

who has been determined to have SMP in a “services market” (i.e. a specific market for electronic communications networks, electronic communications services or associated facilities). Accordingly, having identified the relevant markets, Ofcom is required to analyse each market in order to assess whether any person or persons have SMP as defined in Section 78 of the Act (Article 14 of the Framework Directive).

Definition of SMP

- 7.11 Under the Directives and Section 78 of the Act, SMP has been defined so that it is equivalent to the competition law concept of dominance. Article 14(2) of the Framework Directive states that:

“An undertaking shall be deemed to have significant market power if, either individually or jointly with others, it enjoys a position equivalent to dominance, that is to say a position of economic strength affording it the power to behave to an appreciable extent independently of competitors, customers and ultimately consumers.”

- 7.12 Further, Article 14(3) of the Framework Directive states that:

“Where an undertaking has significant market power on a specific market, it may also be deemed to have significant market power on a closely related market, where the links between the two markets are such as to allow the market power held in one market to be leveraged into the other market, thereby strengthening the market power of the undertaking”.

- 7.13 Therefore, in the relevant market, one or more undertakings may be designated as having SMP (single or collective dominance) where any undertaking, or undertakings, enjoys a position of dominance in that market. Also, an undertaking may be designated as having SMP where it could leverage its market power from a closely related market into the relevant market, thereby strengthening its market power in the relevant market.

- 7.14 In assessing SMP it is important to conduct the analysis under the assumption that no SMP related regulatory intervention currently or potentially exists in that same market. This is because the outcome of the SMP assessment is to test whether or not any regulatory intervention is required. Therefore, assessing SMP in this market requires consideration of a hypothetical market where SMP regulation (or the threat of SMP regulation) does not exist.

The criteria for assessing SMP

- 7.15 In assessing whether an undertaking has SMP, Ofcom took the utmost account of the SMP Guidelines as it is required to do when considering whether to make a market power determination under Section 79 of the Act, as well as considering the application of the equivalent Oftel guidelines as set out in Section 3 above.

- 7.16 Specifically, paragraph 19 of the SMP Guidelines states that:

“NRAs will assess whether the competition is effective. A finding that effective competition exists on a relevant market is equivalent to a finding that no operator enjoys a single or joint dominant position on that market.”

- 7.17 The SMP Guidelines go on to state in paragraph 20 that:

“NRAs will conduct a forward looking structural evaluation of the relevant market, based on existing market conditions. NRAs should determine whether the market is prospectively competitive, and thus whether any lack of effective competition is durable, by taking into account expected or foreseeable market developments over the course of a reasonable period. The actual period used should reflect the specific characteristics of the market and the expected timing for the next review of the relevant market by the NRA. NRAs should take past data into account in their analysis when such data are relevant to the developments in that market in the foreseeable future.”

- 7.18 In paragraph 75 of the SMP Guidelines, the Commission discusses market shares as being an indicator of market power:

“...Market shares are often used as a proxy for market power. Although a high market share alone is not sufficient to establish the possession of significant market power (dominance), it is unlikely that a firm without a significant share of the relevant market would be in a dominant position. Thus, undertakings with market shares of no more than 25% are not likely to enjoy a (single) dominant position on the market concerned. In the Commission's decision making practice, single dominance concerns normally arise in the case of undertakings with market shares of over 40%, although the Commission may in some cases have concerns about dominance even with lower market shares, as dominance may occur without the existence of a large market share. According to established case law, very large market shares — in excess of 50% — are in themselves, save in exceptional circumstances, evidence of the existence of a dominant position...”

- 7.19 However, in paragraph 78 of the SMP Guidelines, the Commission also notes that:

“It is important to stress that the existence of a dominant position cannot be established on the sole basis of large market shares. As mentioned above, the existence of high market shares simply means that the operator concerned might be in a dominant position. Therefore, NRAs should undertake a thorough and overall analysis of the economic characteristics of the relevant market before coming to a conclusion as to the existence of significant market power. In that regard, the following criteria can also be used to measure the power of an undertaking to behave to an appreciable extent independently of its competitors, customers and consumers. These criteria include amongst others:

- Overall size of the undertaking,
- Control of infrastructure not easily duplicated,
- Technological advantages or superiority,
- Absence of or low countervailing buying power,
- Easy or privileged access to capital markets/financial resources,
- Product/services diversification (e.g. bundled products or services),

- *Economies of scale,*
- *Economies of scope,*
- *Vertical integration,*
- *A highly developed distribution and sales network,*
- *Absence of potential competition,*
- *Barriers to expansion.*

A dominant position can derive from a combination of the above criteria, which taken separately may not necessarily be determinative."

7.20 The European Regulators' Group (ERG) has issued a working paper on SMP (the ERG SMP Position) that builds upon the SMP Guidelines. In this paper further criteria are explicitly considered:

- excessive pricing;
- ease of market entry;
- cost and barriers to switching;
- evidence of previous anti competitive behaviour;
- active competition on other parameters;
- existence of standards/conventions;
- customers' ability to access and use information;
- price trends and pricing behaviour; and
- international benchmarking.

Methodology

7.21 When assessing whether SMP exists in a particular market, it is appropriate to take account of any existing or proposed regulation of a service *upstream* of the market that is being considered. It is also appropriate to take into account regulatory obligations that exist independently of an SMP finding in the market under consideration, but which impact on the SMP finding in the markets under consideration. The existence of such regulation needs to be considered to capture the competitive constraints in the market under investigation.

7.22 Notwithstanding this, the mere fact that regulation has been put in place or is proposed in an adjacent market does not automatically mean that this regulation is effective in preventing the exercise of SMP in the market in which it has been imposed. This is particularly the case with respect to regulation that is proposed but which has not yet been put in place. Such regulation needs to be fully implemented and there needs to be compliance with this regulation for a reasonable period of time before it can be assumed that it has dealt with upstream bottlenecks that affect competition in downstream markets.

- 7.23 It is also important to conduct the market analysis against the backdrop of the BT Undertakings provided under Ofcom's Telecommunications Strategic Review (the Undertakings).⁵⁹ The Undertakings were designed to ensure that BT does not discriminate between its own downstream divisions and competitors when offering access services. They require BT to apply Equivalence of Input (Eol) principles to particular access services.
- 7.24 In so far as the Business Connectivity Market Review is concerned, these Undertakings are principally relevant to Wholesale Ethernet services (for example, WES/BES), which are to be provided on an Eol basis. BT is required to provide the following services on an Eol basis:
- WES and BES services; and
 - separate access and backhaul services, to make it easier for other CPs to aggregate leased lines and potentially broadband traffic at BT local exchanges. This includes WES Access, WES Backhaul and WEES products.
- 7.25 With respect to the TISBO market, the Undertakings commit BT to make available new TI Local Access and Backhaul Products to any Communications Provider within a reasonable period of time. Other TISBO services, however, do not have to be provided on an Eol basis.
- 7.26 The assessment of SMP in a particular market should assume that no regulatory intervention (based on an SMP finding) currently or potentially exists *in that same market*. This is because the very purpose of the SMP analysis is to determine whether any regulation is appropriate in that market. Therefore, assessing SMP in this market requires consideration of a hypothetical market where neither regulation nor the threat of regulation exists.
- 7.27 The SMP assessment is based on the most appropriate and current available information. This evidence pertains directly to the retail and wholesale markets under examination. In the case of wholesale markets, it is also based on information in relation to the corresponding retail markets where this can also inform the wholesale analysis. For example, Ofcom has estimated market shares at the wholesale level based on information available at both the retail and wholesale levels.

Review of proposals

- 7.28 In the January 2008 consultation, we asked the following questions in relation to our proposed findings on SMP:

Question 7: Do stakeholders agree with our proposed approach to SMP assessment?

Question 8: Do stakeholders agree with our assessment of SMP in the retail low bandwidth market in the UK excluding the Hull area? In particular, do you agree with our assessment that regulation in this market is still required for the time being?

Question 9: Do stakeholders agree with our assessment of SMP in wholesale TISBO markets in the UK excluding the Hull area?

⁵⁹ The Final statement of BT's Undertakings, published in September 2006, can be found at: http://www.ofcom.org.uk/static/telecoms_review/final_statement.htm

Question 10: Do stakeholders agree with our assessment of SMP in wholesale AISBO markets in the UK excluding the Hull area?

Question 11: Do stakeholders agree with our assessment of SMP in the wholesale trunk segments market?

Question 12: Do stakeholders agree with our assessment of SMP in the retail low bandwidth market in the Hull area?

Question 13: Do stakeholders agree with our assessment of SMP in wholesale TISBO markets in the Hull area?

Question 14: Do stakeholders agree with our assessment of SMP in wholesale AISBO markets in the Hull area?

Question 15: For those markets where we have found no SMP and propose to deregulate, do you agree with Ofcom that the available evidence supports the finding of no SMP?

7.29 In the July 2008 consultation, we asked the following questions in relation to our proposed findings on SMP for the very high TISBO markets:

Question 5: Do stakeholders agree with our assessment of SMP in the wholesale very high bandwidth 155 Mbit/s TISBO market in the UK excluding CELA and the Hull area?

Question 6: Do stakeholders agree with our assessment of no SMP in the wholesale very high bandwidth 155 Mbit/s TISBO market in the CELA?

Question 7: Do stakeholders agree with our assessment of no SMP in the wholesale very high bandwidth 622 Mbit/s TISBO market in the UK excluding the Hull area?

Question 8: Do stakeholders agree with our assessment of SMP in the wholesale very high bandwidth 155 Mbit/s TISBO market in the Hull area?

Question 9: Do stakeholders agree with our assessment of no SMP in the wholesale very high bandwidth 622 Mbit/s TISBO market in the Hull Area?

7.30 In the following sub Sections, we set out, for each of the markets reviewed in this Section, the proposals set out in our consultations. We then review the responses from stakeholders and provide our response. Then, having regard for all evidence and all responses, we set out our conclusions in relation to the SMP assessment for the markets covered by this review.

Retail market for low bandwidth TI retail leased lines (including analogue circuits and digital circuits at bandwidths up to and including 8Mbit/s) in the UK excluding Hull

January 2008 consultation

7.31 In paragraphs 7.38 to 7.155 of the January 2008 consultation we set out why we believed that BT has SMP in the market for retail low bandwidth TI leased lines. Our view was particularly influenced by the following considerations:

- BT's high market shares (80 per cent by volume);
- BT's apparent high profitability, and what appears to be its high pricing⁶⁰;
- BT's control of infrastructure not easily duplicated;
- BT's ability to exploit economies of scale and scope;
- BT's vertical integration;
- a lack of countervailing buyer power;
- the existence of barriers to entry and expansion;
- the absence of potential competition; and
- evidence of previous anti-competitive behaviour by BT.

7.32 We also noted that the impediments to competition largely arise as a result of upstream bottlenecks. Impediments to competition that arise solely at the retail level are much less significant. We considered that this implied that once Ofcom's concerns in regard to BT's position in the upstream market have been fully addressed, it may be possible to de-regulate this market.

Review of responses to the consultation

- 7.33 BT argued that a broader retail market definition should be used, and therefore questioned Ofcom's finding of SMP on the narrower markets it defined. BT argued that a different product market approach would allow a better analysis of geographic markets for low bandwidth retail leased lines, and suggests that the results may show that BT has lower market shares in metropolitan areas. BT also argued that alternative business connectivity services impose competitive constraints on TI leased lines. For example, it argued that VPNs were close substitutes for TI leased lines.
- 7.34 BT also said that its market share in a combined analogue and low bandwidth digital retail leased lines market is skewed by its market share of almost 100 per cent of analogue circuits.
- 7.35 In the context of the three criteria in the European Commission's Recommendation on product and service markets susceptible to ex ante regulation, BT considers that that none of the three criteria are met. BT argues that barriers to entry are low, because wholesale products have been fully available from BT since 2001, and that Ofcom's concerns about replicability have now been addressed. BT also argues that competition law is sufficient to address any concerns.
- 7.36 None of the other respondents who commented on these proposals disagreed with Ofcom's market power findings.

⁶⁰ Paragraphs 7.52 to 7.79 of the January 2008 consultation set out our analysis of this. We noted that there were limitations with the data, which essentially mean that the profitability analysis does not correspond precisely to the market under consideration. Nevertheless, BT's return on sales and return on value added for leased lines to end-users and to MNOs across all bandwidths generally appear to be very substantially above the levels that competition authorities have usually found should apply in effectively competitive markets where capital intensity is low. For example, for analogue lines, the return on sales was 44 per cent in 2006/07 and the return on value added was 70 per cent.

Ofcom's response to respondents' views

- 7.37 We have considered, and rejected, BT's arguments for a wider retail market in Section 3 above. Even if other services are outside the market, it is still possible for them to exert some limited competitive constraint on the market we are considering. However, we do not believe this is a strong effect. For example, the evidence suggests that users do not switch rapidly from TI leased lines to AI leased lines even in response to quite large price differentials, suggesting that the competitive constraint from AI leased lines is not yet strong (see paragraph 3.60).
- 7.38 In defining the retail product market, we rejected the view that VPNs were in the same market as leased lines. This conclusion applied both to VPNs provided using ADSL and those provided over dedicated tails. Internet-based VPNs provide a much lower quality (and lower price) service and are unlikely to be seen as a substitute for leased lines. Leased line based VPNs can provide quality of service approximating to that of a point-to-point leased line. Although we do not believe they are part of the same market, we have nevertheless calculated what BT's market share would be if VPNs using dedicated tails were included in the same market. BT's market share (by volumes) would decline from 80 per cent to 76 per cent. The inclusion of VPNs therefore makes only a small difference to BT's market share, and would not affect our conclusion that BT has SMP in this market.
- 7.39 BT considers that our volume shares are likely to overstate its true share of the retail market, because it supplies a relatively high share of low value products (i.e. analogue lines) but a lower share of high value shares (i.e. 2 Mbit/s digital leased lines).
- 7.40 We recognised this potential bias in the January 2008 consultation.⁶¹ We sought to address this by using information from our trends annex to examine BT's volume share of various components within the retail leased line market (see Table 17 on page 215 of the January 2008 consultation). This indicated that BT has a 99 per cent share of analogue sales, a 50 per cent share of <2 Mbit/s sales and an 89 per cent share of 2-8 Mbit/s sales. However, because these calculations are based on the data used to calculate our trends analysis and revenue shares, they may be unreliable, as that data set is incomplete.
- 7.41 We have therefore calculated BT's service share for different components of the retail leased line market using the same data source that was used to calculate the 80% market share. This information is complete and highly reliable. The results are shown in Table 7.1 below.

Table 7.1: BT's volume share for individual services within the low bandwidth TI retail leased lines market in the UK (excluding the Hull area) (2006)

	BT Share (%)
Analogue	98
Digital SDH <2 Mbit/s	79
Digital SDH 2 Mbit/s	60
Digital SDH >2 to 8Mbit/s	27
All services in market	80

Source: CP data, Ofcom

⁶¹ See discussion at paragraph 7.50 of the January 2008 consultation.

- 7.42 Table 7.1 indicates that BT's volume share declines for higher bandwidth services. This suggests that if BT's share of the market were expressed by value it would be lower than BT's 80 per cent. However, BT's volume share is still 60 per cent or higher for all services except digital leased lines which exceed 2 Mbit/s. Sales of digital leased lines exceeding 2 Mbit/s only represent around 0.1 per cent of the total volumes in this market. It therefore seems safe to conclude that BT's market share by value is likely to be well in excess of the 50 per cent level that the SMP Guidelines consider normally create a presumption of SMP.⁶²
- 7.43 While regulated wholesale terminating segments have been available since 2001, BT's retail leased lines offerings are not yet replicable⁶³, putting BT's competitors at a potential disadvantage. The persistence of BT's market share, despite evidence suggesting high prices and profitability, suggests that there have been significant barriers to entry for OCPs.
- 7.44 Our view is that that the retail products are still not replicable, for the reasons given in Section 8. Ofcom is now considering launching a separate project to consider in more detail BT's compliance with our Replicability Statement of April 2006, with a view to consulting on this early in 2009.
- 7.45 In terms of the European Commission's three criteria, whilst as set out in paragraph 2.30 we do not believe that passing of the three criteria test constitutes a legal requirement for the undertaking of a market review, we believe that this market cumulatively meets all three criteria. The first and second criteria for considering ex ante regulation relate to high and non-transitory barriers to entry and that the market structure does not tend towards effective competition within the relevant time horizon. We set out below, in the forward looking analysis and conclusion, why we think both these criteria are met.
- 7.46 The third criterion is that the application of competition law alone would not adequately address the market failures. We consider that ex ante retail regulation provides a more efficient means of securing effective competition in the retail market, as against the option of solely relying on the application of ex post competition law.
- 7.47 If the proposed SMP retail obligations were to be removed, there is a risk that BT would exploit its SMP through excessive charges. It is also possible that BT would cease to provide some legacy services in the retail market (such as analogue leased lines) prematurely, as discussed in paragraphs 8.314 to 8.322 of the January 2008 consultation. Absent ex ante regulatory intervention, there is a real risk that BT's conduct would depart substantially and persistently from that which would be desirable. A further consideration in the case of analogue services is that there is no ex ante wholesale remedy for these particular services (i.e. these services are not provided to other Communications Providers on a wholesale basis by BT). While analogue users currently have the ability to switch to retail digital leased line services and so benefit from competition based on wholesale digital remedies, the discussion above makes clear that digital services themselves are not completely effective yet.

⁶² We are not able to present reliable market shares on a revenue basis. Although we sought this information, CPs did not generally provide accurate or sufficiently granular information revenue data that corresponded to the market that we had defined. The data that was available suggested that BT's revenue share ranged from 55 to 60 per cent of the market. However, because the data provided by OCPs was incomplete and was not collected in a consistent manner, there are doubts about the reliance that could be placed on these figures. In particular, these figures are likely to understate BT's true revenue share of the market.

⁶³ We set out in paragraph 8.100 our conclusions in respect of the replicability of BT's retail low bandwidth TI leased lines.

Replicability should therefore also benefit analogue users, who will in any event have migrated to these services by 2012.

- 7.48 Because it is almost certain that such conduct would harm consumers and the competitive process, Ofcom considers that it is more efficient to prohibit this conduct via ex ante regulation rather than to rely on an ex post regime which determines after the fact whether particular conduct is unacceptable. An ex ante approach is likely to create greater specification in advance, and is less costly to interpret and apply. Given its relative ease of administration and application, ex ante regulation will tend to encourage greater compliance. Equally, because of its greater clarity, ex ante regulation will mean that BT is likely to be deterred from engaging in behaviour that is prohibited by regulation.

Forward looking analysis and conclusion

- 7.49 We do not consider that wholesale products are yet replicable, which make it difficult for other CPs to replicate BT's retail offerings. As a result, we consider that the very high barriers to entry that exist in the markets upstream of this retail market continue to translate through to high and non-transitory entry barriers at the retail level.
- 7.50 On a forward looking basis, we need to consider whether the current high barriers to entry will remain if replicable wholesale products are introduced and whether the market will tend towards effective competition within the time horizon of this review.
- 7.51 Impediments to competition that arise solely at the retail level are much less significant than those at the wholesale level. At some point in the future, after Ofcom's concerns with regard to wholesale replicability have been fully addressed, it may be possible to de-regulate this market. However, we do not consider that it can be automatically assumed that the upstream remedies will deal with all the competition concerns in the retail market immediately. The end-user research described in the January 2008 consultation found evidence of some switching costs. We concluded in paragraph 7.140 of the January 2008 consultation that these switching costs are not themselves cause for addition competition concerns at the retail level. However, these switching costs may nevertheless slow down the speed with which adequate remedies at the wholesale level feed through to effective competition at the retail level. That this is the case is supported by the fact that previous wholesale remedies that have existed for several years have not served to reduce BT's market share since the 2003/04 Review, indicating customer inertia. We therefore consider that BT is likely to retain SMP for the duration of this market review. This is consistent with the large majority of responses to the January 2008 consultation who commented on the need for continuing regulation of this market.
- 7.52 For the reasons set out in the January 2008 consultation and above, our view remains that BT has SMP in the market for retail low bandwidth TI leased lines and is likely to retain SMP for the duration of this market review.

Wholesale market for low bandwidth TISBOs up to and including 8Mbit/s in the UK (excluding the Hull area)

January 2008 consultation

- 7.53 In paragraphs 7.187 to 7.239 of the January 2008 consultation we set out why we believed that BT has SMP in the low bandwidth TISBO market. Our view was that the factors which are generally accepted to give rise to entry barriers in telecommunications markets apply very strongly in this market. These are not offset

by the high revenues which can be earned in higher bandwidth markets or in markets which provide greater opportunities for traffic aggregation.

7.54 Our conclusion in the January 2008 consultation was particularly influenced by the following factors:

- the ubiquity of BT's infrastructure and the fact that such infrastructure is not easily duplicated;
- BT's ability to exploit economies of scale and scope; and
- the existence of significant barriers to entry and expansion, including as a result of sunk costs.

7.55 We considered that this is reflected in BT's persistent and very high share in this market (estimated to be 89 per cent in 2006 by volume). No other operator had a market share higher than 2 per cent. BT's market share appears to have increased marginally since the last market review, when it was estimated to have been 84 to 88 per cent.

Review of responses to the consultation

7.56 One respondent agreed with our finding of SMP, but argued that it should be considered as part of a single market for wholesale TISBO across all bandwidths.

7.57 None of the other respondents who commented on these proposals disagreed with Ofcom's market power findings.

Ofcom's response to respondents' views

7.58 For the reasons set out in Section 5, we continue to believe it is appropriate to segment the market at 8 Mbit/s.

7.59 While not covered in responses, since the January 2008 consultation, we note that BT has issued its 2007/08 regulatory accounts.⁶⁴ These restate BT's reported revenues for 2006/07 for the TISBO markets, significantly reducing revenues. This affects the numbers reported in the earlier consultations. However, for the reasons explained in paragraphs 7.194 to 7.201 of the January 2008 consultation, we did not put much weight on BT's ROCE in the TISBO markets in reaching our view on whether BT has SMP, and hence do not believe that the 2007/08 accounts or the restated 2006/07 accounts affect our conclusions. This also applies to the other wholesale TISBO markets.

Forward looking analysis and conclusion

7.60 Our view remains that BT has SMP in the market up to and including 8 Mbit/s, for the reasons set out in the January 2008 consultation, and summarised above.

7.61 We have assessed whether the SMP that presently characterises the market is likely to be attenuated during the period covered by this review. We have not been able to identify any developments that would serve to reduce the high structural barriers to

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<http://www.btplc.com/Thegroup/Regulatoryinformation/Financialstatements/2008/Currentcostfinancialstatements2008.pdf>

entry that characterise the market, which would generate sufficient competitive pressures within the next four years to alter the current finding of SMP.

- 7.62 In particular, we consider that the low rate of growth which characterises many of the retail leased line markets that make use of low bandwidth TISBO services is likely to prevent BT's wholesale competitors expanding to a scale where they can operate as efficiently as BT.

Wholesale market for high bandwidth TISBOs above 8Mbit/s up to and including 45Mbit/s in the UK (excluding CELA and the Hull area)

January 2008 consultation

- 7.63 In paragraphs 7.240 to 7.267 of the January 2008 consultation we set out why we believed that BT has SMP in the high bandwidth TISBO market in the UK excluding CELA and the Hull area.
- 7.64 As set out in the January 2008 consultation, our view was that the following factors in particular provide BT with SMP in this market:
- the ubiquity of BT's infrastructure and the fact that such infrastructure is not easily duplicated;
 - BT's ability to exploit economies of scale and scope; and
 - the existence of significant barriers to entry and expansion, including as a result of sunk costs. OCPs have informed us that it is not economical for them to expand beyond their current size in this market. New network build is generally only economical if very short lines are required and if there are no other impediments to competition (e.g. the need to obtain way-leaves).
- 7.65 We considered that this is reflected in BT's persistently high share in this market (45 per cent in 2006).

Review of responses to the consultation

- 7.66 BT put forward arguments for the existence of further TISBO geographic markets. It argued that the high presence of alternative networks in major business centres outside of London should cause us to identify them as competitive areas.
- 7.67 None of the other respondents who commented on these proposals disagreed with Ofcom's market power findings.

Ofcom's response to respondents' views

- 7.68 In Section 6 we have set out why we do not consider it appropriate to define other geographic markets. In summary, while there is some evidence which could be used to support a conclusion of local geographic markets in other parts of the UK, it is our view that when the available evidence is considered as a whole that a conclusion of local geographic markets in other areas cannot be robustly justified and that the weight of evidence supports the geographic markets we have defined. Our analysis has included assessing the competitive conditions in the postal sectors outside the CELA.

- 7.69 As a result of the minor change in the postal sectors included in the definition of the CELA, the geographic definition of the market excluding the CELA also changes very slightly. We have therefore recalculated the market shares for this market. However, they are unchanged from those reported in paragraph 7.244 and Table 21 of the January 2008 consultation; BT's market share remains at 45 per cent.

Forward looking analysis and conclusion

- 7.70 For the reasons summarised in paragraph 7.64 above, our view remains that BT has SMP in this market.
- 7.71 We have assessed whether the SMP that presently characterises the market is likely to be attenuated during the period covered by this review. There is no evidence that suggests that this market is prospectively competitive, in part because our discussions with the operators that acquire these services indicate that this market is not likely to grow in the future. This is likely to prevent BT's wholesale competitors expanding to a scale where they can operate as efficiently as BT.

Wholesale market for high bandwidth TISBOs above 8Mbit/s up to and including 45Mbit/s in the CELA

January 2008 consultation

- 7.72 As set out in paragraphs 7.268 to 7.283 of the January 2008 consultation, Ofcom's view is that no company has SMP in the high bandwidth TISBO market in the CELA and that, therefore, the market is effectively competitive.
- 7.73 We considered that the small territory covered by this market, combined with the high number of retail customers within the area, enable various CPs to attain scale in this market. The economies of density that can be attained in this market also prevent BT operating at an advantage as a result of any economies of scope that it is able to attain. We considered that Colt's market share of 45 per cent (now revised to 46 per cent) was unlikely to indicate that it has SMP because various other CPs have invested in networks covering the whole area of the CELA. In our response to respondents below, we discuss further why we do not regard Colt as having SMP despite its relatively high market share.
- 7.74 The network reach analysis on which the definition of the CELA is partly based substantiates the fact that there is substantial facilities-based competition in this market. It seems likely that the density of customers within this market provides some assurance to CPs that sunk costs that are incurred in serving any one customer are likely to be recovered in this market, even if they lose the custom of a particular customer.

Review of responses to the consultation

- 7.75 Several respondents argued that the CELA should not be considered a separate market. These respondents argued that high bandwidth TISBO should be considered a national market in which BT has SMP.
- 7.76 One respondent suggested that, even if CELA is considered a separate market, the lack of granularity in Ofcom's research gave them reason to doubt our finding of no SMP. This respondent also argued that the market was clearly a Colt/BT duopoly.

- 7.77 Two respondents believed that the definition of three operators within 250m was insufficient to demonstrate actual sustained competition.
- 7.78 One respondent argued that despite the existence of other providers in the CELA, there are technical, commercial and quality of service barriers to interconnection with OCPs. These factors make it generally preferable to connect with BT, and cast doubt on the finding of no SMP.
- 7.79 BT agreed with our finding of no SMP in the CELA and argued that Ofcom needed to go further and define further geographic markets in other major business centres.

Ofcom’s response to respondents’ views

- 7.80 We have considered the arguments for different geographic market definitions in Section 6. Our view remains that the CELA is an appropriate geographic market definition. We believe this is supported by the fact that the area in which there are two or more operators in addition to BT closely matches the area in which BT’s service share is relatively low.
- 7.81 However, after considering responses, we have revised down the build distance used in our geographic analysis from 250m to 200m. This has the effect of changing the precise boundary of the CELA. As a result of this, we have recalculated the market shares. The revised market shares are given in Table 7.2 below.

Table 7.2: Volume shares for high bandwidth TISBO in the CELA (2006)

	Share (%)
Colt	46
BT	20
Cable and Wireless	14
Verizon	9
Thus	6
Others (no other CP had >3%)	6

Source: CP data, Ofcom

- 7.82 These market shares are almost the same as those reported in the January 2008 consultation (see paragraph 7.271 and Table 23 of that consultation). When rounded to the nearest percent, the only operator whose market share changes is Colt, whose market share increases by 1 per cent, from 45 per cent to 46 per cent. This very minor change does not affect the analysis set out in the January 2008 consultation.
- 7.83 Colt’s market share is above the threshold of 40 per cent that the SMP Guidelines state normally raises concerns about dominance. Nevertheless, for the reasons given below, we do not believe that Colt has SMP in the CELA.
- 7.84 As set out in paragraph 7.11, an undertaking has SMP if it enjoys a position of economic strength that affords it the “power to behave to an appreciable extent independently of competitors, customers and ultimately consumers”. A key test of whether Colt has SMP is whether it would be able to profitably sustain an increase in price above the competitive level within the CELA. We consider that Colt would be unlikely to be able to do this.
- 7.85 If Colt were to increase prices above the competitive level, then a large share of customers would be likely to switch to another provider. The CELA has been

constructed such that there are at least three network operators within 200m of large business sites within each postal sector. Our end-user research indicates that even smaller end-users review their business connectivity services regularly. This suggests that if Colt were to try to increase prices above a competitive level, then customers would want to switch to a competitor and that there would be competitors within an economic build distance who would be able to offer lower prices. Colt would find the original price rise to be unprofitable and could not be regarded as being able to act independently of competitors and customers.

- 7.86 The situation in the CELA is in sharp contrast to the high bandwidth TISBO market in the UK excluding CELA and the Hull area. Although BT has a fractionally lower market share (at 45 per cent) in that market than Colt has in the CELA (at 46 per cent), the crucial difference is the ability of the largest operator's current customers to switch to an alternative provider. Competitive conditions within the CELA are such that Colt's customers are able to switch to one of two or more other operators throughout the area. By contrast, outside the CELA, competition is more variable. This variability raises the possibility of defining other geographically distinct markets outside the CELA and we have considered this question in Section 6 (see paragraphs 6.12 to 6.16 above). We have concluded that, on the evidence, there is currently a single market outside the CELA. Nonetheless, in some areas which are relatively easily supplied by another operator, BT has been gradually losing market share over time. However many of BT's customers do not have any realistic alternative to taking services from BT. This means that many of BT's customers would be unable to switch if BT were to price above a competitive level. Outside the CELA, BT can therefore act independently of competitors and customers to an appreciable extent.
- 7.87 The reason that competition has developed in the CELA is mainly that it has much higher customer density. This makes entry easier in that sunk costs that are incurred in serving any one customer are likely to be recovered in this market, even if the CP loses the custom of that particular customer. For example, if one end-user within a building were to cease acquiring very high bandwidth services before the initial investment in infrastructure had paid off, a CP could attempt to win the custom of other end-users within the building. The high customer density in the CELA, combined with the number of competing networks within an economic build distance of these customers, also means that neither Colt nor any other operator is likely to have a significant scale advantage over other operators.
- 7.88 That entry is easier in the CELA is illustrated by Colt's own position. When compared to BT, Colt itself can be regarded as a new entrant, having built the first part of its network in London in 1993. Colt's market share has not therefore been systematically high for a long period of time. Colt's position has been built up by competing against BT and others, and is not the result of it having significant advantages in terms of infrastructure that is not easily duplicated.
- 7.89 While its market share has fallen to 20 per cent, BT retains its ubiquitous network and hence its ability to supply all of Colt's customers in the CELA at a competitive price. After Colt and BT, Cable and Wireless is the most important operator in the CELA in this market. Following Cable and Wireless's recent purchase of Thus, the combined market share will be 20 per cent, the same as BT's market share. Given that other operators already have networks throughout the CELA, it is unlikely that Colt, or any other operator, will have a significant cost advantage through having control of infrastructure.

- 7.90 Barriers to interconnection were discussed in paragraphs 6.57 to 6.64 of the January 2008 consultation. Ofcom continues to believe, on the basis of the analysis conducted at that time, that technical and commercial barriers to interconnection between OCPs are limited. On quality of service barriers, while we have been consistently told by operators that this is an issue, the end-user research found that end users were less concerned about using networks which utilised wholesale inputs from multiple network operators and would tend to link premises using the lowest cost provider at the time the connection was raised. This, together with the data from OCPs which showed that there exists significant interconnection between OCPs, suggests that barriers to interconnection are not insurmountable. We therefore do not accept that this gives BT a significant advantage. This is also consistent with the fact that it does not have the largest market share in the provision of these services in the CELA.
- 7.91 If in the future circumstances were to change such that Colt was able to act independently of competitors and customers to an appreciable extent, then it would have SMP. However, given that the CELA has been constructed such that there are at least three network operators within each postal sector, we consider this to be unlikely. For an operator to have SMP in this situation, we would need to have evidence that the operator had particular advantages over its competitors that inhibited customers switching operators in response to a price above the competitive level. A high market share on its own would be a poor indicator of market power in such a market.

Conclusion

- 7.92 For the reasons set out in paragraphs 7.268 to 7.283 of the January 2008 consultation (summarised in paragraph 7.73 above) and the additional reasons set out above, Ofcom's view is that no company has SMP in the high bandwidth TISBO market in the CELA and that, therefore, the market is effectively competitive.

Wholesale very high bandwidth 155 Mbit/s TISBO market in the UK excluding CELA and the Hull area

July 2008 consultation

- 7.93 Paragraphs 5.22 to 5.52 of the July 2008 consultation set out Ofcom's view that BT has SMP in the wholesale very high bandwidth 155 Mbit/s TISBO market in the UK excluding CELA and the Hull area.
- 7.94 This conclusion was based particularly on the following factors:
- BT's high market share (56 per cent by volume);
 - the ubiquity of BT's infrastructure and the fact that such infrastructure is not easily duplicated;
 - BT's ability to exploit economies of scale and scope; and
 - the existence of significant barriers to entry and expansion, including as a result of sunk costs. New network build is generally only economical if short lines are required and if there are no other impediments to competition.
- 7.95 Our view that BT has SMP in this market has been informed by responses to the January 2008 consultation. OCPs and MNOs generally said that 155 Mbit/s TISBOs

are only supplied in competitive conditions in some metropolitan areas, and that in the rest of the UK there is no realistic alternative to BT.

- 7.96 Some respondents to the January 2008 consultation provided confidential evidence to support this view. This evidence included a description of the extent to which one company had tried to encourage companies other than BT to supply it with 155 Mbit/s TISBO services outside of major metropolitan areas (including offering longer term contracts), and the fact that their efforts were largely unsuccessful. Another example consisted of a case study of a major infrastructure bid, and the limited extent to which the OCP was able to justify expanding its own network, or finding an alternative to BT, for 155 Mbit/s TISBO services.

Review of responses to the consultation

- 7.97 BT was concerned about the figures used to calculate its share of the very high bandwidth TISBO market. In particular, BT was concerned that the analysis did not fully capture the ability of MNOs to self-provide network connectivity using point to point radio links, and the competitive constraint this exerts on 155 Mbit/s TISBOs. BT wanted to see a breakdown of demand to assess whether it captured all demand, including MNO self supply.
- 7.98 Most other responses agreed with Ofcom's finding of SMP. However, other respondents also had concerns about the market share data used, in particular about the allocation of products between markets and a concern about whether BT's own internal demand had been fully included.

Ofcom's response to respondents' views

- 7.99 We concluded in Section 5 that MNOs' self supply of 155 Mbit/s radio links were in the same market to the extent that the links are used for RBS backhaul (that is, links that connects a mobile communications provider's base-station to the mobile communications provider's mobile switching centre). Our understanding based on information from MNOs provided in response to the July 2008 consultation is that the 155 Mbit/s links that MNOs self-supply are not in general used for backhaul. On this basis, BT's market share of 56 per cent presented in Table 5.1 of the July 2008 consultation was calculated excluding all MNO self-supply.
- 7.100 However, even if we had included all MNO self-supplied 155 Mbit/s radio links, BT's market share would be around 46 per cent. This is shown in Table 7.3 below.

Table 7.3: Volume shares for very high bandwidth 155 Mbit/s TISBO market in the UK excluding CELA and the Hull area

	Excluding all MNO self supplied radio links	Including all MNO self supplied radio links ⁶⁵
BT	56%	46%
Cable and Wireless	31%	25%
Thus	4%	4%
MNO self-supply	n/a	19%
Others	9%	7%

Source: CP data, Ofcom

- 7.101 46 per cent might be thought of as a lower bound of BT's market share, because some of the self-supplied radio links included may be used for purposes other than RBS backhaul. Even at 46 per cent, BT's market share would be above the threshold of 40 per cent that the SMP Guidelines state normally raise concerns about dominance, whilst being below the 50 per cent level that the SMP Guidelines consider normally create a presumption of SMP.
- 7.102 There are other reasons for thinking that the threat of MNOs self supplying 155 Mbit/s radio links is unlikely to act as a significant constraint on BT's pricing of equivalent fixed line circuits. Using radio or microwave backhaul links is infeasible in many instances, due to, for example, line of sight problems. It is likely that wireless backhaul links are already used by MNOs where this is feasible, suggesting that there is limited scope for the threat of such circuits to constrain BT.

Forward looking analysis and conclusion

- 7.103 BT's market share is between 46 and 56 per cent, and is probably at the upper end of this range. Given this market share and for the other reasons set out in the July 2008 consultation (summarised in paragraph 7.94 above) and the additional reasons given above, our view remains that BT has SMP in this market.
- 7.104 We do not consider that BT's SMP that currently characterises this market is likely to reduce during the period covered by this review. The underlying factors that give BT SMP currently are unlikely to change during the period covered by this review.

Wholesale very high bandwidth 155 Mbit/s TISBO market in the CELA

July 2008 consultation

- 7.105 Paragraphs 5.53 to 5.75 of the July 2008 consultation set out Ofcom's view that no operator has SMP in the wholesale very high bandwidth 155 Mbit/s TISBO market in the CELA and that the market is therefore effectively competitive.
- 7.106 From the information available to Ofcom, Colt rather than BT has the largest market share, in terms of volumes. Colt has a market share of 55 per cent. The SMP Guidelines consider that a market share of greater than 50 per cent is itself evidence of SMP except in exceptional circumstances⁶⁶ and that a market share of greater than 50 per cent normally creates a presumption of SMP if this market share has

⁶⁵ In this calculation, we have also included all MNO self-supplied 155 Mbit/s *fibre* links which according to our information are used for RBS backhaul.

⁶⁶ See paragraph 75 of the SMP Guidelines

remained constant over time. However, we believe that exceptional circumstances do exist in the CELA and Colt does not have SMP in this market. We expand on these reasons in paragraphs 7.113 to 7.116 below.

- 7.107 When compared to BT, Colt can be regarded as a new entrant, having built the first part of its network in London in 1993. Colt's market share has not therefore been systematically high for a long period of time. Colt's position has been built up by competing against BT and others, and is not the result of it having significant advantages in terms of infrastructure that is not easily duplicated. The fact that Colt has entered this market and gained a relatively high market share illustrates the fact that sunk costs and economies of scale and scope are not overwhelming in this market, and that the customer density in the London area makes entry easier than in the rest of the UK.
- 7.108 The reason that high customer density makes entry easier is that sunk costs that are incurred in serving any one customer are likely to be recovered in this market, even if the CP loses the custom of that particular customer. For example, if one end-user within a building were to cease acquiring very high bandwidth services before the initial investment in infrastructure had paid off, a CP could attempt to win the custom of other end-users within the building. The high customer density in the CELA, combined with the number of competing networks within an economic build distance of these customers, also means that neither Colt nor any other operator is likely to have a significant scale advantage over other operators.
- 7.109 As with the corresponding high bandwidth market, the small territory covered by the CELA, combined with the high number of retail customers within the area, enable OCPs to attain scale more quickly in this market compared to other markets. The economies of density that can be attained in this market prevent any one company from operating at an advantage as a result of any economies of scale or scope that it is able to attain compared to the other companies with extensive networks within the CELA. This is consistent with many of the responses to the January 2008 consultation that expressed views on this.

Review of responses to the consultation

- 7.110 A number of respondents expressed concern about the way the CELA was constructed, for example about the dig distance used. Another argued that while there is more competitive pressure in the CELA, it is not yet effectively competitive, though the implication was that it was BT that had SMP rather than Colt.
- 7.111 No respondent explicitly argued that Colt had SMP in this market.

Ofcom's response to respondents' views

- 7.112 Concerns about the method used to define the CELA relate to market definition rather than SMP and have been discussed in Section 6. Given this market definition, Ofcom does not accept that the market is not yet effectively competitive, for the reasons given above.

Conclusion

- 7.113 The SMP Guidelines consider that a market share of greater than 50 per cent is itself evidence of SMP except in exceptional circumstances. The note in the SMP Guidelines clarifying this states that "large market shares can become accurate measurements only on the assumption that competitors are unable to expand their

output by sufficient volume to meet the shifting demand resulting from a rival's price increase⁶⁷. As explained further below, we consider that Colt's competitors in the CELA are able to expand their output sufficiently to constrain a price increase by Colt. For the reasons give below, we consider that exceptional circumstances do exist in the CELA.

- 7.114 The CELA has been constructed such that there are at least three network operators within 200m of large business sites within each postal sector. In addition to Colt's network, there are therefore at least two other networks within an economic build distance of customers in the CELA. As these competing networks are already in place, they would be able to serve Colt's customers relatively easily. Our end-user research indicates that even smaller end-users review their business connectivity services regularly. This suggests that if Colt were to try to increases prices above a competitive level, then customers would want to switch to a competitor and that there are competitors within an economic build distance who would be able to offer lower prices. Colt would find the original price rise to be unprofitable and could not be regarded as being able to act independently of competitors and customers.
- 7.115 We have set out this argument in slightly more detail in paragraphs 7.84 to 7.91 above in relation to the wholesale high bandwidth TISBO market in the CELA. We consider that the same reasoning also applies to our finding of no SMP for the wholesale very high bandwidth 155 Mbit/s TISBO market in the CELA, in which Colt has an even higher market share.
- 7.116 Ofcom's conclusion that no operator has SMP for the wholesale very high bandwidth 155 Mbit/s TISBO market in the CELA is therefore unchanged.

Wholesale very high bandwidth 622 Mbit/s TISBO market in the UK excluding the Hull area

July 2008 consultation

- 7.117 Paragraphs 5.76 to 5.97 of the July 2008 consultation set out Ofcom's view that no company has SMP in the wholesale very high bandwidth 622 Mbit/s TISBO market in the UK and that, therefore, the market is effectively competitive. The reasons for this view are summarised below.
- 7.118 BT, which has the most extensive network and greatest scope to take advantage of any economies of scope, only has a market share of 7 per cent. There are three operators with larger market shares. The market is not particularly concentrated.
- 7.119 Compared to lower bandwidth markets, we considered that barriers to entry and expansion appeared to be much lower because of the high revenues that can be earned in this market. The very large amount of traffic that can be carried over a single very high 622 Mbit/s bandwidth TISBO circuit also makes it easier to obtain scale in this market.
- 7.120 Our proposals in the July 2008 consultation were consistent with most responses to the January 2008 consultation that expressed views on this. These generally suggested that this market was competitive.

⁶⁷ See note 78 in the SMP Guidelines.

Review of responses to the consultation

7.121 Only a small number of respondents commented on the SMP assessment in the 622 Mbit/s market. There was a concern that competitive conditions varied across the country and BT was likely to have SMP in some areas.

Ofcom's response to respondents' views

7.122 We recognise that competition conditions in the wholesale very high bandwidth 622 Mbit/s TISBO market may vary across the UK. However, we expect that any such variation would be limited. This is because, as discussed in Section 6, there are currently only a very limited number of postal sectors in which 622 Mbit/s circuits are provided. We expect that over the period of this market review that demand for 622 Mbit/s circuits is likely to continue to be concentrated in major urban or business areas. Such concentration reduces barriers to entry and expansion which in turn we expect will allow other CPs to compete effectively with BT given the high revenues that can be earned in this market.

Conclusion

7.123 Ofcom's view remains that this market is effectively competitive, for the reasons given in the July 2008 consultation and summarised above. While we recognise that competitive conditions may vary across the UK, we consider it likely that demand for 622 Mbit/s circuits will be concentrated in areas where other CPs can compete with BT. Given BT's current low market share, we consider it unlikely that the position will change materially within the timeframe of this review.

Wholesale market for low bandwidth AISBOs up to and including 1Gbit/s in the UK excluding the Hull area

January 2008 consultation

7.124 In paragraphs 7.310 to 7.334 of the January 2008 consultation, we set out why we considered that BT has SMP in this market. Our broad reasoning was similar to that which applied in the low bandwidth TISBO market. Our conclusion was based on an analysis of primarily the following SMP criteria:

- BT's high market share (73 per cent by volume in 2006);
- the high profits that BT appears to earn in respect of the relevant services;
- the advantages enjoyed by BT due to the ubiquity of its infrastructure and the existence of barriers to entry and expansion, notably those provided by sunk costs; and
- the greater economies of scale and scope enjoyed by BT.

7.125 We considered that the low opportunities for aggregating traffic in this part of the network, together with the correspondingly low expected retail revenues earned in relation to low bandwidth AISBO services meant that operators are often reluctant to extend their network footprint in order to serve this market.

7.126 Further, we considered that the fact that BT's share of the market has fallen only marginally since the last market review indicates that BT's SMP is likely to persist in this market. In 2004, BT's market share of the overall AISBO market was 75 per cent

(which encompassed all bandwidths), and its share of AISBO services below 100 Mbit/s was estimated to be between 75 per cent and 80 per cent. This is compared to its market share of 73 per cent in 2006 for the market defined as terms of AISBO up to and including 1 Gbit/s.

Review of responses to the consultation

- 7.127 BT did not consider that our finding that it held SMP in the low bandwidth AISBO market was correct in certain metropolitan areas.
- 7.128 BT considered that our supply-side analysis had failed to take into account several factors, including:
- the differences in supply conditions between fibre and copper access;
 - the emergence of strong, vertically integrated competitors since the last market review; and
 - the fact that in a number of cases, BT faces the same cost as its fibre competitors due to the requirement for additional building work to deliver dedicated point-to-point services.
- 7.129 BT also argued that Ofcom had underestimated the future competitiveness of the AISBO market as an increasing number of technologies are able to substitute AISBO services.
- 7.130 No other respondents disagreed with Ofcom's finding of SMP in this market.
- 7.131 In response to the July 2008 consultation, Cable and Wireless raised the issue of whether BT's own use of backhaul is included in market share figures.

Ofcom's response to respondents' views

- 7.132 We do not believe that a separate market for AISBOs in the CELA (or other metropolitan areas) can be identified. Variations in competitive conditions are much less significant than for TISBOs where for certain product markets the CELA has been defined as a distinct geographic market (see Section 6). Nevertheless, we have estimated that BT's share of the low bandwidth AISBO market in the CELA is approximately 57 per cent. When combined with the other advantages BT enjoys relative to OCPs, such as economies of scope from access to duct and a more extensive existing fibre network, this strongly suggests it would have SMP in a separate CELA market and that in practice our findings would be unchanged even if we had formally considered the CELA separately.
- 7.133 Ofcom accepts that there are differences in the supply conditions of fibre and copper access. In particular, while BT's copper access network is ubiquitous, BT's fibre network has been built in response to specific customer demand. However, BT is still likely to have significant advantages over OCPs in terms of benefiting from its much more extensive duct and fibre network. This is a particularly important advantage for the low bandwidth AISBO market, where the costs of duct and fibre form a high proportion of the total cost. We therefore still believe that BT is likely to have significant advantages from greater economies of scale and scope compared to OCPs. Also, because these are sunk costs, they also contribute to the significant barriers to entry and expansion.

- 7.134 The consolidation of competitors since the last market review that BT refers to in its response has not affected BT's market share significantly, as that has only declined marginally (as described in paragraph 7.126 above). This suggests that this consolidation of competitors has not had a dramatic effect on BT's market power.
- 7.135 Since the earlier consultations, BT has issued its 2007/08 regulatory accounts. These restate BT's reported revenues for 2006/07 for the AISBO markets, significantly raising them. For all bandwidths, BT's ROCE on AISBOs was 31 per cent in 2007/08. The restated ROCE for 2006/07 was 27 per cent, compared to the figure reported in the January 2008 consultation of 20 per cent. The large majority of the revenue relates to bandwidths up to and including 1Gbit/s, suggesting that the ROCE would be similar for this market in isolation. This high profitability strengthens the case that BT has SMP.
- 7.136 The issue Cable and Wireless raised about the inclusion of BT's own backhaul is relevant to the low bandwidth AISBO market, given that BT does not use high bandwidth AISBO for its own backhaul. Where BT sells wholesale broadband access (WBA) products (such as IPStream), it does not make use of unbundled local loops to supply WBA and therefore does not make explicit use of a BES input. We therefore understand that the data BT has provided for low bandwidth AISBOs will not include any BES figures for exchanges. If in the future BT were to use BES for wholesale broadband access products, this would increase BT's market share, which would reinforce our current decision that BT has SMP.

Forward looking analysis and conclusion

- 7.137 Our conclusion remains that BT has SMP in the low bandwidth AISBOs market outside the Hull area. Our conclusion is based primarily on:
- BT's high market share (73 per cent by volume in 2006) and that it has fallen only marginally since the last market review;
 - the high profits that BT appears to earn in respect of the relevant services (which are now higher than as set out in the January 2008 consultation);
 - the advantages enjoyed by BT due to its much more extensive duct network and its existing fibre network and the existence of barriers to entry and expansion, notably those provided by sunk costs; and
 - the greater economies of scale and scope enjoyed by BT.
- 7.138 We have considered whether the SMP that presently characterises the market is likely to be attenuated during the period covered by this review. We consider this to be unlikely. In particular, the fact that BT's market share has only fallen marginally since the last review suggests it is unlikely that there will be a rapid decrease in BT's market share over the next few years. The advantages that BT enjoys are based on physical infrastructures which are unlikely to change quickly.

Wholesale market for high bandwidth AISBOs in the UK excluding the Hull area

January 2008 consultation

- 7.139 In paragraphs 7.335 to 7.350 of the January 2008 consultation, Ofcom proposed that BT did not have SMP in the wholesale market for high bandwidth AISBOs in the UK excluding Hull.
- 7.140 Ofcom considered that the very high revenues that can be earned in the downstream retail markets mean that OCPs are generally willing to sink the high fixed costs that are necessary to operate in this market. Further, the very large amount of traffic that can be carried over a single high bandwidth AISBO service enables OCPs to attain scale in this market and prevent other factors such as economies of scope from placing BT at a cost advantage. We considered that these conclusions are reflected in the relatively unconcentrated nature of the market.

Review of responses to the consultation

- 7.141 As described in Section 5, several respondents disagreed with our conclusion that there is a break in the market for circuits above 1Gbit/s.
- 7.142 Some respondents argued that, even if AISBO circuits over 1 Gbit/s constitute a separate market, BT has or will soon have SMP in that market. Respondents gave various reasons in support of this argument including:
- the large fall in BT's market share since the last review is suspicious and Ofcom's market share analysis may not be robust due to the small number of lines counted;
 - although BT does currently have a low market share, it has a significant cost advantage over its competitors due to access to duct and supply-side synergies with the low bandwidth AISBO market, as fibre represents around 60% of the costs base of circuits above 1 Gbit/s;
 - Ofcom is mistaken to assert that there are low entry barriers due to the high price/returns, because BT has a low cost base and can therefore reduce its price in response to entry;
 - due to the small size of the current market, it may not necessarily be a good indicator of competitive conditions in the future;
 - the development of the wholesale Ethernet market means that SMP in the above 1Gbit/s sector is likely to be entrenched for some time to come; and
 - currently, the market is small and competitive, based largely in London. However, the market will expand rapidly as bandwidth requirements for broadband backhaul grow and as broadband and leased line traffic is aggregated for transmission over converged 21CN infrastructure. Therefore BT's underlying fibre infrastructure will be a strong advantage and BT's market share will increase.
- 7.143 BT agreed with Ofcom's view that it did not have SMP.
- 7.144 Following publication of the January 2008 consultation, we were informed by two CPs that some of the data they had supplied to us was incorrect. We have therefore

worked with them to ensure that the information on which we base our decision is revised and accurate.

Ofcom's response to respondents' views

Market share

7.145 As a result of the responses, we have reviewed and updated our estimates of market share. This was partly to reflect the fact that we had been misinformed, with some circuits being allocated to this market when they actually fell outside it. It was also to gather additional information to review the argument that the market was not well developed and that BT's market share would grow as the market developed. The table below shows the market share estimates, by volume.

Table 7.4: Volume estimates for high bandwidth AISBO in the UK (excluding the Hull area)

	December 2006		April 2008 ⁶⁸
	Original market shares reported in Jan 2008 consultation	Revised market shares	
BT	26%	49%	38% to 40%
New entrants since Dec 06	0%	0%	17% to 18%
Others	74%	51%	42% to 45%

Source: Ofcom analysis on CPs data, June 2008

7.146 For December 2006, BT's market share is now estimated to have been 49 per cent rather than the originally estimate of 26 per cent.

7.147 We have asked the largest CPs present in the market at that time (including BT) for an update on their sales in this market as of April 2008. We worked with these CPs to ensure that there was a common understanding of the market boundaries and which circuits should be included in these estimates. We also gathered data from some other CPs who we believed were likely to have entered the market.

7.148 BT's market share at April 2008 is estimated to be around 38 to 40 per cent. We believe that this estimate may overstate BT's market share.⁶⁹ BT market share is therefore estimated to be just below the threshold of 40 per cent that the SMP Guidelines state normally raises concerns about dominance, though we recognise that market share is only one indicator and SMP can occur at lower market shares.

7.149 The above table also indicates recent trends in market share. Given the revisions to the December 2006 market shares, BT's market share has fallen between December 2006 and April 2008. This is consistent with a longer term downward trend in BT's volume share, as BT's market share was estimated to have been in excess of 70 per cent at the time of the last market review, albeit on very small volumes.

⁶⁸ The mid point of these ranges sum to 100 per cent.

⁶⁹ The market shares estimates for April 2008 are not definitive. We did not approach the smallest CPs present in the market as at December 2006 for an update on their sales as at April 2008, and we may not have included all CPs who may have entered the market. This may mean that BT's market share estimate is biased upwards and that its actual market share may be lower. Also, for the April 2008 estimates we were not able to replicate the count of wholesale ends, on which the December 2006 wholesale shares are based. The April 2008 estimates therefore represent *wholesale circuits* rather than *wholesale ends*.

- 7.150 The table shows that there has been considerable new entry since December 2006. Companies which were not present in the market in December 2006 accounted for 17 to 18 per cent of the market by April 2008.

BT's control of infrastructure not easily duplicated

- 7.151 It has been argued that Ofcom underestimated the extent of supply side synergies between high and low bandwidth AISBO markets. In particular, both high and low bandwidth products use the same underlying fibre infrastructure, and BT has a much more extensive fibre network than any other company. Such infrastructure forms a large part of total costs. BT could therefore more readily offer high bandwidth products compared to other companies.
- 7.152 We recognise that BT benefits from already having in place some of the infrastructure necessary to compete in this market. However, as we said in the January 2008 consultation, at this stage AISBO services are still generally provided on a point-to-point basis, which implies that some of the economies of density that BT attains in respect of its SDH/PDH infrastructure are less likely to apply to this market.
- 7.153 Moreover, the higher revenues that can be earned in the downstream markets mean that CPs will be more willing to sink the high fixed costs that are necessary to operate in this market. This means that BT's control of infrastructure is less likely to mean that BT has SMP in this market.
- 7.154 We believe this view is supported by the evidence of continued market entry, and the fact that the recent new entrants have been able to obtain nearly a fifth of the market in a relatively short space of time. This suggests that other CPs are able to compete with BT in this market.
- 7.155 Demand for high bandwidth AISBO services will increase in the future. A number of OCPs have provided us with their own demand forecasts, which show their demand increasing significantly over the next few years. It has been argued that this will increase BT's market power. However, growth in demand is not in itself likely to lead to increasing market power for BT. Indeed, in general, growing demand is likely to make it easier for new firms to enter and compete. This is consistent with recent trends in market share: BT's market share has fallen over the last 18 months during a period when volumes have been growing.
- 7.156 While we do not regard future growth in demand as necessarily meaning that BT will have increasing market power, we do recognise that this could be the case depending on the location of the future demand. Some respondents suggested that our assessment of competitive conditions might differ if we looked at this on a forward-looking basis. In particular, once the demand for circuits above 1 Gbit/s grows in areas outside London, where alternative infrastructures are less well developed, these operators argue that competitive conditions in the high bandwidth AISBO market will come to resemble those in the low bandwidth market. Our conclusion is that this is unlikely to happen, for the following reasons:
- applications that require such high bandwidths tend to be concentrated in urban areas where large users such as financial institutions and government offices are located;
 - demand for LLU backhaul in dense traffic areas is currently being met with circuits of speeds up to 1 Gbit/s, with investments for the forthcoming years now