Non-Confidential

ITS submission to Ofcom in relation to the review of the wholesale leased lines market as part of the Telecoms Access Review

Introduction

ITS is among the largest wholesale providers of business connectivity services in the UK. Our network now covers more than 25% of business premises in the country and has already connected over 10,000 business premises with leased line, or dark fibre connectivity products.
ITS is an INCA member and is actively supporting the range of papers submitted by INCA as part of the TAR process. However, as a business-only and wholesale-only provider, ITS has a specific perspective and specific concerns which are set out below.

Level of competition in the wholesale leased lines market

In recent market reviews, Ofcom has gradually deregulated the wholesale leased lines (WLL) market. The rationale has been the relatively large number of competitive providers of leased lines in the market and the presumption that this has reduced BT's market power and its ability to abuse that power.
ITS, whilst keen and able to compete in a commercial market, is concerned at the deregulatory trend – we outline our reasons below:

- Ofcom has deregulated the WLL market geographically, based on the number of WLL competitors present, but the nature of the leased lines market is that the connectivity sought by end customers often requires presence in several locations. The different levels of regulation imposed on BT depending on geography adds an additional level of complexity to an already very complex market. ITS considers that the geographic deregulation of BT makes it harder for competitors to address the national WLL market.
- Ofcom has deregulated the WLL market geographically ***based on the number of WLL competitors present only*** but not whether those competitors are established and do, in fact represent sufficient competition to BT to constrain BT's behaviour. ITS notes that, for the broadband market, Ofcom proposed in the WFTMR that any deregulation would be judged based on a ***combination of the number of competitors present (>50% of postcodes) and how established those competitors***

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are. In ITS's view, the broadband market approach to deregulation is more appropriate and better represents market conditions where a powerful player such as BT would find it difficult to abuse that market power.
- As noted above, it should also be noted that the WLL market is not 'local' in the same sense as the broadband market and, therefore, local presence (even if established locally) is likely to represent a lesser constraint on BT in the WLL than in the broadband market. Thus, Ofcom should consider the effects of local deregulation on the national market as well as in the specific location considered for deregulation.
- Ubiquity is powerful in the WLL. Although competitors to BT can seek third party solutions to (attempt to) match BT's national offering, that is extremely difficult to achieve.

Reviewing BT's returns[1] in the leased lines market we note that they are above the level one would expect from an effectively competitive market. That is appropriate given Ofcom's policy of encouraging competitive market entry at the infrastructure level, but it does not suggest that the existing levels of competition are sufficient to compete away excess profits. ITS and other competitors in the WLL market are working hard to gradually erode Openreach's market share, but the RFS suggests that BT's WLL volumes are stable, not reducing. This suggests that BT remains able to use its national ubiquity and incumbency advantage to retain both high market share and high prices. ITS offers excellent quality and pricing but is frequently faced with the multiple advantages of BT that a market entrant cannot replicate.

Wholesale Leased Lines regulation in the TAR

ITS understands that it may be difficult for Ofcom to reintroduce regulation in the CLA and increase regulation in the HNR, but we recommend that Ofcom considers these options carefully and analyses the risks associated with not doing so.
In any event, the WLL market must not be subject to further deregulation in any part of the country and Ofcom should consider, if Ofcom decides to not increase regulation, the introduction of increased reporting by and oversight of BT to gain a better understanding of the impact of competition on BT's operations in those markets.

Wholesale Leased Lines price regulation

INCA understands that the WFTMR charge control for WLL is a single large basket of Ethernet products, within which BT can set prices for individual products as it wishes as long as the basket complies with the CPI-0 overall control.
ITS has observed the price changes BT has made during the first three years of the WFTMR and is concerned that the significant pricing freedom afforded to BT through the large basket and no sub-baskets has enabled BT to apply nearly all the allowed price increases to the lower speed products, with only very limited increases to the VHB products, thus

[1] In the 2022/2023 Regulatory Financial Statements (RFS), which shows an Area 2 return of between 14.6% and 16.2% and the Area 3 return to be between 18.8% and 22%.

making the pricing curve more shallow with smaller price differences between each product speed variant.

Relative to the allowed price increases allowed by the CPO-0 charge control, BT is effectively reducing the prices for the VHB circuits where competition is keenest and where such price reductions can, therefore, cause the most harm to emerging competitors who are typically expected to undercut BT by at least 20%. In the WFTMR, Ofcom recognised the importance of the VHB circuits to BT's competitors:

"Although VHB price caps are above accounting costs, this is an important revenue source for competing networks and our view is that a reduction in price caps would reduce the incentive to invest in competing networks and would not promote investment." [WFTMR V4 para 1.170]

ITS considers that BT's pricing behaviour during the WFTMR indicates that it is very much exploiting the pricing freedom allowed within the large basket, and that this is causing harm to emerging competitors. ITS, therefore, recommends that Ofcom consider the introduction of smaller baskets or sub-baskets applicable to VHB products in a manner that BT cannot transfer the revenue reductions from the VHB price reductions to the less competitive lower speed circuits.

Convergence between the broadband and leased lines markets

There is much debate about the extent to which the increasing availability of full-fibre broadband and XGSPON means that business users are substituting the use of leased lines with fibre broadband connections.

Without a doubt, some users of leased lines will move to full-fibre broadband, but they will be primarily consumers of lower bandwidth and for whom the characteristics of leased lines (such as the security, lower latency and typically bespoke and short time-frame SLAs and SLGs). For the majority (and specifically larger users) of leased liens customers, the use of leased lines remains separate from the use of full-fibre broadband and the different characteristics of the two products are likely to result in the existence of two separate markets for eh foreseeable future.

The impact of BT exchange closures programme

With the expected closure of >80% of BT's current exchanges, the connection points at which WLL circuits are available will be dramatically reduced. ITS is concerned about the impact of these closures on the structure of the Ethernet product portfolio and pricing at both retail and wholesale levels. ITS is also concerned that the exchange closures programme appears to be offering BT's wholesale customers below cost connectivity to the enduring exchanges, at least during the transition phase. This could result in retail and wholesale customers being lured into a sense of certainty that could be completely overturned when BT later has to ensure that its product portfolio and accompanying pricing needs to be cost reflective. That potentially below-cost transitory pricing is also a further concern for competitive WLL providers, who compete with BT, but now has to compete against below-cost transition prices that will result in customers becoming further embedded into the BT network architecture.

Finally, ITS is concerned of how the exchange closures may impact on the boundaries of the CLA and HNR geographic markets. Any extension beyond the current scope of those markets would almost certainly have a hugely detrimental effect on infrastructure competition and investment in the WLL market.