliance statement)	None
Safeguard cap	None	As appropriate	None (revenues and volumes in a compliance statement)	None
CPI-X charge control	Published	As appropriate	Published	Published
Cost orientation/basis of charges	Published	As appropriate	Published	Depends upon specific nature of cost orientation requirement

<sup>60</sup> See page 165 of the WBA MR. “Direction under section 49 of the Communications Act 2003 and Condition 8.4 setting the requirements in relation to preparation, delivery, publication, form and content of the Regulatory Financial Statements”

<sup>61</sup> See pages 174 and 175 of the WBA MR.

<sup>62</sup> See paragraphs 7.51-7.53 of the WBA MR.

<sup>63</sup> See page 165 of the WBA MR.

<sup>64</sup> See pages 176 and 177 of the WBA MR.

<sup>65</sup> See Openreach response to the Narrowband Market Review Consultation dated 24 March 2017

### *Cost components for reported services*

5.16. We welcome Ofcom's proposal that FAC component cost information at the service level is no longer published in the RFS.<sup>66</sup> We agree it is appropriate that we continue to provide this private information to Ofcom, and consider we already provide a suitable level of information to Ofcom in the Data File.

## Proposed requirements for private information to be provided to Ofcom

### Additional private information

5.17. Ofcom proposes eight services to be reported within WBA Market A: IPstream Rentals; IPstream Bandwidth; IPstream Other; WBC Connections; WBC Rentals; WBC Bandwidth; WBC Other; Other WBA Market A.<sup>67</sup> However, Ofcom has also proposed that a more granular listing of services is included within the Data File, including all services that were published in BT's 2016/2017 RFS.<sup>68</sup> We consider this disproportionate given the size of the remaining WBA Market A services.

5.18. For example, the proposal requires that IPstream Rentals continue to be split in the Data File between IPstream Connect Max and Max Premium, and IPstream Home and Office products. The proposal would also mean that specific services must be maintained on our REFINE reporting system for IPstream Migrations, Regrades and Cancellations in order to populate the Data File.

5.19. This is excessively prescriptive because we will separately be required to accurately calculate the necessary eight services needed for the RFS publication including IPstream Other, which may require separate REFINE services visible in the Data File. For example, if additional REFINE services are needed in order to ensure accurate component to service allocations in REFINE for individual elements of IPstream Other (such as Migrations and Regrades), then these services will be visible in the Data File without Ofcom directing them to be so. However, if these services are not needed in REFINE, we would be able to provide a split of information by IPstream Migrations, Regrades etc. upon demand by Ofcom when necessary. Therefore, a direction for service level reporting within the Data File is disproportionate compared to the size of the WBA Market A, particularly in light of Ofcom's general information gathering powers.<sup>69</sup> This should be reflected e.g. in the Proposed regulatory reporting Direction 5, Annex B, reference 5(a)(xii).<sup>70</sup>

5.20. We do not agree with Ofcom that the proposals for additional private information are consistent with the 2016 BCMR Statement.<sup>71</sup> There is a significant difference in size of the market between Business Connectivity and WBA markets and the nature of the remedies imposed, and hence separate considerations should be given to each market.

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<sup>66</sup> See paragraph 7.55 of the WBA MR.

<sup>67</sup> See paragraph 7.53 of the WBA MR.

<sup>68</sup> See paragraphs 7.61-7.63 of the WBA MR.

<sup>69</sup> See paragraphs 7.64-7.65 and 7.76 of the WBA MR.

<sup>70</sup> See page 185 of the WBA MR.

<sup>71</sup> See paragraph 7.68 of the WBA MR.

## Amendments to/removal of existing schedules

- 5.21. We welcome Ofcom's agreement that where information is provided within the Data File, no separate AFI should be required.<sup>72</sup>
- 5.22. We agree with Ofcom's clarification that we are required to provide the file "FAC adjustment Summary" (for LRIC model), which contains the post RFS adjustments to cost categories for the purposes of LRIC reporting, and to formalise the provision of EOI charges by service within WBA Market A and the Wholesale Residual schedule as part of the Data File.<sup>73</sup>
- 5.23. Ofcom's consultation states that it expects us to provide as part of the Data File the following information: revenues, volumes and FAC component cost on a CCA basis for IPstream Connect Max, IPstream Connect Premium, IPstream Connect Regrades, IPstream Connect Migrations and IPstream Connect Cancellations.<sup>74</sup> We currently do not split out IPstream Connect Max and IPstream Connect Premium in the REFINE service structure. We do not believe it is not Ofcom's intention to propose an additional level of service reporting. We would welcome Ofcom's confirmation of this in the final statement. This should be reflected e.g. in the Proposed regulatory reporting Direction 5, Annex B, reference 5(a)(xii).<sup>75</sup>

## Proposed Removal of AFI schedules where the information is provided as part of the Data File

- 5.24. We welcome Ofcom's proposal to remove the requirement to provide AFI schedules on transfer charges, geographical analysis of costs and assets on a cost accounting and EOI basis.<sup>76</sup>
- 5.25. We agree with the proposal to remove AFI-C1 and AFI-C2 schedules.<sup>77</sup>

## Accounting Deadlines

Ofcom proposes that non-LRIC AFIs, should be provided alongside the RFS (i.e. two weeks prior to publication), whereas LRIC AFIs should be supplied when the RFS is published, and the Data File no later than two weeks after the RFS is published.<sup>78</sup>

We broadly agree with Ofcom's proposals above, however:

- While Ofcom acknowledges that LRIC data (including all LRIC AFIs) cannot be prepared under the same deadlines as the RFS, Ofcom's proposed LRIC deadlines do not fully reflect the system processing time that LRIC production needs, nor does it allow for any governance. To ensure appropriate checks and approvals take place to assure Ofcom of robust and reliable data, we suggest that BT provides the LRIC AFIs, together with the Data File, two weeks after publication of the RFS. This should be reflected e.g. in paragraph 18 of the proposed Direction on page 167 of

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<sup>72</sup> See paragraphs 7.72-7.73 of the WBA MR.

<sup>73</sup> See paragraph 7.74 of the WBA MR.

<sup>74</sup> See paragraph 7.75 of the WBA MR.

<sup>75</sup> See page 185 of the WBA MR.

<sup>76</sup> See paragraph 7.78 of the WBA MR.

<sup>77</sup> See paragraph 7.79 of the WBA MR.

<sup>78</sup> See paragraph 7.92 and [PROPOSED] Direction under section 49 of the Communications Act 2003 and Condition 8.4 setting the requirements in relation to preparation, delivery, publication, form and content of the Regulatory Financial Statements, paragraphs 17 and 18, Annex 5, p.166-167 of the WBA MR.

the Consultation, so that all information required in 17(ii), 17(iv), 17(xii) and 17(xv) shall be provided to Ofcom two weeks after BT publishes its RFS.

- We consider that the same reason for extended deadlines related to LRIC AFI also applies to the reconciliation report, as both rely on the final RFS. Therefore, we propose that we provide a final version of the reconciliation report to Ofcom on the same date that the RFS is published, and publish the report two weeks after the RFS. That would need to be reflected in the legal instrument, e.g. Condition 8.8(v) and 8.8(vi)<sup>79</sup>.

### Non-confidential compliance information

We agree with Ofcom's proposal to remove the requirement for non-confidential compliance information, given the removal of the charge control.<sup>80</sup>

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<sup>79</sup> Page 117 of the WBA MR

<sup>80</sup> See paragraph 7.94 of the WBA MR.

## Annex 1: BT's comments on Product Market Definition

*Question 3.1: Do you agree with Ofcom's proposed product market definition? Please provide reasons and evidence in support of your views*

1. Ofcom proposes to retain the product market definition from 2014 which includes residential and business services, and copper, fibre and cable networks:
2. *"Asymmetric broadband access and any backhaul as necessary to allow interconnection with other telecoms providers, which provides an always-on capability and allows both voice and data services to be used simultaneously."*<sup>81</sup>
3. Ofcom repeats its findings from the retail market analysis set out in the parallel WLA Consultation.<sup>82</sup> BT agrees with Ofcom's finding that fibre, copper and cable based services should all be included in the relevant product market, as retail services based on all three technologies are regarded by consumers as substitutes. BT provided more detail on Ofcom's retail market analysis in its response to the WLA consultation.<sup>83</sup>
4. As in 2014, Ofcom proposes to exclude from the relevant retail product market definition service provided using alternative networks, namely mobile, fixed wireless and satellite networks.<sup>84</sup> Retail services provided using alternative networks such as mobile or fixed wireless may, however, then be directly viable alternatives for products in the relevant market (typically lower speed products). Whether or not this constraint satisfies the test for these services to be included in the relevant product market, this pressure should be recognised as part of Ofcom's market analysis. We provide some commentary on these matters below.

### Mobile

5. Ofcom provisionally concludes that most consumers do not regard mobile as a viable substitute. This is because of bandwidth and data restrictions albeit Ofcom accepts that the small number of consumers requiring low bandwidth and little data may regard mobile as a reasonable substitute.<sup>85</sup> We consider that this assessment underestimates the constraint from mobile on fixed broadband and its potential growth over time for at least parts of the WBA market.
6. Figure 3.15 of the WLA consultation<sup>86</sup> (copied below) shows the proportion of customers using fixed or mobile broadband for different online activities. Mobile broadband lags only slightly behind fixed broadband for the top three activities quoted by the majority of respondents (namely emailing, purchasing goods/services and social networking). Larger differentials only emerge for activities that are named by only a minority of respondents, including a number of different variants of watching TV or video content online.

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<sup>81</sup> See paragraph 3.3 of the WBA MR.

<sup>82</sup> See the BT response to the WLA MR. - [https://www.ofcom.org.uk/data/assets/pdf\\_file/0033/99636/Vol1-Market-review.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0033/99636/Vol1-Market-review.pdf)

<sup>83</sup> See the BT response to Ofcom WLA MR - [https://www.ofcom.org.uk/data/assets/pdf\\_file/0008/105011/BT.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0008/105011/BT.pdf)

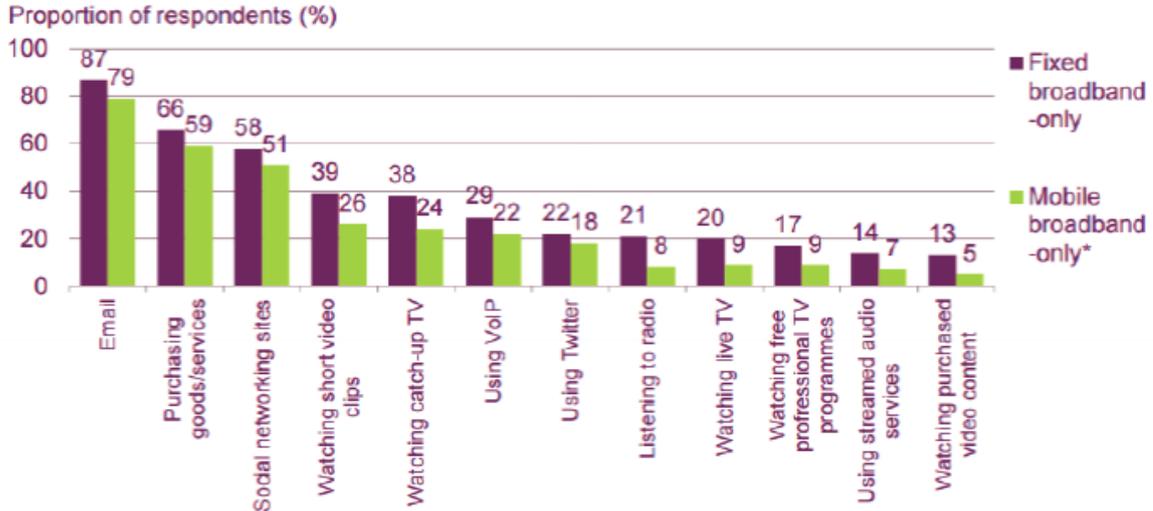
<sup>84</sup> See paragraph 3.4 of the WBA MR.

<sup>85</sup> See paragraphs 3.60-3.64 of the WLA MR.

<sup>86</sup> Figure 3.15 of the WLA MR.

Figure 3 – Online activities among fixed and mobile broadband users (Ofcom’s WLA consultation)

Figure 3.15: Online activities among fixed-only and mobile-only broadband users



Note: \*Caution: base between 50 and 100 therefore results are indicative only QE20 (QE5A) Which, if any, of these do you use the internet for?

Source: Ofcom Technology Tracker, wave 1 2015 Base: All adults who only use fixed broadband (2519), all adults who only use mobile broadband (75). See also CMR 2015, Figure 4.20.

- Ofcom and other commentators have found that there is a trend towards accessing the internet increasingly via mobile devices and wireless connections,<sup>87</sup> even when in the home. Applications that are designed to run on mobile devices (over wireless connections) tend to require lower bandwidths, in other words bandwidth requirements and download file size have adapted to levels more easily accommodated by mobile networks. This would suggest that a larger share of consumers may regard a suitably priced mobile data package (particularly in areas where free wi-fi networks are available, such as e.g. O2 wi-fi, that mobile users can access to balance their mobile data usage) as a reasonable substitute, to fixed broadband, and with the advent of 5G may increasingly do so in the future.
- As mobile becomes a closer substitute to fixed broadband for the reasons outlined above, its ability to exert competitive constraints on parts of the WBA market should be reviewed carefully.

### Fixed Wireless

- For similar reasons as for mobile, Ofcom considers that fixed wireless access is unlikely to be a close substitute for fixed broadband services over copper, fibre or cable. For fixed wireless, data tends to be capped and speeds are comparable only to SBB services while the service tends to be less reliable than fixed broadband over copper, fibre or cable. Ofcom also argues that fixed

<sup>87</sup> Communications Chambers, Communications Chambers/Brian Williamson, Mobile first, fibre as required - The case for Fibre to 5G (FT5G), January 2017, page 9: “Ericsson research shows that since 2012, the average consumer globally has increased their viewing on mobile devices by 4 hours a week, while their fixed screen viewing has declined by 2.5 hours a week.<sup>16</sup> Between 2011 and 2015, teens increased their TV/video viewing at home on smartphones by 85 percent and nearly halved their time spent watching on a traditional TV screen – with smartphone viewing and TV comparable by 2015.<sup>17</sup> As video consumption moves to mobile devices, peak speed requirements may decrease.”

wireless broadband services are only available in small geographic areas and are, therefore, not available to a large proportion of the country. For these reasons, Ofcom proposes not to include it in the relevant product market.

10. BT agrees with Ofcom's assessment that with innovations in wireless technology and the advent of 5G spectrum standards such services will become a stronger substitute in the future, and Ofcom should review its position on alternative mobile and wireless access technologies as and when the necessary spectrum is made available in the UK.
11. Communications Chambers presents evidence from the US indicating that the arrival of 5G could see a major increase in fixed wireless access technologies, either from new start-ups or as alternatives from existing access network providers where such technologies could become more cost effective ways of connecting consumers than fixed fibre access.<sup>88</sup>
12. We are of the view that services that are economic substitutes to fixed broadband over copper, fibre or cable should be included in the market, irrespective of whether their inclusion would alter the subsequent SMP assessment. This may be of particular significance in certain areas and may therefore have an impact on Ofcom's geographic market definition. Ofcom acknowledges this to be the case in certain areas; it states "*in some locations fixed wireless access may be functionally equivalent to fixed broadband access, particularly where premises are close to the broadcasting router, or in areas where fixed broadband speeds are particularly low.*"<sup>89</sup>

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<sup>88</sup> Communications Chambers, Communications Chambers/Brian Williamson, Mobile first, fibre as required - The case for Fibre to 5G (FT5G), January 2017, page 16-17.

<sup>89</sup> See paragraphs 3.77-3.81 of the WLA MR.

## Annex 2: Is the proposed Market A a Relevant Economic Market that warrants ex ante regulation?

1. Having undertaken a detailed modelling exercise to assess competitive conditions by geography, Ofcom has arrived at a 'non-competitive' market covering around 2% of UK premises (c600k). In this annex we address the question of whether Market A can be viewed as a meaningful separate economic market. The key reasons for this are the relative size of Market A, in combination with the interdependencies between Market A and B, and the indirect competitive constraints on BT's behaviour in Market A imposed by effective competition in Market B.
2. At the same time Openreach is continuing to roll out its fibre access network, meaning that the size of Market A will continue to shrink. Acting in any way differently in Market A compared to Market B no longer has any commercial value to BT, and to the extent that it does today offer different prices and terms and conditions to its customers in Market A compared to Market B is entirely driven by the existence of regulation in Market A.
3. This annex provides evidence that would allow Ofcom, if it so chose, to find a single national market. It also explains why BT no longer has any incentive to exploit any kind of SMP in a notionally separate Market A, meaning that at the very least Ofcom should greatly reduce regulation in Market A as preserving the status quo would serve no purpose and only impose costs.
4. We first set out guidance given by the EU that would provide sufficient justification to Ofcom to find there is no longer a separate Market A. The remainder of this annex reviews the evidence relating to Ofcom's SMP analysis that illustrate further that in fact a separate market is no longer meaningful.<sup>90</sup>

### The EU's guidance on defining separate geographic markets

5. There is a good case for removing the finding of separate geographic markets in the WBA market review, as separate relevant economic markets only exist if the competitive conditions in each are "appreciably different", for three key reasons set out in the European Commission's Explanatory Note to its Recommendation on relevant markets<sup>91</sup>.

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<sup>90</sup> Given the close linkage between the market definition and SMP assessment exercise in the WBA market, as the geographic market boundaries are set by reference to different competitive conditions, BT has not distinguished between arguments supporting the finding of a separate market and the finding of SMP within such a market. In theory it would be feasible to define a separate Market A and find no SMP for BT within that on the basis of a number of features including entry barriers, common pricing constraints and countervailing buyer power. However, given that the market boundaries reflect a perceived delineation between areas in which different competitive conditions prevail, it is more appropriate to include these factors in a discussion of market boundaries. Focusing on the market boundary definition only on the basis of count of competitive presence automatically produces very high market shares in the residual Market A areas for BT. This risks eclipsing a full and proper consideration of other competitive factors that evidence the strength of the indirect competitive constraints from Market B into Market A.

<sup>91</sup> See Page 14 of the European Commission, Explanatory Note. Accompanying the document Commission Recommendation on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services (SWD(2014) 298), October 2014 - <https://ec.europa.eu/digital-single-market/en/news/explanatory-note-accompanying-commission-recommendation-relevant-product-and-service-markets>

- The Explanatory Note makes clear that the fact that competitors are not present in all areas is in itself insufficient to find distinct geographic markets. The key reason for this is that “regional” competitors can still exercise a competitive pressure beyond the area in which they are present if the incumbent applies uniform national prices, and the regional competitors are “too large to ignore”. Ofcom recognised that BT was unlikely to remove its national pricing policy at the retail level<sup>92</sup>, and the competitive pressures in Market B (98% of UK premises in Ofcom’s analysis, which we believe is now likely to be around 99%) are indeed too large to ignore.
  - Furthermore, to the extent that price differences exist there must be evidence that these reflect not merely variations in the underlying costs but other fundamental demand or supply side differences between the two markets. Ultimately, Market A is distinct predominantly because the unit cost of providing services are higher in areas which are more sparsely and remotely populated. As Market A prices have been dictated by cost based charge controls and EOI regulation there is no evidence available about the prices which would have prevailed in absence of regulation. The most likely scenario is that Market A prices would have followed Market B prices for each of BT’s customers, given the relative size of business each CP has with BT in Markets A and B.
  - Finally, the relative size of the market is also of relevance. The Explanatory Note reiterates the established Article 7 procedure which requires that the units on which the NRAs base their assessments are “big enough to avoid a resource intensive and burdensome micro-analysis that could lead to a fragmentation of markets”.<sup>93</sup>
6. Our position on these points can be summarised as follows. First, Market A is in effect a residual part of a national market in which broadband services are offered under effectively competitive conditions. In the absence of regulation, the prices of the services at both retail and wholesale levels would be driven by Market B conditions. Second, given the finding of full dependencies in prices and the relative size of Market A as defined by Ofcom, Market A is no longer an economic market of sufficient size that is considered separately by market players, and consequently it should not be considered separately by Ofcom. It is simply not large enough to justify micro-analysis and burdensome regulation. We discuss below the specific factors highlighted by Ofcom as part of its SMP assessment but which also inform the question of whether Market A is indeed a relevant separate economic market.

### Wholesale pricing in Market A

7. We disagree with Ofcom’s interpretation of the level of pricing in Market A to date.<sup>94</sup> Ofcom suggests that because BT has been pricing close to the level of the charge control for almost all IPstream services, then it was likely BT would have priced more highly in absence of a charge control. This is, however, a misleading interpretation of the evidence:
- BT has been planning to withdraw IPstream and switch its services to the more superior WBC product for some time. Pricing IPstream at a higher level relative to WBC is

<sup>92</sup> See paragraph 6.31 of the WBA MR

<sup>93</sup> See page 14 of the European Commission, Explanatory Note, *ibid*.

<sup>94</sup> See paragraph 5.14 of the WBA MR.

consistent with incentivising migration. Where currently there is only IPstream available (mainly in Market A exchanges) this will be phased out and replaced by WBC services within the timeframe of this review.

- As BT is constrained in Market A in negotiating WBA charges with individual customers by EOI remedies, it is unsurprising that BT did not seek to lower its charges across the board significantly below the charge control as it would have had to extend the identical price to all of its customers. Absent charge control and EOI<sup>95</sup>, BT and its wholesale customers would have an incentive to negotiate nationwide prices which would be more efficient, and likely make Markets A and B indistinguishable in terms of pricing. The key basis for price variation may then be the provision of different products and higher unit costs for service provision at smaller exchanges.

### Countervailing buyer power

8. There is significant countervailing buyer power which arises from the competition in Market B which Ofcom has not factored into their assessment. Given the remaining size of Market A the incentive to withhold services, or in any way offer unreasonable terms for Market A, is very strongly curtailed by the volume of sales generated by the same customers in competitive Market B where they have at least one alternative source for WBA services (TTG).
9. BT provided detailed information on service shares for its top 10 customers between the current Market A and B definitions.<sup>96</sup> The data illustrates two points:
  - ✂
  - ✂
10. On that basis, absent regulation, it is inconceivable that the fact that BT has SMP in Market A, even at 10% of the UK market as defined by Ofcom in 2014, would affect the negotiations with these customers in any shape or form – much less when Market A shrinks to less than 2% of UK premises. The indirect threat of losing business in the much larger Market B areas is a bigger lever for BT's customers that counteracts any market power of BT in isolated areas across the UK. The negotiations which include Market B would drive a fair price to be paid in Market A.

### Evidence on retail pricing

11. At the retail level Ofcom acknowledges that the evidence is mixed, but on balance finds there is no common pricing constraint<sup>97</sup> based on the following:
  - Although BT has been adopting a national pricing policy for its main brand, Plusnet and EE levy surcharges for certain areas.<sup>98</sup>

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<sup>95</sup> Under a Modified Greenfield approach Ofcom is required to assess BT's pricing behaviour in the absence of regulation currently applied to the market in question.

<sup>96</sup> BT data requested by Ofcom in their Re-issued Section 135 for the Wholesale Local Access and Wholesale Broadband Access Market Reviews, dated 2<sup>nd</sup> November 2016

<sup>97</sup> See paragraph 4.22 of the WBA MR.

<sup>98</sup> See paragraph 4.18 of the WBA MR.

- Some of BT's main competitors (namely TTG, Sky, Vodafone and Virgin) do not offer services in some areas.<sup>99</sup>
12. BT has always offered nationally uniform residential retail prices. Ofcom recognises that BT has no commercial incentives to change this approach when Market A has shrunk to less than 2% of UK premises. This is because the costs of implementing the necessary systems changes, putting in place the necessary marketing, and most importantly the risk of negative reputational backlash from such actions would by far outweigh any theoretical gains from such a move.
  13. We also note that EE changed its pricing policy for new customers acquiring standard broadband from January 2017. For new customers it no longer levies a surcharge for services in Market A.<sup>100</sup>
  14. As discussed above, a national pricing policy that extends a competitive retail price into areas outside of the areas in which direct retail competition is effective has been recognised by the EU Commission as strong justification for finding a single geographic market. When considering remedies, Ofcom already relies on BT's national pricing at the retail level to provide sufficient protection to consumers in Market A from excessive pricing.<sup>101</sup> The same argument can also justify a finding of a single geographic market.

## Conclusion

15. In short, there are no longer any grounds to continue to heavily regulate Market A. Ofcom has sufficient evidence available to find that there is no longer a separate Market A, or to find that there is no meaningful benefit to continuing the existing onerous SMP regulation given (a) any remaining Market A is de minimis; and/or (b) the factors we have set out above mean that BT lacks the ability or incentive to exploit any notional SMP that Ofcom may find.
16. The evidence is clear that regulation to date of the WLA and WBA markets has been successful in promoting and protecting effective retail competition based predominantly on wholesale access to Openreach's network and competition from alternative networks.
17. Going forward, WLA regulation and a strong focus on network based competition will continue to provide the necessary protection of effective retail competition, including in Market A areas, especially in light of widespread national pricing at the retail level and VULA access reaching further into remote areas.

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<sup>99</sup> See paragraph 4.19 of the WBA MR.

<sup>100</sup> See EE Broadband Terms & Conditions - <http://ee.co.uk/content/dam/ee-help/Help-PDFs/Business-PDFs/Standard-Broadband-and-Fibre-Broadband-Plans-from-24-January-2017.pdf>

<sup>101</sup> See paragraph 6.31 of the WBA MR.

## Annex 3: BT's comments on Ofcom's geographic analysis

1. Ofcom has provided a detailed explanation of the geographic analysis they have undertaken in the market review process.<sup>102</sup> BT generally supports Ofcom's approach, but has a number of suggestions to help improve the accuracy and robustness of Ofcom's analysis.

### Ofcom must ensure their analysis is based on the best available data

2. The data used in Ofcom's analysis<sup>103</sup> was collected between October 2015 and November 2016. Given Openreach's continued roll out of NGA services, especially to rural areas as part of the BDUK programs, it is crucial for Ofcom to make sure it has the most accurate picture of the broadband market. BT estimates that when this additional rollout is taken into account then Market A will fall to less than 1%.
3. Similarly, we expect Ofcom to update information from other data sources, including other Principal Operators (POs). In particular we note the data collected from Virgin Media, both network coverage and premises served, dates from 2015. Public reports from Virgin Media highlight their extensive recent network expansion (465,000 in 2016 and a forecast 800,000 in 2017<sup>104</sup>). We also believe that Virgin Media have re-stated their network coverage to include an additional 250,000 premises. Thus Virgin Media's network coverage is expected to be 1.5 million higher than when last reviewed by Ofcom.

### Ofcom's model excludes FTTP rollout and planned fibre build by other operators

4. Ofcom acknowledge CPs can compete using fibre broadband services in areas where they have not invested in equipment in the copper exchange.<sup>105</sup> We therefore agree that Ofcom should take the NGA network into account when defining the geographic market. However, Ofcom's model needs to be adjusted to also include FTTP rollout and fibre build by other operators.
5. Although the overall percentage of FTTP is relatively low, it is highly concentrated and will therefore impact whether an exchange is designated as Market A or B in specific areas. Whether a premise is served by FTTC or FTTP is a function of technical constraints and prioritisation of intervention funding by local government. This results in some areas having a much higher concentration of FTTP. So there is no justification to exclude FTTP coverage as exactly the same service can be offered from same handover location (i.e. all NGA customers in a given copper local exchange area are handed over at the same fibre serving exchange).
6. There is also a growing amount of third-party infrastructure build that Ofcom has not currently taken into account. Where intervention funding has been used, the winning supplier is required to offer a wholesale service, and over time this is likely to be consumed by the POs. Ofcom therefore should ensure this data is considered in its geographic market assessment.

### Ofcom's network overlap coverage threshold is too high

7. In previous market reviews Ofcom has used the figure of 65% of premises covered as the threshold at which it counts Virgin Media as "present" in an area. Whilst it is attractive to also

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<sup>102</sup> See Section 4 and Annex 8 of the WBA MR.

<sup>103</sup> See Annex 8 table A8.1 of the WBA MR.

<sup>104</sup> Virgin Media investor presentation February 2017, numbers for UK and Ireland

<sup>105</sup> See page 32, footnote 75, of the WBA MR.

use a 65% threshold to assess the presence of fibre, BT has always maintained that this threshold is a conservative figure as both networks continue to expand.

8. Virgin Media's expansion is almost exclusively still in urban areas where there is already competition from other POs. In contrast, intervention funding and BT's UBC commitment is enabling fibre to roll out into areas where there is currently limited competition at the WBA level, and thus fibre has a material effect on the geographic market definition on a forward looking basis.

### Ofcom's model has a very limited forward look

9. Ofcom should take into account a forward look of competitors' footprints. There are two aspects of a PO's fibre footprint; the in exchange fibre coverage and the PO's presence at the point of handover (fibre serving exchange).

#### In exchange fibre coverage

10. Ofcom's seeks to include a forward look in its model by using data on future committed roll-out plans. However, it only includes data where a specific exchange is identified, in practice this means its outlook is only for a 3 month period. BDUK contracts also contain coverage commitments,<sup>106</sup> however precise areas only become "committed" after detailed surveys have been completed.<sup>107</sup>
11. BT's fibre build has already extended beyond Ofcom's "forward look" gathered in November 2016. When Ofcom updates the planned network coverage data BT expects there will be a significant increase in the calculated coverage in many exchanges compared to the figures seen in the Consultation.
12. Furthermore, the NGA coverage of an exchange will continue to increase over the timeframe of this review. One way to address this would be to use a lower threshold value than the 65%, with the assumption that over time the exchange coverage will increase over the review period.

#### POs presence at fibre POHs

13. Ofcom's model also identifies whether a PO can serve an area using fibre based services.<sup>108</sup> This appears to be based on whether a PO is currently present at the handover exchange ("fibre serving exchange") but it is unclear if this "presence" is based on the purchase of copper services, fibre services or either.
14. It should be economically viable for all active POs to connect to all handover sites, given the limited barriers to entry to connect to additional handover exchanges on a forward looking basis. We therefore think that Ofcom should lift the restriction that a PO need to be present at a handover site today for them to be counted.

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<sup>106</sup> (and in the future will also apply to BT's Universal Broadband Commitment, where a significant proportion of this additional network build will be based on FTTC and FTTP technologies)

<sup>107</sup> For example a planned area may be de-selected if the quote for providing power in that location is extremely high but in such cases another area, with more favourable economics, will be selected and so the network rollout will occur.

<sup>108</sup> See paragraphs 4.66 and A8.35 of the WBA MR.

### Number of UK premises

15. Ofcom has changed the base data it uses to assess the number of premises in the UK as a measure of broadband demand (i.e. the number delivery points “DPs”). This is now 31.1million compared to 28.6 million in the last review.
16. This change is the result of the move to a new database - OS AddressBase Plus. The issue of which locations should be used when examining broadband demand is not straightforward. Ofcom has already undertaken a significant amount of work in this area, as part of its Connected Nations program. It therefore makes sense for Ofcom to use a consistent set of data to identify the number of DPs in both the WBA review and Connected Nations program.

### BT can help to reduce the number of mismatched postcodes

17. When Ofcom matched the OS postcode to BT’s postcodes there were a significant number that could not be matched. Whilst there is likely to always be some mis-match, this appears to be larger than would be explained by the different dates of the underlying postcode files.
18. Further review has identified a potential cause for this mis-match and BT is happy to work with Ofcom to try to reduce this error margin. We would expect the number of mis-matched postcodes to further reduce if Ofcom aligns the underlying data set with the Connected Nations list of premises.
19. If a significant degree of mis-match remains in the refreshed data, BT is happy to help investigate further in order to try to identify any systematic data issues.

### Improving Ofcom’s calculation of the size of each exchange

20. Ofcom uses postcodes to allocate DPs to each exchange. It acknowledges that this will result in some “edge effect” errors as some postcodes are served by multiple exchanges. We agree that the impact of this may be minimal but think it worthwhile to assess the impact.
21. This would be a relatively simple task as BT maintains a premise-level model where every premise is allocated to a serving exchange. Therefore we can share BT’s estimate of exchange size, and Ofcom can compare this to their model to identify any significant discrepancies.
22. Using a standardised set of DPs (as used by the Connected Nations program) should also reduce the potential for discrepancies (such as the treatment of University halls of residences).

### Ofcom’s Network Overlap calculation systematically underestimates fibre coverage in an exchange

23. In addition to the wider comments noted above, we believe Ofcom’s analysis method results in a systematic under estimate of fibre coverage in an exchange area. This is because Ofcom has used its OS AddressBase Plus selection to calculate the “size” of each exchange (the denominator), and the number of premises covered by FTTC as supplied by Openreach (the numerator). As Ofcom has identified more DPs than Openreach, the NGA coverage will, on average be underestimated. Moving to an agreed list of broadband DPs will eliminate this error.
24. As an additional check, Ofcom could compare its calculations with Openreach’s estimate of exchange coverage to identify any significant discrepancies.

## Annex 4: Proportionality of imposing an EOI remedy to Market A and its wider effect on competition and end-customers

1. In the main body of this response, we have set out the reasons we believe Ofcom should now find either that there is no longer a separate Market A in which BT has SMP, or that a light-touch reporting remedy is all that is required to meet Ofcom's regulatory goals.
2. However, if Ofcom remains minded despite the countervailing evidence to find a separate Market A in which BT has SMP. This annex expands on the reasons that Ofcom's continued imposition of an EOI remedy is especially inappropriate. In particular:
  - how the interdependence of Markets A and B imposes costs adversely affecting both competition in Market B and innovation and investment incentives in Market A;
  - how the proportionality of imposing EOI (or indeed any SMP remedy) should be assessed; and
  - what effect removing the Undertakings would have on an SMP EOI remedy.

### Adverse effects of EOI

3. Ofcom appears only to consider direct costs to BT in terms of compliance costs when it assesses the costs and benefits of EOI. But there are wider costs imposed on BT and on the market more widely that Ofcom's assessment does not mention at all.
4. These costs arise from the interdependence and linkage between Market A (where SMP remedies are currently imposed) and Market B (which is deregulated as it is deemed that no one has SMP).
5. BT currently runs a single network that serves both Markets A and B. Therefore, any change to the network, or product offered on the network, in most cases affects both Markets A and B.
6. In a hypothetical world in which BT ran separate networks in Markets A and B it would be incentivised to introduce innovative products and network improvements in Market B that allow BT Consumer to compete effectively with its LLU-, VULA- and cable-based downstream competitors, namely Sky, TTG and Virgin. In the separate network serving Market A it would be bound by regulatory obligations to ensure all network changes were consulted on and shared with all of BT's WBA customers on EOI terms.
7. However, there are no two separate networks. BT is still strongly incentivised to introduce innovative products and network improvements to allow BT Consumer to compete effectively with LLU-, VULA- and cable-based competitors in Market B. Absent regulation, given the relative size of Market A to Market B, there would be no benefit to treating Market A areas any differently to Market B areas, and consequently Market A areas would indirectly benefit from the same service and network improvements introduced as a result of effective competition in Market B areas.
8. The presence of regulation for Market A, especially EOI, however, affects BT's incentives to act in this way, for the following reasons:
  - any change or new product introduced across the entire network must be consulted on and published 90 days in advance of launch. Even if a product is expected to be relevant

mainly, or solely, in Market B areas, if it will or may also be launched in Market A, BT must still comply with these obligations. The effect is that BT's competitors gain a competitive advantage from having insight into BT's plans for Market B well in advance, giving them more time to react, or to learn from BT's innovations that they otherwise would not have had access to.

- Loss of competitive advantage as described above means BT is incentivised to design, where feasible, network changes or products in such a way that they do not get extended into Market A areas, to avoid having to make public its innovation plans. It means that, especially as Market A shrinks to a de minimis level, BT may need to consider whether network improvements or new products should ever be extended into Market A. This is because the cost of doing so (in terms of losing competitive advantage in Market B, at least 98% of UK premises) is higher than the benefits gained from offering an improved product in a tiny fraction of the market (less than 2% of UK premises).

9. Below we set out two practical examples to illustrate how EOI can negatively affect product development:

- ✂
- ✂

#### ✂ Product Development

10. ✂

11. ✂

12. ✂

13. ✂

14. ✂

15. ✂:

- ✂
- ✂
- ✂

#### ✂ Product Development

16. ✂

17. ✂

18. ✂

19. ✂

20. ✂

21. ✂

22. ✂

23. ✂

## Conclusion

24. In conclusion, these two examples show clearly how the constraints in a vanishingly small part of the market have adverse effects far beyond Market A. They hinder BT's ability to develop products flexibly in Market B in the same way its LLU-, VULA- and cable based competitors can. This ultimately not only harms BT's competitive position in Market B but also serves to withhold innovation and investment both in Market A and Market B. As Ofcom has not made a credible case for significant benefits from EOI in Market A, it is hard to see how such significant adverse effects from regulation could be justified.

## Ofcom's duties to promote competition

25. Ofcom has a principal duty, in carrying out its functions, 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 (s.3(1)).<sup>109</sup> It must also have regard, where relevant, to the desirability of promoting competition and the desirability of encouraging investment and innovation in relevant markets (s.3(4)).<sup>110</sup> Finally, Ofcom must also have regard to the interests of consumers in respect of choice, price, quality of service and value for money (s.3(5)).<sup>111</sup>
26. However, as we set out in the section above, Ofcom's focus on protecting competitors in Market A is likely to have negative consequences for competition, investment and innovation in the much larger Market B. The cost of compliance, added to the competitive disadvantage that BT faces in Market B as compared to Virgin Media and the LLU operators, will continue to stifle BT's ability to innovate and provide effective competition at the retail level in Market B.
27. Ultimately, this results in a weakening of competition and worse consumer outcomes than would be the case absent regulation. Limiting BT's ability to compete on a level playing field in Market B will harm (and already has harmed) the interests of the vast majority of UK consumers in getting the best choice, price, quality of service and value for money. This is balanced against the very limited benefits that result from the ongoing protection of a few competitors in Market A. BT's view is that this trade is not a good one.

## Assessing the proportionality of the EOI remedy against Ofcom's duties

28. Ofcom argued that the costs of an EOI remedy were not disproportionate where a) BT was already providing services on an EOI basis, and b) BT developed new products.
29. Ofcom appeared to consider only direct costs to BT in terms of systems and procedural cost burdens. We discussed above that far greater costs arise from unintended adverse consequences on competition in Market B and innovation and investment in both Markets A and B. These are not repeated here but focus on whether Ofcom's assessment is consistent with its statutory obligations under the Communications Act when considering the proportionality of remedies.

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<sup>109</sup> See s.3(1) of the Communications Act

<sup>110</sup> See s.3(4) of the Communications Act

<sup>111</sup> See s.3(5) of the Communications Act

30. The first section discusses whether Ofcom has discharged its duty to consider the removal of regulatory burdens, and the second section discusses whether Ofcom's analysis of proportionality was adequate.

#### a. Duty to consider removal of regulatory burdens

31. Ofcom is under an explicit legal duty to consider the removal of regulatory burdens. S.6 of the Communications Act 2003 states:<sup>112</sup>

*s.6 (1) OFCOM must keep the carrying out of their functions under review with a view to securing that regulation by OFCOM does not involve –*

*(a) the imposition of burdens which are unnecessary; or*

*(b) the maintenance of burdens which have become unnecessary.* [emphasis added]

32. This provision clearly reflects Parliament's intention that communications regulation should be 'light touch'. It places an active duty on Ofcom to consider whether or not it should maintain regulatory burdens which have become unnecessary.

33. In addition to being consistent with its duty under s.6, imposing more limited regulation in Market A would also be consistent with Ofcom's duty under s.3(3)(a) of the Act<sup>113</sup> to have regard to any other principles appearing to Ofcom to represent the best regulatory practice. Guidance on best regulatory practice was provided by the Better Regulation Task Force in September 2003, which said:

*"The option of not intervening...should always be seriously considered. Sometimes the fact that a market is working imperfectly is used to justify taking action. But no market ever works perfectly, while the effects of...regulation and its unintended consequences, may be worse than the effects of the imperfect market"*

34. As to the question of whether regulation has become unnecessary, Ofcom itself conceded that its proposed regulation only served the purpose of protecting existing competition in Market A, less than 2% of the UK, and likely falling to around 1% on the basis of updated figures. This is a very limited benefit, and therefore any regulatory burden must be extremely low to justify its imposition. EOI, by Ofcom's own admission, imposes higher regulatory burdens than alternative approaches to imposing a non-discrimination obligation on BT.

35. Furthermore, these obligations imply that the appropriate counterfactual for assessing the costs of a remedy is having no remedy imposed, rather than the current status quo. If costs were assessed compared to the current status quo and only incremental additional costs were counted as a relevant burden then regulation would never be removed.

36. Yet Ofcom appear to have based their judgement on the fact that BT is already supplying products on an EOI basis, because it is under an EOI obligation via the Undertakings. However this position is flawed:

- EOI supply is costly, and although BT already has processes and systems in place that accommodate EOI their removal would have significant savings as these processes and

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<sup>112</sup> See s.6 of the Communications Act

<sup>113</sup> See s.3(3)(a) of the Communications Act

systems would no longer have to be maintained. Therefore the continuation of EOI cannot simply be brushed aside as an inconsequential cost to BT.

- When the Undertakings are removed as a result of the DCR process and the introduction of new Commitments on Openreach, the maintenance of EOI obligations for BT in Market A would be solely based on the SMP remedy. The entire costs for maintaining systems and processes for less than 2% of UK premises would then fall onto the SMP remedy.

37. BT's view is that the WBA consultation response does not contain evidence that Ofcom has actively undertaken a 'serious consideration' of the option of not continuing to impose EOI regulation at all. Specifically in the context of EOI, it appears that Ofcom is essentially satisfied it can continue to impose this remedy because BT is already subject to it, rather than because it is genuinely the right thing to do. This approach is not consistent with the principles of regulatory best practice.

## b. Proportionality assessment

38. Further, Ofcom is required to consider the proportionality of its proposed SMP remedies, under both its general s.3(3)(a) duties and the specific requirements around the imposition of SMP conditions under s.47(2)(c) of the Act.<sup>114</sup>

39. However, for a proposal that will significantly affect competition in both Market A and Market B over a three year period, Ofcom's discussion of proportionality in relation to EOI is remarkably brief:

*'it would enable telecoms providers to compete effectively with BT at the retail level for the benefit of consumers, and BT would not incur any further costs in complying with the condition, given that it already supplies network access on an EOI basis and the ongoing costs of providing these services on an EOI basis are likely to be low. In addition, we consider it is unlikely to be more costly or time consuming to develop new services on an EOI basis (compared to creating different systems for its retail and wholesale services).'*<sup>115</sup>

40. For a measure to be proportionate it must pass a four-part legal test, but this brief paragraph does not provide evidence that Ofcom has given full consideration to each part of the test.

41. To be proportionate, a measure:

- must be effective to achieve the legitimate aim in question (**appropriate**);
- must be no more onerous than is required to achieve that aim (**necessary**);
- must be **the least onerous**, if there is a choice of equally effective measures; and
- in any event must **not produce adverse effects** which are disproportionate to the aim pursued

42. EOI on Market A only meets the first limb of the test (and even then only in a qualified way), with the consequence that imposing it would be disproportionate.

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<sup>114</sup> See s.3(3)(a) and s.47(2)(c) of the Communications Act

<sup>115</sup> See paragraph 6.67 of the WBA MR.

## Appropriateness

43. BT recognises it is common regulatory practice for an SMP network access obligation to be accompanied by a requirement to do so on non-discriminatory terms. We therefore accept that, in principle, an EOI remedy may be an appropriate means of achieving Ofcom’s goals if it decides to continue to mandate provision of network access.
44. However, we do not believe it is the most appropriate. Ofcom states in its consultation document that it considers EOI to be the most effective form of non-discrimination.<sup>116</sup> It appears that Ofcom is wrongly equating ‘most stringent’ with ‘most effective’, and does not engage in any assessment of the extent to which EOI may be eliminating “undue” compared to procompetitive discrimination, preferring a “bright line” remedy irrespective of its adverse consequences on the market and consumers, which we have discussed in the previous section.
45. In particular Ofcom sets against this, among other points, the argument that NUD provides less certainty to competitors than EOI. While we understand that EOI has some minor administrative advantages for Ofcom, we do not agree that it would lead to greater uncertainty for telecoms providers and/or undermine existing competition in the market, as Ofcom claims.<sup>117</sup>
46. Ofcom has long-established guidance on its approach to ‘no undue discrimination’.<sup>118</sup> This sets out in pragmatic terms how it should approach the question of when conduct amounts to undue discrimination. It also notes that the guidance *‘encourage[s] compliance by explaining conditions imposed, thereby ensuring that SMP providers understand their obligations and enabling potential customers to identify contraventions’*.
47. Ofcom’s intention in publishing its guidance was to promote certainty and transparency on how ‘no undue discrimination’ should be applied. This remains an appropriate safeguard, and undermines Ofcom’s claim that no undue discrimination would lead to substantially greater uncertainty than EOI. This leaves little material difference in the efficacy of ‘no undue discrimination’ and EOI.

## Necessity of EOI

48. The evidence set out in Sections 3 and 4 in the main response indicates that the historically stringent approach to regulation in Market A is no longer **necessary** in order to secure the aim of ensuring customers are treated fairly.
49. In particular:
- a) the national-level constraints imposed by Market B on Market A;
  - b) BT’s incentives to treat its customers fairly in order to retain them; and
  - c) the availability of UK and EU competition law as a disincentive and potential *ex post* remedy,

mean that imposing a strict EOI remedy goes far beyond what is necessary to secure Ofcom’s aims.

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<sup>116</sup> See paragraph 6.59 of the WBA MR.

<sup>117</sup> See paragraph 6.9 of the WBA MR.

<sup>118</sup> See Ofcom document *‘Undue discrimination by SMP providers’*, 15 November 2005 - [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0021/46038/contraventions4.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0021/46038/contraventions4.pdf).

*Ofcom must choose the least onerous of equally effective measures*

50. If Ofcom retains concerns about the potential for BT to discriminate in its treatment of customers, it has the option to maintain a reduced level of regulation. However, the third limb of the proportionality test requires it to impose the least onerous of any equally effective measures, and Ofcom has not given the necessary consideration to the effectiveness and costs of a lighter touch non-discrimination remedy in comparison with EOI.
51. ‘No undue discrimination’ was Ofcom’s preferred SMP remedy prior to the 2014 WBA market review, and remains a less onerous way for Ofcom to achieve its regulatory aims. It is clear that Ofcom agrees that NUD is a less onerous remedy than EOI, and comes with a number of key benefits which should weigh heavily in any proportionality assessment, particularly that it allows for more flexibility and a more practical approach.<sup>119</sup> Given that BT’s analysis suggests that lighter forms of regulation, are appropriate, EOI cannot be the least onerous remedy possible.
52. In this regard, Ofcom only appears to have considered NUD as an alternative general remedy. However, as discussed in the previous section, given the harm to Market B from non-discrimination regulation in Market A, and the lack of incentive for BT to discriminate in a Market A which is increasingly de minimis, appropriate alternatives may also include remedies (a) that carve out exemptions for specific cases in which product and network improvements are clearly targeted at Market B; and/or (b) impose reporting obligations on BT allowing Ofcom actively to monitor the WBA market and intervene if it has any cause for concern.

## Conclusion

53. In summary, Ofcom’s analysis falls short of the statutory requirements on its assessment of regulatory burdens and the proportionality of imposing regulation. Given the extremely limited benefits of any continuing regulation on Market A, Ofcom should at most have considered lighter touch non-discrimination obligations than EOI. EOI is a blunt tool and therefore a very costly way to secure non-discrimination. While that may have been regarded imposing little extra cost given the Undertakings, the situation will change significantly once the Undertakings are withdrawn.

### c. Impact of removal of the Undertakings

54. At present BT is subject to two separate EOI obligations in Market A – the SMP remedy and the Undertakings. In practice the Undertakings EOI came first and SMP EOI was only introduced in the last WBA market review. BT’s internal practices and procedure to ensure compliance with EOI have all been developed in the context of the Undertakings, alongside the training, monitoring and reporting functions associated with compliance.
55. This internal infrastructure will be dismantled as the Undertakings fall away and are replaced by BT’s Commitments given to Ofcom in its Digital Communications Review. It is disproportionate to require BT to maintain or recreate it only for WBA services. This is particularly the case for the Annex 2 infrastructure surrounding information sharing which is supported by maintaining an Annex 2 register, mandatory Undertakings training for all directory listings specifying Annex 2 status etc.

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<sup>119</sup> See paragraph 6.56 of the WBA MR.

