

bandwidth 155 Mbit/s TISBOs. We present a summary of that assessment in the following paragraphs.

### Options assessment

- 8.192 Before setting out our analysis of appropriate remedies, we considered our broader policy options and how best we could meet our policy objectives considering BT's SMP finding. We considered two main policy options, namely keeping the existing regulation or varying it to address the shortcoming we had identified, against the counterfactual of not imposing any regulation at all.
- 8.193 In particular, in the July 2008 consultation, we considered the following regulatory options:
- *No regulation*;
  - *Status quo*, which means to continue to regulate BT's provision of very high bandwidth 155 Mbit/s TISBOs, with the same SMP Conditions as set out in the 2003/04 Review; and
  - *Variations and additional measures*, in particular reviewing the SLA/SLGs regime and applying an amended interpretation of the no undue discrimination obligation, under which we would presume that saw-tooth discounts are unduly discriminatory.
- 8.194 For each option, we considered how well it would serve our policy objectives, how it would affect the development of competition in downstream retail markets, and the impact it would have on the various key stakeholders, including BT.
- 8.195 Firstly, in paragraphs 5.22 to 5.52 of the July 2008 consultation we set out the arguments for and our proposals in support of the finding of SMP for BT in this market. BT's market share in this market was found to be 56%. In our view, its market power is, *inter alia*, derived from its control of ubiquitous infrastructures, which cannot be readily duplicated by competitors, given the importance of sunk costs and presence of economies of scale and scope. We set out why we believed that other providers would require regulated access from BT to be able to compete effectively in downstream retail leased lines markets. In the absence of regulation, we argued, BT would be able to further exploit its market power by restricting access to its network and leveraging its market power into the downstream market, thus reducing end users access to a choice of competitive services and prices. We considered therefore that the option of no regulation would poorly serve our objectives and, in particular, the promotion of competition in downstream markets for the benefit of end users.
- 8.196 We then considered the current obligations (*status quo*) and the way they have worked in order to verify if changes would be required to the current set of obligations to ensure that they do promote greater competition in the future.
- 8.197 In particular, we discussed in paragraph 6.34 to 6.43 how some of the problems identified with the current regime in relation to low and high bandwidth TISBO, namely the shortcomings of the SLAs/SLGs regime and the potentially anti competitive effect of saw tooth discounts, were also relevant for the very high bandwidth 155 Mbit/s TISBO market. We have provided a summary of the relevant discussions at, respectively, paragraphs 8.53 and 8.55 of this Section.

- 8.198 Our preliminary conclusion was that the current regime required some changes if it was to promote greater competition in the downstream retail market in the future. We therefore considered that the option of keeping the current framework unaltered would not serve well our policy objectives, and in particular the promotion of competition in downstream markets to the benefits of end users.
- 8.199 The obligations imposed on BT, however, had promoted some level of competition. In particular, we found that competitive conditions for the provisions of wholesale very high bandwidth 155 Mbit/s TISBOs exist in the CELA. However, such competitive conditions were not found elsewhere in the UK (excluding Hull), where BT remains the main provider of these services. Without regulated access to BT's network, it was argued, competition could be restricted or distorted, and end users could suffer through not having access to a choice of competitive offerings and prices.
- 8.200 We therefore continued to believe that BT should be subject to SMP conditions relating to the provision of regulated access in relation to very high bandwidth 155 Mbit/s TISBO in the UK excluding the CELA and the Hull area. In addition, we suggested that we should adopt the following variations and additional measures:
- review the SLAs/SLGs regime; and
  - clarify our interpretation of undue discrimination as comprising saw tooth discounts.
- 8.201 Finally, at paragraph 6.69 of the July 2008 consultation we considered the impact on stakeholders of the different options. We concluded that the option of varying the existing regime with the proposed amendments had the greatest benefits, as it would best achieve the promotion of competition, and would set the basis for future lower prices and better quality services for end users.
- 8.202 We therefore concluded that adopting the suggested variations and additional measures would best meet our policy objectives and should form the basis for proposing regulatory obligations on BT.

Preliminary conclusions: proposed regulatory obligations

- 8.203 In the July 2008 consultation we set out in paragraphs 6.49 to 6.64 why we thought it would be appropriate to impose on BT certain obligations relating to the provision of network access at regulated terms and conditions, including prices. The obligations we proposed should apply to BT were:
- Provision of fair and reasonable Network Access;
  - Obligations not to unduly discriminate, (in this respect we proposed that we would consider in the future that saw-tooth discounts might be unduly discriminatory);
  - Cost orientation obligation; and
  - Maintaining the transparency and notification obligations currently applying to BT in this market.
- 8.204 In addition, we proposed that Ofcom should consider further the imposition of charge controls and indicated that we would consult separately on it.

- 8.205 With respect to the types of access BT should provide, we considered that BT should continue to be subject to the PPC Direction but that we should lift the LLU Backhaul requirement currently imposed on BT. The arguments in support of our conclusion are the same as those discussed in relation to the market for low bandwidth TISBO in the UK as set at paragraph 8.143 and following of this Section.
- 8.206 With respect to the SLAs/SLGs regime, we proposed amending the current PPC Direction to reflect the work that is being done by the OTA and industry on KPIs and, once Ofcom's work on Ethernet SLAs/SLGs has been completed, aligning the SLGs for PPCs with those for Ethernet products.
- 8.207 We then proposed to continue to engage with BT to ensure that any reasonable request for disaggregated access and backhaul products is properly considered, and that such new services are promptly developed.
- 8.208 Finally, we set out our view that there should in the future be a presumption that saw-tooth discounts are unduly discriminatory, and therefore in breach of an SMP requirement not to discriminate unduly.
- 8.209 Paragraph 6.69 of the July 2008 consultation set out how we thought the proposed remedies met the Communications Act tests. We have set out in detail at the end of this sub Section the appropriate Communications Act tests for each of the regulatory obligations we have concluded will apply to BT.

#### **Responses to the July 2008 consultation and Ofcom's response**

- 8.210 In general most stakeholders agreed with us that the current regime should be amended if it is to serve well the interests of end users by promoting competition, and that the variations we had identified were broadly appropriate.
- 8.211 However, BT argued that the imposition of charge controls on these services would be disproportionate. Another respondent argued that in markets that are prospectively competitive we should not impose charge controls.
- 8.212 Having considered these responses, we remain of the view charge controls should be applied to the services provided by BT in this market, given BT's dominant position and the fact that we consider the market not to be prospectively competitive. In the absence of a charge control, we consider there is a significant risk that BT could increase its charges above competitive levels, and that this could lead to higher prices in retail markets, to the detriment of consumers. We accept that there is a possibility that lower prices may deter some infrastructure investment by competing operators. However, we consider the likelihood of this occurring to be low, given the declining nature of the TISBO market. In addition, such investments may be inefficient, if they are prompted solely by prices being above competitive levels.

#### **Review of proposals for remedies**

- 8.213 We have reviewed our proposals for remedies having regard to all responses and representations received and all evidence available to us following the consultations of January and July 2008. These proposals were set out in full at paragraphs 6.49 to 6.68 of the July 2008 consultation, and a summary has been provided at paragraphs 8.203 to 8.209 above.
- 8.214 We consider that the regulatory objectives and analysis of the appropriate regulatory obligations for this market are broadly the same as for the high bandwidth TISBO

market in the UK excluding the CELA and the Hull area, as described in paragraphs 8.154 to 8.166 above. This market is fairly large, with BT's (internal and external) revenues of around £100m in 2007/08<sup>93</sup> for the whole of the UK, with the large majority of these likely to be outside the CELA. Given the size of the market and BT's SMP position, there is scope for significant consumer harm if BT were not regulated. For the same reasons as for the high bandwidth TISBO market in the UK excluding the CELA and the Hull area, we consider it appropriate to impose a broadly similar set of remedies.

## Conclusions

- 8.215 Having considered all responses to the consultations, and having reviewed all evidence available to us, we conclude that the most appropriate remedies are as set out in the July 2008 consultation. In reaching our decision we have taken account of the considerations described in paragraphs 8.8 to 8.25 above. The reasons for our conclusion were discussed at paragraphs 8.137 to 8.177 of the January 2008 consultation and in the paragraphs immediately above.
- 8.216 Using the powers conferred upon Ofcom under Sections 87 and 88 of the Act, Ofcom has therefore decided to impose the following obligations on BT in the market for the very high bandwidth 155 Mbit/s TISBO in the UK excluding the CELA and the Hull area:
- an obligation to provide Network Access;
  - a requirement not to unduly discriminate;
  - cost orientation;
  - a requirement to publish a reference offer;
  - an obligation to give 90 days notice of changes to prices, terms and conditions for existing services;
  - an obligation to give 28 days notice of the introduction of prices, terms and conditions for new services;
  - a requirement to publish quality of service information;
  - a requirement to notify technical information with 90 days notice; and
  - obligations relating to requests for new network access.
- 8.217 We also consider that BT should in principle be subject to a charge control with respect to the services in this market, the scope and form of which is considered in a separate consultation published alongside this Statement.
- 8.218 In addition, BT will continue to be subject to the PPC Direction. This is set out in detail in Annex 8 to this Statement.

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<sup>93</sup> Source: BT Regulatory financial Statement 2007/08, <http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2008/Regulatoryfinancialstatements2008.htm>

- 8.219 With respect to the SLAs/SLGs regime that should apply to services in this market, Ofcom and the OTA have now completed the work referred to in the January 2008 consultation. We set out our decisions in relation to the future SLAs/SLGs regime in paragraph 8.481 and following later in this Section.
- 8.220 With respect to the development of disaggregated access and backhaul products by BT, we consider that BT and industry should continue to engage in how best to meet future requirements for disaggregated products, having regard to the obligations set in BT's Undertakings. Ofcom will continue to work with industry and BT on this issue, but sees no need at present to mandate particular types of access from BT. However, should we in the future be presented with evidence that BT is not meeting a reasonable demand for disaggregated TDM access and backhaul products, we would consider using our powers to mandate such access as necessary.
- 8.221 In the January 2008 consultation, we also expressed our concern that saw-tooth discounts, which are offered by BT on some products, may act as a barrier to market entry or expansion and, in a market characterised by SMP, may restrict the development of competition. Given their potentially anti-competitive effects, we remain of the view that in the future there should be a presumption that saw-tooth discounts are unduly discriminatory in the future.
- 8.222 The obligations set out above will also apply to interconnection and accommodation services in this market as discussed at paragraph 8.448 and following later in this Section.
- 8.223 In the remainder of this sub Section, we first set out the how we believe the obligations we are imposing on BT meet the legal tests we are required to carry out under the Act. We then set out how we have taken into account the ERG Wholesale Leased Lines Common Position on remedies in setting what we believe is the appropriate level of obligations on BT in order to promote greater competition in the downstream retail market for low bandwidth TI leased lines.

### **Communications Act tests**

#### Introduction

- 8.224 It is our view that the regulatory obligations we are imposing on BT comply with the requirements set out in the Act. In the paragraphs that follow, we first consider how we believe they comply with Section 87(1) of the Act. Secondly, we consider, as suggested by recital 27 of the Framework Directive, whether competition law remedies alone would suffice to address the concerns and competition problems we have identified, and give our reasons why we think it would not. We then set out, individually for each of the obligations we are imposing on BT, how we believe it meets the appropriate legal tests under Section 47(2) of the Act. Finally, We set out how we believe the cost orientation obligation we are imposing on BT meets the further test set out in Section 88 of the Act.

#### SMP Conditions are appropriate

- 8.225 Section 87(1) of the Act provides that, where Ofcom has made a determination that a person has SMP in the market reviewed, it must set such SMP conditions as it considers appropriate and as authorised by the Act. This implements Article 8 of the Access Directive.

- 8.226 Having considered all responses to the consultations and all evidence available to us, we have identified in Section 7 BT as having SMP in this market. In the light of the assessment of the costs and benefits of addressing the SMP through the remedies considered at paragraph 8.214, we have concluded that BT shall be subject to the obligations set out at paragraph 8.216 and following in this Section.
- 8.227 For the reasons set out in paragraphs 8.137 to 8.177 of the January 2008 consultation, and summarised at paragraph 8.214, we believe it is appropriate to impose such conditions on BT in relation to the objective we have set out to achieve in this review for the market for very high bandwidth 155 Mbit/s TISBO in the UK. In particular, in relation to the promotion of greater competition in the downstream retail market, which, we consider, would bring substantial benefits to end users by increasing their access to a competitive choice of prices and providers.
- 8.228 Finally, when considering what should be the appropriate remedies, we have had regard to a series of considerations as set out at paragraph 8.109 in this Section.

Reliance on Competition Law alone not sufficient

8.229 The case for not relying on Competition Law alone to remedy the finding of market power on BT is the same as the case for the other wholesale markets for terminating segments of leased lines where BT has been found to have SMP. We do not therefore repeat these arguments here, and refer to the discussion provided in relation to the market for low bandwidth TISBO at paragraph 8.110 and following in this Section.

Tests under Section 47(2) of the Act

- 8.230 We set out in the table below how we think each remedy passes the relevant Communications Act tests as set out in Section 47(2) of the Act, according to which each obligation must be:
- objectively justifiable in relation to the networks, services or facilities to which it relates;
  - not such as to discriminate unduly against particular persons or a particular description of persons;
  - proportionate to what the condition is intended to achieve; and
  - in relation to what it is intended to achieve, transparent.

**Table 8.8: Summary of Ofcom’s reasons for believing that the test of Section 47 (2) of the Act is met for the obligations imposed on BT as a result of it having SMP in the market for very high bandwidth 155 Mbit/s TISBO in the UK excluding the Hull area**

<i>Is it <b>objectively justifiable</b> in relation to the networks, services and facilities which it relates?</i>	<i>Is it <b>such as not to discriminate unduly</b> against particular persons or a particular description of persons?</i>	<i>Is it <b>proportionate</b> to what the condition is intended to achieve?</i>	<i>In relation to what it is intended to achieve, is it <b>transparent</b>?</i>
<i>Obligation to provide access</i>			
The obligation is objectively	The obligation does not discriminate unduly as it	The obligation is proportionate since BT is	The obligation is transparent since the

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<p>justifiable as, in the absence of this condition, BT might refuse to supply very high bandwidth 155 Mbit/s TISBO, which would prevent effective competition in the retail market. By ensuring that OCPs can gain access to BT's wholesale very high bandwidth 155 Mbit/s TISBO services on fair and reasonable terms, it will enable OCPs to compete in the retail leased lines market. By enabling OCPs to compete fairly with BT, it puts pressure on BT to reduce costs and so promotes efficiency, confers the greatest possible benefits on end-users and promotes effective and sustainable competition. Although the charge control conditions will, if imposed following our separate consultation, limit average charges, they will not in themselves require BT to supply very high bandwidth 155 Mbit/s TISBO.</p>	<p>applies only to operators which have SMP in the relevant market and which therefore would be able to, and would have an incentive to, distort competition by denying access on fair and reasonable terms.</p>	<p>not required to provide access if the request is unreasonable and because Ofcom does not consider that other operators will install competing facilities to an extent to undermine BT's SMP. BT is already providing network access, which is therefore clearly feasible. In the absence of Ex-ante regulation, entry barriers and BT's SMP mean that competition might never become established.</p>	<p>condition has been drafted for maximum clarity and because the purpose of the obligation and the reasons for imposing it are clearly explained in this document.</p>
<p><i>Non discrimination</i></p>			
<p>The requirement is justified because otherwise BT, as a vertically integrated operator, would be able to distort competition by discriminating against its rivals to the benefit of its own (downstream)</p>	<p>The requirement does not discriminate unduly as it applies only to operators who, by possessing SMP in the relevant market, would be able to, and would have an incentive to, distort competition by discriminating against competitors.</p>	<p>The requirement is proportionate in that only discrimination which is unduly is prohibited and because it is the least onerous obligation required to address this particular risk of harm to competition. Ex ante regulation is more effective than ex post</p>	<p>The requirement is transparent since the condition has been drafted for maximum clarity and because the purpose of the obligation and the reasons for imposing it are clearly explained in this document.</p>

<p>divisions, e.g. through charging other operators higher prices than it charges BT Retail. It also ensures that BT does not abuse its SMP position by charging excessive prices or offering inadequate quality of service to particular groups of customer and, via the retail market, to end users. The requirement therefore promotes competition and furthers the interests of consumers.</p>		<p>competition law where, as here, entry barriers and SMP mean that otherwise, effective competition might never become established.</p>	
<p><i>Cost orientation</i></p>			
<p>The requirement is justified because, although the charge control conditions will, if imposed following our separate consultation, limit average charges, they do not in themselves control the level of individual charges within a basket subject to an average charge control. In the absence of this condition, BT might set individual charges at excessively high or anti-competitively low levels within a basket.</p>	<p>The requirement does not discriminate unduly as it applies only to operators who, by possessing SMP in the relevant market, would be able to, and would have an incentive to, distort competition by setting charges which are not based on costs.</p>	<p>The requirement is proportionate because, by taking into account costs, including an appropriate contribution to the recovery of common costs and a reasonable return on investment, the cost orientation condition allows BT's charges to be proportionate to the extent of BT's investment in the provision of the relevant services. Ex ante regulation is necessary for the reasons set out above.</p>	<p>The requirement is transparent since the condition has been drafted for maximum clarity and because the purpose and meaning of the obligation and the reasons for imposing it are clearly explained in this document.</p>
<p><i>Transparency obligations</i></p>			
<p>These obligations are justified in that they provide certainty to operators and prevent BT withholding information from customers and competitors, or</p>	<p>The obligations do not discriminate unduly as they apply only to operators who, by possessing SMP in the relevant market, would be able to, and would have an incentive to, exploit customers and distort competition by</p>	<p>The obligations are proportionate as the information which BT is obliged to publish is necessary to enable OCPs to make effective use of the network access which BT is also required to provide. The transparency obligations</p>	<p>The obligation is transparent since the condition has been drafted for maximum clarity and because the purpose and meaning of the obligation and the reasons for imposing it are clearly explained</p>

<p>misusing information in a way which could harm competition. In addition, they facilitate Ofcom's monitoring of compliance with the other obligations, notably the obligation not to unduly discriminate.</p>	<p>withholding or misusing information.</p>	<p>therefore support the other conditions imposed to address BT's SMP in this market. Without this information, OCPs could be unable to compete fairly with BT.</p>	<p>in this document.</p>
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Test under Section 88 of the Act

8.231 Section 88 of the Act, which implements Article 13 of the Access Directive, further requires that, when considering a cost orientation obligation, we are able to demonstrate that:

- there is a risk of adverse effect from price distortion; and
- that the cost orientation obligation is appropriate to: promote efficiency, promote sustainable competition, and conferring the greatest possible benefits on end-users.

8.232 Paragraph (3) of Section 88 further argues that there is a relevant risk of adverse effects arising from price distortion if the dominant provider might:

- So fix and maintain some or all of its prices at an excessively high level, or
- So impose a price squeeze, as to have adverse consequences for end-users of public electronic communications services.

8.233 As discussed in Section 7, where we assessed SMP in this market, it appears from the market analysis that there is a relevant risk of adverse effects arising from price distortion. In particular, we have identified the risk that BT, given its market power, could engage in price discrimination between its downstream arms and its competitors when granting access to its network. We think therefore that without an obligation to orient prices to costs, BT could, given its scale and scope advantages, afford to price below cost to deter further entry and push competitors out of the market (i.e. margin squeeze). It could also price above cost, which would result in higher prices for end users in retail markets, given the reliance of the market on BTs' wholesale access services. Given that the dominant provider might engage in such practices, we think that we have identified a relevant risk of adverse effects arising from price distortions ex Section 88(3).

8.234 It also appears that the setting of the condition is appropriate for the purposes of promoting efficiency, promoting sustainable competition and conferring the greatest possible benefits on the end-users of public electronic communications services. We set out why think this condition is appropriate in paragraph 8.164 of the January 2008 consultation.

8.235 As required by Section 88(1)(b) of the Act, Ofcom considers that this obligation fulfils the following requirements:

- promotes efficiency, by promoting cost based pricing and efficient market entry; and
- confers the greatest possible benefits on the end-users by ensuring that providers competing for customers in the retail market are not exploited by BT setting unreasonable conditions in the wholesale market.

8.236 The cost orientation condition that Ofcom is imposing requires that, unless Ofcom directs otherwise, BT shall set all charges such that they are reasonably derived from the costs of provision based on a forward looking long run incremental cost approach and allowing an appropriate mark up for the recovery of common costs. If a charge were set below the long run incremental cost of supply, then some customers may buy that product when they would not have been prepared to pay the full long run incremental costs of providing it. This is likely to be inefficient and result in a loss for society as a whole. Moreover, such a low charge is likely to be inconsistent with promoting sustainable wholesale competition, because it could mean that an equally efficient competitor is prevented from entering the market because it is unable to recover its incremental costs. By promoting efficiency and ensuring that competition is not distorted, requiring charges not to be below long run incremental costs will tend to confer the greatest benefits on end users. If a charge were above long run incremental costs plus an appropriate mark up, then it is higher than it needs to be in order to produce the service and this is unlikely to be in consumers' interests. If there were particular circumstances that mean that a charge set on the basis of long run incremental costs plus an appropriate mark up would not be appropriate, and would be detrimental to consumers' interests, then the condition allows Ofcom to direct that the charges are not required to be set on that basis.

#### Account taken of the ERG Wholesale Leased Lines Common Position

8.237 In accordance with ERG's Statement of 12 October 2006<sup>94</sup>, while ERG Common Positions are not binding, ERG members must take the utmost account of them. Table 8.9 below summarises how Ofcom has taken into account the ERG Wholesale Leased Lines Common Position in proposing the regulatory remedies for this market.

**Table 8.9 Account taken of the ERG Wholesale Leased Lines Common Position**

Objective of remedy	Account taken by Ofcom
Assurance of supply	The requirement to provide Network Access on reasonable request should provide competitors with reasonable certainty of ongoing supply of wholesale leased lines in order to give them confidence to enter the market.
Level playing field	The requirement not to unduly discriminate, together with the Discrimination Guidelines, should ensure that entrants will be able to compete on a level playing field.
Avoidance of unfair first-mover advantage	The requirement not to unduly discriminate, together with the Discrimination Guidelines, should ensure that there is no unfair first-mover advantage.
Transparency of terms and conditions	The requirement to publish a Reference Offer and the requirement to notify charges, terms

<sup>94</sup> ERG(06)51.

	and conditions in advance should provide clarity of terms and conditions of wholesale leased lines.
Reasonableness of technical parameters of access	The requirement to publish a Reference Offer and the requirement to publish technical information and the obligation relating to request for new network access should ensure that the technical parameters of access are reasonable. In addition, the obligation to provide certain interconnection services should provide competitors with the ability to interconnect efficiently and economically at a wide range of locations for the purpose of wholesale leased lines interconnection.
Fair and coherent access pricing	The cost orientation obligation and the obligation to comply with charge controls should guarantee competitors that prices for wholesale leased lines is coherent with other services and gives the appropriate incentives for efficient investment decisions to both the SMP operator and its competitors.
Reasonable quality of access products	The proposed revisions of the SLAs/SLGs regime for PPCs should deliver a much improved framework for dealing with the quality of the services provided by BT to its competitors.

**Wholesale market for low bandwidth AISBO in the UK excluding the Hull area**

**Introduction**

8.238 In this sub Section, we set out the regulatory obligations that we intend to impose on BT as a result of our finding of it having SMP in the provision of low bandwidth AISBO in the UK excluding the Hull area.

8.239 We first set out a summary of our proposals as set out in the January 2008 consultation. Secondly, we review the responses to the consultations, providing our response to the issues raised by respondents. Thirdly, we review the choice of the appropriate remedies, having regard to all responses and all evidence available to us. We then set out our conclusions and the remedies we have decided to impose on BT.

8.240 The last part of this sub Section sets out how we believe our obligations comply with the relevant tests in the Act. In addition, we set out how we have taken into account the ERG WLL CP in setting our obligations.

**Summary of proposals**

8.241 In paragraphs 7.310 to 7.334 of the January 2008 consultation we set out our proposals in support of the finding of SMP for BT in this market. This finding has now been confirmed in Section 7. In the table below, we set out the key arguments in support of our finding.

Table 8.10 Key market power indicators

	Wholesale low bandwidth AISBO market	Downstream retail market
<i>Quantitative indicators</i>		
<b>Market Share</b>	73% (was 78% in the 2003/04 Review <sup>95</sup> )	72% (was 70-75% in the 2003/04 Review <sup>96</sup> )
<b>Profitability</b>	31% ROCE <sup>97</sup>	Not available
<i>Qualitative indicators</i>		
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		
The existence of significant barriers to entry and expansion, including as a result of sunk costs		

8.242 In paragraphs 8.208 to 8.267 of the January 2008 consultation we then reviewed the regulatory options available to us, identified which option we believed would most appropriately serve our policy objectives, and which remedies, if any, should apply to BT in relation to its proposed SMP determination in the provision of low bandwidth AISBO in the UK excluding the Hull area. We present a summary of that assessment in the following paragraphs.

#### Options assessment

8.243 Before setting out our analysis of appropriate remedies, we considered broader policy options and how best we could meet our policy objectives, given the finding of SMP and BT's persistently high market share since 2004. Two alternatives were identified, namely maintaining the existing regulation or varying it to address the shortcoming we had identified, against the counterfactual of not imposing any regulation at all.

8.244 Specifically, in the January 2008 consultation, we considered the following regulatory options:

- *No regulation;*
- *Status quo*, which means to continue to regulate BT's provision of low bandwidth AISBO, with the same SMP Conditions as set out in the 2003/04 Review; and
- *Variations and additional measures*, including: reviewing the SLA/SLGs regime, regulating the provision of accommodation services required by OCPs to aggregate wholesale low bandwidth AISBO services, removing the distance limits for WESs and BESs, and imposing of a charge control on these services.

<sup>95</sup> As stated in paragraph 7.315 of the January 2008 consultation, BT's market share for this market in the 2003/04 Review encompassed all bandwidths.

<sup>96</sup> As stated in paragraph A6.15 of the January 2008 consultation, BT's market share for this market in the 2003/04 Review encompassed all bandwidths. Its' share of AI services below 100 Mbit/s was estimated to be between 75% and 80%, its share of 100 Mbit/s services was found to be 70%, and its share of 1 Gbit/s services was found to be 55-60%.

<sup>97</sup> This figure relates to all AISBOs, but 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. In the January 2008 consultation, we reported 20 per cent, based on BT's 2006/07 results, though this has since been restated.

- 8.245 In paragraphs 8.208 to 8.235 of the January 2008 consultation, for each option we considered how well it would serve our policy objectives, how it would affect the development of competition in downstream retail markets, and the impact it would have on the various key stakeholders, including BT.
- 8.246 Given our proposal to find that BT had SMP in this market, we set out why we believed that other providers would require regulated access from BT to be able to compete effectively in downstream retail leased lines markets. We had found BT to have persistently high market shares over time which were also reflected in the downstream retail market, and to be deriving an advantage from the ubiquity of its infrastructure and from economies of scale and scope not available to its competitors. In the absence of regulation, we argued, BT would be able to leverage its market power into the downstream market by restricting access to its network, thus reducing end user access to a choice of competitive services and prices. We considered therefore that the option of no regulation would poorly serve our objectives and, in particular, the promotion of competition in downstream markets for the benefit of end users.
- 8.247 Having found that some regulation was likely to be appropriate we considered whether the evidence available to us suggested that the current regime could be improved.
- 8.248 As for other markets, the starting point was to consider the current obligations and their effectiveness. Various regulatory obligations have been in place on BT since the 2003/04 Review was completed in June 2004. Yet BT's market share does not appear to have changed significantly in either this market or the related retail market. In the course of the review, we had received various representations, from OCPs amongst others, which pointed to some weaknesses in the existing regime in promoting competition.
- 8.249 In paragraphs 8.215 to 8.232 of the January 2008 consultation we discussed what the appropriate variations should be, based on the issues and shortcomings of the current regime that had emerged in the course of the review. We present below a summary of the discussion for each proposed variation.

*Accommodation in local exchanges*

- 8.250 Some OCPs had expressed dissatisfaction with the accommodation product offered by BT to enable aggregation of disaggregated access and backhaul products at the exchanges. In particular, they had lamented that the service was not offered at regulated terms and conditions, and that it did not provide for an efficient use of accommodation already purchased for supporting LLU services.

*Product development*

- 8.251 Several CPs had argued that BT was being slow in developing new Ethernet wholesale services based on WDM technology to provide, in particular, more cost efficient backhaul products. Ofcom had been seeking to address this issue through discussions with BT over the implementation of the Undertakings. At the time of the January 2008 consultation, BT had initiated a programme of investments in WDM technology under the name of Project ORCHID. We considered that we should continue to work with BT and industry to ensure that BT committed to an appropriate roll out timetable for wholesale Ethernet products based on Project ORCHID and that we should consider such a commitment through a separate consultation, which we expected to publish later in 2008.

*Limited distance of BES and WES services*

- 8.252 BT's Undertakings had set a limit of 25 Kms radial distance (35 Kms route distance) for BESs and WESs to ensure that OCPs would not use these products to build their trunk networks. We considered that such restrictions should be removed, as they were, in some cases, hampering OCPs ability to access appropriate backhaul services.

*Excessive and discriminatory pricing*

- 8.253 After reviewing the cost and revenue data for these services in Annex 12 of the January 2008 consultation, we provisionally concluded that the return that BT was earning on low bandwidth AISBO services appeared to be significantly in excess of its cost of capital. We considered that such returns were not compatible with those earned in a competitive market, and, as a result, efficient competition might be restricted or distorted. In addition, those high returns could have detrimental effects for end users through the setting of retail prices above those that could be found in a competitive market.
- 8.254 BT has been subject to a cost orientation requirement for these services since the 2003/04 Review. We considered however that, given the relatively high returns, a cost orientation alone might not be enough in the future. We therefore considered that, among other things, Ofcom should look further at the adoption of charge controls for low bandwidth AISBO services, and that we would consult separately on it.

*SLAs/SLGs regime*

- 8.255 At the time of the January 2008 consultation, Ofcom had initiated a review of the Ethernet SLAs/SLGs regime through a separate project. This project was to address the inconsistency in the regime, and the unsatisfactory levels of SLGs offered by BT, which were not in line with the penalties providers would have to pay to end users for compensating delays in delivering or repairing AI services.

*Simplification of the existing notification regime*

- 8.256 Following the implementation of BT's Undertakings, BT is subject to an Equivalence of Input (EoI) obligation for its wholesale access and backhaul Ethernet services. This obligation was designed to deter non-price discrimination behaviour and, in particular, to prevent BT from discriminating between its downstream divisions and its competitors who need access to its access and backhaul Ethernet products. We considered that, in the presence of such an obligation, there could be scope for reducing the regulatory burden on BT and, particularly, for withdrawing some of the existing SMP obligations relating to the notification of changes to prices, terms and conditions, technical information and requests for new network access.

*Conclusion on the choice of option*

- 8.257 For the reasons outlined above, our preliminary conclusion was that the current regime required would need to be amended if it is to promote greater competition in the downstream retail market in the future. We considered that the option of keeping the current framework unaltered would not serve well our policy objectives.
- 8.258 We argued that some elements of the existing framework should be retained. In particular, BT should still be required to provide access on regulated and transparent

terms and conditions. However, we had concluded in the course of the review that some changes were required. We therefore suggested that we should adopt the following variations and additional measures:

- Regulate the provision of accommodation services required by OCPs to aggregate wholesale AISBO services;
- Ensure a timely development of WDM based wholesale AISBO services by BT;
- Ensure that the distance limits on WESs and BESs are removed;
- Complete the review of the Ethernet SLAs/SLGs regime; and
- Simplify the notification regime applying to BT.

8.259 In addition, we considered that Ofcom should review the introduction of charge controls for low bandwidth AISBO services, which would be considered in a separate consultation.

8.260 Finally, at paragraph 8.233 of the January 2008 consultation we considered the impact on stakeholders of the different options. We concluded that the option of varying the existing regime with the proposed amendments had the greatest benefits, as it would best achieve the promotion of competition, and would set the basis for future lower prices and better quality services for end users.

Preliminary conclusions: proposed regulatory obligations

8.261 Having reviewed what the appropriate level of remedies should be, we therefore proposed the following obligations should apply to BT:

- an obligation to provide Network Access;
- a requirement not to unduly discriminate;
- cost orientation;
- charge controls (although the imposition of such a remedy would be subject to further consultation); and
- a requirement to publish a reference offer.

8.262 With respect to SLAs/SLGs, we proposed to incorporate Ofcom's separate work on Ethernet SLAs/SLGs, once completed, by means of a Direction to be imposed under the SMP access obligation.

8.263 We proposed to continue to engage with BT to ensure that it would develop and launch in a timely manner new AISBO services based on Project ORCHID and, where appropriate, obtain specific commitments from BT on the launch of such services.

8.264 We also proposed to regulate more tightly BT's provision of accommodation services in relation to wholesale disaggregated AISBO products and to ensure the removal the distance limits on BESs and WESs. In particular, we proposed to extend the obligations applying to BESs and WESs to BT's accommodation service in support of disaggregated Ethernet products.

- 8.265 In addition, we considered that Ofcom should further consider the opportunity to impose charge controls on all low bandwidth AISBO services, including accommodation services, on which we would consult separately.
- 8.266 In paragraph 8.267 of the January 2008 consultation we set out how we thought the proposed remedies met the Communications Act tests. We have set out at the end of this sub Section the appropriate Communications Act tests in detail for each of the regulatory obligations we have concluded will apply to BT.

## Responses to the consultations and Ofcom's response

### Charge controls

- 8.267 Most OCPs expressed their support for the proposal to further consider charge controls.
- 8.268 BT, on the other hand, argued that the charge controls for wholesale Ethernet services are, in their view, unjustified, on the grounds that:
- there is effective competition in geographic areas such as city centres;
  - a charge control would force Openreach to focus on delivering efficiency gains to meet its regulatory commitments, and this would divert effort and resources away from service innovation, to the detriment of its customers;
  - Openreach plans to introduce new pricing structures in the near future which are likely to make a new price cap redundant and disproportionate. These new price structures may include geographic pricing, and a price control could have unintended consequences for this development;
  - BT recognises that there may be a basis for different charging where there are public safety and policy considerations, e.g. in relation to products used in relation to the CCTV market; and
  - it considers that a price control could act as a significant disincentive for investment by other players.
- 8.269 In case a charge control is imposed, BT argued that it should be light-touch and flexible, with the capability of being adapted to reflect uncertainty and change in this developing area of business connectivity. Further, BT argued that the key test for any price cap should be that it does not adversely impact incentives to introduce the new and innovative services that the market demands.
- 8.270 Having considered these responses, we remain of the view charge controls should be applied to the services provided by BT in this market. BT argued that it faces effective competition in some geographies, and that, as a result, a charge control would be disproportionate. We have considered BT's comments in relation to varying degree of competition in this market at paragraph 6.17 and have concluded that the market is national in scope. In Section 7, we have found that BT is dominant in this market and that we consider the market is not prospectively competitive (see paragraph 7.137). In addition, we have found that BT is earning high returns on these services (see paragraph 7.135). In the absence of a charge control, we consider there is a significant risk that BT could increase its charges above competitive levels, and that this could lead to higher prices in retail markets, to the detriment of consumers.

- 8.271 BT has also made the point that a charge control could discourage investments in alternative infrastructures. However, we consider the likelihood of this occurring to be low. Since the 2003/04 Review, when these services were excluded from charge controls due to the emerging nature of the market, we have found in Section 7 that even with BT earning high returns on these services, very limited alternative infrastructure has been deployed in this market.
- 8.272 BT has also argued that a charge control could discourage innovation. We disagree with this view. Historically, charge controls have been preferred to other means of controlling prices because of their ability to incentivise efficiency and, through this, innovation.

Transparency deregulation

- 8.273 Many respondents objected to the proposed deregulation of certain transparency obligation. OCPs argued that the Undertakings alone are insufficient because BT does not use the same backhaul products, and because the Undertakings offer relatively weak enforcement options.
- 8.274 BT supported the deregulation, as did one CP that noted that it would bring some benefits to CPs provided the impact of deregulation was monitored closely.
- 8.275 We have reviewed this issue, in particular in the light of the new market definition set in Section 6 which we are implementing in this Statement. In particular, we have concluded that the boundaries of the wholesale AISBO market should be identified by a set of 56 aggregation nodes. Currently the EoI obligation under the Undertakings applies to access and backhaul services up to BT's Metro nodes, of which there are 106. If we were to relax certain notification obligations as proposed in the January 2008 consultation, and in the absence of an extension of the EoI obligation, OCPs purchasing wholesale AISBO terminating segments which require inter-Metro transport could be placed at a disadvantage, relative to BT's own downstream business.
- 8.276 We have therefore reconsidered our proposals in the light of the new market definition, and believe it is appropriate to continue to require BT to comply with certain transparency obligation for the market for wholesale low bandwidth AISBO in order to avoid the risk of undue discrimination between customers, including obligations relating to requests for new network access.
- 8.277 One alternative solution could have been to reconsider the extent of the EoI obligation currently applying to BT under the Undertakings. However, such an opportunity should be considered as part of the on going implementation of BT's Undertakings, rather than as a piecemeal solution to a potential problem in a particular market. Should such an extension of the EoI obligation be considered in the future, we would reconsider the opportunity to relax certain notification requirements on BT.

Concerns about ORCHID

- 8.278 Several respondents expressed uncertainty about project ORCHID and demanded that its impact be considered in the charge controls. They also demanded that Ofcom extract public commitments from BT on the rollout of ORCHID.
- 8.279 With respect to extracting public commitments with respect to the launch of project ORCHID, Ofcom notes that, following engagement with all stakeholders, BT has

published its plans for productising project ORCHID, and that same services, such as the Ethernet Backhaul Direct, are already being offered to CPs. We therefore consider that, as long as BT and industry continue to work together effectively for the launch of new products and services based on Project ORCHID, there is no need at present for Ofcom to manage the process.

- 8.280 With respect to the comment on the treatment of project ORCHID in the review of charge controls, we have provided already our response to points raised in relation to charge controls at paragraph 8.270 above.

Distance limits for WESs, BESs, and WEES

- 8.281 BT and UKCTA both welcomed the proposed removal of distance limits for WESs and BESs. UKCTA argued that the 25km limit for WEES should remain.
- 8.282 Having considered these comments, we think it is appropriate to confirm the removal of the distance limits, but keep those limits in place for WEES services, in order to encourage infrastructure competition over longer distances.

SLAs/SLGs regime

- 8.283 Several respondents agreed with our proposal that the SLAs/SLGs regime for wholesale AISBO services should be more tightly regulated.
- 8.284 Ofcom has now completed the review of SLGs for BT's wholesale Ethernet portfolio, and has indicated what it considers to be a fair and reasonable set of SLGs for these products, having taken into account the work done by industry and the OTA2 in this area. A new commercial framework is currently being implemented by the industry. We set out in detail at paragraph 8.481 and following our approach for the SLAs/SLGs regime, which includes adopting the approach taken in the SLG Statement<sup>98</sup> and carry this over under the new SMP conditions. Ofcom believes that problems with the quality of these services from Openreach should be largely solved once the new commercial framework is implemented.

**Review of proposals for remedies**

- 8.285 We have reviewed our proposals for remedies having regard to all the responses and representations received and all the evidence available to us following the January 2008 consultation. Our original proposals were set out in full at paragraphs 8.236 to 8.263 of the January 2008 consultation, and a summary has been provided at paragraphs 8.261 to 8.266 above.
- 8.286 We consider that the regulatory objectives and analysis of the appropriate regulatory obligations for this market are broadly the same as for the high bandwidth TISBO market in the UK excluding the CELA and the Hull area, as described in paragraphs 8.154 to 8.166 above. The low bandwidth AISBO market is very large. BT's (internal and external) revenues for all AISBO bandwidths were around £440m in 2007/08<sup>99</sup>, and the large majority of this is likely to be for low bandwidth circuits. Given the size of the market and BT's SMP position, there is scope for significant consumer harm if BT were not regulated. For the same reasons as for the high bandwidth TISBO

<sup>98</sup> <http://www.ofcom.org.uk/consult/condocs/slg/statement/>

<sup>99</sup> Source: BT Regulatory Financial Statement 2007/08, <http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2008/Regulatoryfinancialstatements2008.htm>

market in the UK excluding the CELA and the Hull area, we consider it appropriate to impose a broadly similar set of remedies.

- 8.287 OCPs generally opposed our proposals for relaxing certain notification obligations currently applying to BT in relation to AISBO products. We have reconsidered our proposals in the light of those comments and in the light of the market definition set out in Section 6, and we have concluded, for the reasons discussed at paragraphs 8.273 to 8.277, that it would not be appropriate to confirm our proposal. We are therefore keeping the current transparency obligations on BT.
- 8.288 Stakeholders agreed with us in relation to the proposals for the review of the Ethernet SLAs/SLGs and the removal of the distance limits currently applying to WESs and BESs. This issue will be considered further in the context of a possible amendment to BT's Undertakings.

## **Conclusions**

- 8.289 Having considered all responses to the consultations, and having reviewed all evidence available to us, we conclude the review of this market by setting out below the appropriate regulatory obligations to apply to BT. In reaching our decision we have taken account of the considerations described in paragraphs 8.8 to 8.25 above. The reasons for our conclusion are referred to in the paragraph 8.285 above.
- 8.290 Using the powers conferred upon Ofcom under Sections 87 and 88 of the Act, Ofcom has therefore decided to impose the following obligations on BT in the market for low bandwidth AISBO in the UK, excluding the Hull area:
- an obligation to provide Network Access;
  - a requirement not to unduly discriminate;
  - cost orientation;
  - a requirement to publish a reference offer;
  - an obligation to give 90 days notice of changes to prices, terms and conditions for existing services;
  - an obligation to give 28 days notice of the introduction of prices, terms and conditions for new services;
  - a requirement to publish quality of service information;
  - a requirement to notify technical information with 90 days notice; and
  - obligations relating to requests for new network access.
- 8.291 We also consider that BT should in principle be subject to a charge control with respect to the services in this market, the scope and form of which is considered in a separate consultation published alongside this Statement.
- 8.292 With respect to the SLAs/SLGs regime that should apply to services in this market, Ofcom and the OTA2 have now completed the work referred to in the January 2008

consultation. As a result, Ofcom has issued a Statement on Ethernet SLGs<sup>100</sup>, which imposed a new SLG Direction under the existing SMP conditions imposed by the 2003/04 Review. We intend to re impose the SLG Direction under the new SMP Conditions that will apply once this Statement is published. We further set out our decisions in relation to the future SLAs/SLGs regime in paragraph 8.481 and following later in this Section.

- 8.293 The obligations set out above will also apply to interconnection and accommodation services in this market as discussed at paragraph 8.448 and following later in this Section.
- 8.294 In the remainder of this sub Section, we first set out how we believe the obligations we are imposing on BT meet the legal tests we are required to carry out under the Act. We then set out how we have taken into account the ERG WLL CP in setting what we believe is the appropriate level of obligations on BT in order to promote greater competition in the downstream retail market for low bandwidth AI leased lines.

## Communications Act tests

### Introduction

- 8.295 It is our view that the regulatory obligations we are imposing on BT comply with the requirements set out in the Act. In the paragraphs that follow, we first consider how we believe they comply with Section 87(1) of the Act. Secondly, we consider, as suggested by recital 27 of the Framework Directive, whether competition law remedies alone would suffice to address the concerns and competition problems we have identified, and give our reasons why we think it would not. We then set out, individually for each of the obligations we are imposing on BT, how we believe it meets the appropriate legal tests under Section 47(2) of the Act. Finally, We set out how we believe the cost orientation obligation we are imposing on BT meets the further test set out in Section 88 of the Act.

### SMP Conditions are appropriate

- 8.296 Section 87(1) of the Act provides that, where Ofcom has made a determination that a person has SMP in the market reviewed, it must set such SMP conditions as it considers appropriate and as authorised by the Act. This implements Article 8 of the Access Directive.
- 8.297 Having considered all responses to the consultations and all evidence available to us, we have identified in Section 7 BT as having SMP in this market. In the light of the assessment of the costs and benefits of addressing the SMP through the remedies considered at paragraph 8.285 and following in this Section, we have concluded that BT shall be subject to the obligations set out at paragraph 8.290 and following in this Section.
- 8.298 For the reasons set out in paragraphs 8.137 to 8.177 of the January 2008 consultation, and reviewed at paragraph 8.285 of this Section, we believe it is appropriate to impose such conditions on BT in relation to the objective we have set out to achieve in this review for the market for low bandwidth AISBO in the UK. In

<sup>100</sup> *Service level guarantees: incentivising performance*, 20 March 2008, <http://www.ofcom.org.uk/consult/condocs/slg/statement/>

particular, in relation to the promotion of greater competition in the downstream retail market. This would bring substantial benefits to end users by increasing their access to a competitive choice of prices and providers.

8.299 Finally, when considering what should be the appropriate remedies, we have had regard to the considerations set out in paragraph 8.109 of this Section.

Reliance on Competition Law alone not sufficient

8.300 The case for not relying on Competition Law alone to remedy the finding of market power on BT is the same as the case for the other wholesale markets for terminating segments of leased lines where BT has been found to have SMP. We do not therefore repeat these arguments here, and refer to the discussion provided in relation to the market for low bandwidth TISBO at paragraph 8.110 and following in this Section.

Tests under Section 47(2) of the Act

8.301 We set out in details in the table below how we think each remedy passes the relevant Communications Act tests. In particular, how we believe each obligation we are imposing on BT meets the tests set out in Section 47(2) of the Act, according to which each obligation must be:

- objectively justifiable in relation to the networks, services or facilities to which it relates;
- not such as to discriminate unduly against particular persons or a particular description of persons;
- proportionate to what the condition is intended to achieve; and
- in relation to what it is intended to achieve, transparent.

**Table 8.11: Summary of Ofcom’s reasons for believing that the test of Section 47 (2) of the Act is met for the obligations imposed on BT as a result of it having SMP in the market for low bandwidth AISBO in the UK excluding the Hull area**

<i>Is it <b>objectively justifiable</b> in relation to the networks, services and facilities which it relates?</i>	<i>Is it <b>such as not to discriminate unduly</b> against particular persons or a particular description of persons?</i>	<i>Is it <b>proportionate</b> to what the condition is intended to achieve?</i>	<i>In relation to what it is intended to achieve, is it <b>transparent</b>?</i>
<i>Obligation to provide access</i>			
The obligation is objectively justifiable as, in the absence of this condition, BT might refuse to supply low bandwidth AISBO, which would prevent effective competition in the retail market. By ensuring that OCPs	The obligation does not discriminate unduly as it applies only to operators which have SMP in the relevant market and which therefore would be able to, and would have an incentive to, distort competition by denying access on fair and reasonable terms.	The obligation is proportionate since BT is not required to provide access if the request is unreasonable and because Ofcom does not consider that other operators will install competing facilities to an extent to undermine BT’s SMP. BT is already providing network	The obligation is transparent since the condition has been drafted for maximum clarity and because the purpose of the obligation and the reasons for imposing it are clearly explained in this document.

<p>can gain access to BT's wholesale low bandwidth AISBO services on fair and reasonable terms, it will enable OCPs to compete in the retail leased lines market. By enabling OCPs to compete fairly with BT, it puts pressure on BT to reduce costs and so promotes efficiency, confers the greatest possible benefits on end-users and promotes effective and sustainable competition. Although the charge control conditions will, if imposed following our separate consultation, limit average charges, they will not in themselves require BT to supply low bandwidth AISBO.</p>		<p>access, which is therefore clearly feasible. In the absence of Ex-ante regulation, entry barriers and BT's SMP mean that competition might never become established.</p>	
<p><i>Non discrimination</i></p>			
<p>The requirement is justified because otherwise BT, as a vertically integrated operator, would be able to distort competition by discriminating against its rivals to the benefit of its own (downstream) divisions, e.g. through charging other operators higher prices than it charges BT Retail. It also ensures that BT does not abuse its SMP position by charging excessive prices or offering inadequate quality of service to particular groups of customer and, via the retail market, to</p>	<p>The requirement does not discriminate unduly as it applies only to operators who, by possessing SMP in the relevant market, would be able to, and would have an incentive to, distort competition by discriminating against competitors.</p>	<p>The requirement is proportionate in that only discrimination which is unduly is prohibited and because it is the least onerous obligation required to address this particular risk of harm to competition. Ex ante regulation is more effective than ex post competition law where, as here, entry barriers and SMP mean that otherwise, effective competition might never become established.</p>	<p>The requirement is transparent since the condition has been drafted for maximum clarity and because the purpose of the obligation and the reasons for imposing it are clearly explained in this document.</p>

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<p>end users. The requirement therefore promotes competition and furthers the interests of consumers.</p>			
<p><i>Cost orientation</i></p>			
<p>The requirement is justified because, although the charge control conditions will, if imposed following our separate consultation, limit average charges, they do not in themselves control the level of individual charges within a basket subject to an average charge control. In the absence of this condition, BT might set individual charges at excessively high or anti-competitively low levels within a basket.</p>	<p>The requirement does not discriminate unduly as it applies only to operators who, by possessing SMP in the relevant market, would be able to, and would have an incentive to, distort competition by setting charges which are not based on costs.</p>	<p>The requirement is proportionate because, by taking into account costs, including an appropriate contribution to the recovery of common costs and a reasonable return on investment, the cost orientation condition allows BT's charges to be proportionate to the extent of BT's investment in the provision of the relevant services. Ex ante regulation is necessary for the reasons set out above.</p>	<p>The requirement is transparent since the condition has been drafted for maximum clarity and because the purpose and meaning of the obligation and the reasons for imposing it are clearly explained in this document.</p>
<p><i>Transparency obligations</i></p>			
<p>These obligations are justified in that they provide certainty to operators and prevent BT withholding information from customers and competitors, or misusing information in a way which could harm competition. In addition, they facilitate Ofcom's monitoring of compliance with the other obligations, notably the obligation not to unduly discriminate.</p>	<p>The obligations do not discriminate unduly as they apply only to operators who, by possessing SMP in the relevant market, would be able to, and would have an incentive to, exploit customers and distort competition by withholding or misusing information.</p>	<p>The obligations are proportionate as the information which BT is obliged to publish is necessary to enable OCPs to make effective use of the network access which BT is also required to provide. The transparency obligations therefore support the other conditions imposed to address BT's SMP in this market. Without this information, OCPs could be unable to compete fairly with BT.</p>	<p>The obligation is transparent since the condition has been drafted for maximum clarity and because the purpose and meaning of the obligation and the reasons for imposing it are clearly explained in this document.</p>

Test under Section 88 of the Act

- 8.302 Section 88 of the Act, which implements Article 13 of the Access Directive, further requires that, when considering a cost orientation obligation, we are able to demonstrate that:
- there is a risk of adverse effect from price distortion; and
  - that the cost orientation obligation is appropriate to: promote efficiency, promote sustainable competition, and conferring the greatest possible benefits on end-users.
- 8.303 Paragraph (3) of Section 88 further argues that there is a relevant risk of adverse effects arising from price distortion if the dominant provider might:
- So fix and maintain some or all of its prices at an excessively high level, or
  - So impose a price squeeze, as to have adverse consequences for end-users of public electronic communications services.
- 8.304 As discussed in Section 7, where we assessed SMP in this market, it appears from the market analysis that there is a relevant risk of adverse effects arising from price distortion. In particular, we have identified the risk that BT, given its market power, could engage in price discrimination between its downstream arms and its competitors when granting access to its network. In addition, in Section 7 we have also found that BT could potentially be earning high returns from these services. We think therefore that without an obligation to orient prices to costs, BT could, given its scale and scope advantages, afford to price below cost to deter further entry and push competitors out of the market (i.e. margin squeeze). It could also price above cost, which would result in higher prices for end users in retail markets, given the reliance of the market on BTs' wholesale access services. Given that the dominant provider might engage in such practices, we think that we have identified a relevant risk of adverse effects arising from price distortions *ex* Section 88(3).
- 8.305 It also appears that the setting of the condition is appropriate for the purposes of promoting efficiency, promoting sustainable competition and conferring the greatest possible benefits on the end-users of public electronic communications services. We set out why we think this condition is appropriate in paragraph 8.250 of the January 2008 consultation.
- 8.306 As required by Section 88(1)(b) of the Act, Ofcom considers that this obligation fulfils the following requirements:
- promotes efficiency, by promoting cost based pricing and efficient market entry; and
  - confers the greatest possible benefits on the end-users by ensuring that providers competing for customers in the retail market are not exploited by BT setting unreasonable conditions in the wholesale market.
- 8.307 The cost orientation condition that Ofcom is imposing requires that, unless Ofcom directs otherwise, BT shall set all charges such that they are reasonably derived from the costs of provision based on a forward looking long run incremental cost approach and allowing an appropriate mark up for the recovery of common costs. If a charge were set below the long run incremental cost of supply, then some customers may

buy that product when they would not have been prepared to pay the full long run incremental costs of providing it. This is likely to be inefficient and result in a loss for society as a whole. Moreover, such a low charge is likely to be inconsistent with promoting sustainable wholesale competition, because it could mean that an equally efficient competitor is prevented from entering the market because it is unable to recover its incremental costs. By promoting efficiency and ensuring that competition is not distorted, requiring charges not to be below long run incremental costs will tend to confer the greatest benefits on end users. If a charge were above long run incremental costs plus an appropriate mark up, then it is higher than it needs to be in order to produce the service and this is unlikely to be in consumers' interests. If there were particular circumstances that mean that a charge set on the basis of long run incremental costs plus an appropriate mark up would not be appropriate, and would be detrimental to consumers' interests, then the condition allows Ofcom to direct that the charges are not required to be set on that basis.

**Account taken of the ERG Wholesale Leased Lines Common Position**

8.308 In accordance with ERG's Statement of 12 October 2006<sup>101</sup>, while ERG Common Positions are not binding, ERG members must take the utmost account of them. Table 8.12 below summarises how Ofcom has taken into account the ERG WLL CP in proposing the regulatory remedies for this market.

**Table 8.12 Account taken of the ERG Wholesale Leased Lines Common Position**

Objective of remedy	Account taken by Ofcom
Assurance of supply	The requirement to provide Network Access on reasonable request should provide competitors with reasonable certainty of ongoing supply of wholesale leased lines in order to give them confidence to enter the market.
Level playing field	The requirement not to unduly discriminate, together with the Discrimination Guidelines, should ensure that entrants will be able to compete on a level playing field.
Avoidance of unfair first-mover advantage	The requirement not to unduly discriminate, together with the Discrimination Guidelines, should ensure that there is no unfair first-mover advantage.
Transparency of terms and conditions	The requirement to publish a Reference Offer and the requirement to notify charges, terms and conditions in advance should provide clarity of terms and conditions of wholesale leased lines.
Reasonableness of technical parameters of access	The requirement to publish a Reference Offer and the requirement to publish technical information and the obligation relating to request for new network access should ensure that the technical parameters of access are reasonable. In addition, the obligation to provide certain interconnection services should provide competitors with the ability to interconnect efficiently and

<sup>101</sup> ERG(06)51.