

## DIRECTION REGARDING REMOVAL OF COST ORIENTATION OBLIGATION FOR MPF TRANSFER AND SMPF CONNECTION

**Decision with regards to the Direction under section 49 of the Communications Act 2003 and SMP Condition FAA4.1 imposed on BT as a result of a market power determination made by OFCOM in “Review of the wholesale local access market – Statement on market definition, market power and remedies” as published on 7 October 2010, that BT has significant market power in the market for wholesale local access services in the United Kingdom excluding the Hull Area**

### Background

1. On 7 October 2010, OFCOM published their statement entitled “Review of the wholesale local access market – Statement on market definition, market power and remedies” (the “**WLA Statement**”).
2. In the WLA Statement, OFCOM determined that BT held Significant Market Power (“**SMP**”) in the market for wholesale local access in the United Kingdom but not including the Hull Area.
3. As a result, OFCOM imposed a number of remedies on BT in order to address identified competition concerns. Those remedies included the SMP services condition FAA4 which applied to the market set out at paragraph 2 above.
4. FAA4 imposes a cost orientation obligation upon BT, as follows:

***FAA4.1** Unless Ofcom directs otherwise from time to time, the Dominant Provider shall secure, and shall be able to demonstrate to the satisfaction of Ofcom, that each and every charge offered, payable or proposed for Network Access covered by Condition FAA1 and/or Conditions FAA9, FAA10 and FAA12 is 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 including an appropriate return on capital employed.*

5. On 7 March 2012, OFCOM published their statement entitled “Charge control review for LLU and WLR services” (the “**LLU and WLR Statement**”).
6. In the LLU and WLR Statement, OFCOM set an SMP services Condition FAA4(A), which, among others, imposes an obligation on BT to take all reasonable steps to secure that, at the end of the Second Relevant Year, the Percentage Change in the charge for each of MPF Transfer and SMPF Connection is not more than RPI decreased by 11.3%. The charge ceiling applicable in the First Relevant Year is £33.54.
7. BT Currently offers MPF Transfer and SMPF Connection within the market described at paragraph 2 above. Information available to OFCOM now which was not available at the time of the LLU and WLR Statement indicates that the charge ceilings imposed by SMP services Condition FAA4(A) on MPF Transfer and SMPF Connection in the Second Relevant Year are likely to be below forward looking long-run incremental cost for each and every charge, and therefore on this basis these charge ceilings are not consistent with the SMP Condition FAA4.1. Therefore, OFCOM considers that paragraph FAA4.1 should not apply to MPF Transfer and SMPF Connection in the Second Relevant Year.

8. For the reasons set out in the explanatory statement accompanying this Direction, in accordance with section 49(2) of the Act, OFCOM is satisfied that this Direction is —

- (a) objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;
- (b) not such to discriminate unduly against particular persons or against a particular description of persons;
- (c) proportionate to what it is intended to achieve; and
- (d) in relation to what it is intended to achieve, transparent.

9. In accordance with section 49C of the Act, copies of this Direction have been sent to the Secretary of State and the European Commission.

10. For the reasons set out in the explanatory statement accompanying this Direction, OFCOM has considered and acted in accordance with its general duties set out in section 3 of, and the six Community requirements set out in section 4 of the Act in making this Direction.

### **Direction**

11. OFCOM hereby, in accordance with section 49 of the Act and under SMP services Condition FAA4.1, directs that SMP services Condition FAA4 shall not apply to MPF Transfer and SMPF Connection provided by BT in the market set out in paragraph 8(a) of the Notification to the WLA Statement, that is to say: wholesale local access services.

12. The effect of, and the reasons for making this Direction are set out in the accompanying explanatory statement.

### **Effective Date**

13. This Direction shall take effect on 1 April 2013.

### **Interpretation**

14. Except for references made to the identified services market in this Direction and subject to paragraph 18 below, words or expressions used in this Direction shall have the same meaning as they have been ascribed in the Act.

15. In this Direction —

- (a) “**Act**” means the Communications Act 2003 (c.21);
- (b) “**BT**” means British Telecommunications plc, whose registered company number is 1800000, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined in section 1159 of the Companies Act 2006;
- (c) “**First Relevant Year**” means the period beginning on 1 April 2012 and ending on 31 March 2013;

- (d) **“Hull Area”** means the area defined as the ‘Licensed Area’ in the licence granted on 30 November 1987 by the Secretary of State under section 7 of the Telecommunications Act 1984 to Kingston upon Hull City Council and Kingston Communications (Hull) plc;
- (e) **“LLU and WLR Statement”** has the meaning given to it in paragraph 5 of this Direction.
- (f) **“MPF Transfer”** shall be construed as having the same meaning as ‘MPF Connection charge – Singleton migrations (Transfer from WLR/SMPF or Change of CP migrations)’ has as provided by BT on its website for definitions and explanations of its products;
- (g) **“OFCOM”** means the Office of Communications as established pursuant to section 1(1) of the Office of Communications Act 2002 (c. 11);
- (h) **“Percentage Change”** has the meaning given to it in paragraph FAA4(A).5 of SMP services Condition FAA4(A);
- (i) **“Second Relevant Year”** means the period beginning on 1 April 2013 and ending on 31 March 2014;
- (j) **“SMP”** has the meaning given to it in paragraph 2 of this Direction.
- (k) **“SMPF Connection”** shall be construed as having the same meaning as ‘SMPF Connection charge, Basic Provide on existing narrowband, Simultaneous Provide of SMPF with narrowband, Singleton Migration (Transfer or change of CP migrations) from Narrowband, MPF, SMPF and ISDN/ Highway’, as provided by BT on its website for definitions and explanations of its products;
- (l) **“United Kingdom”** has the meaning given to it in the Interpretation Act 1978 (c.30);
- (m) **“WLA Statement”** has the meaning given to it in paragraph 1 of this Direction.

For the purpose of interpreting this Direction—

- (a) headings and titles shall be disregarded; and
- (b) the Interpretation Act 1978 (c. 30) shall apply as if this Notification were an Act of Parliament.

**Signed by**

**Marina Gibbs**

**Director Competition Policy**

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

**26<sup>th</sup> March 2013**

# Explanatory Statement

## Direction

### Background

On 7 March 2012, we published our Statement on the Charge Control Review for LLU and WLR Services (the “Statement”) which, among others, set charge controls related to certain LLU services under SMP services Condition FAA4(A).

These LLU services include MPF Transfer<sup>1</sup> and SMPF Connection<sup>2</sup> in relation to which the Statement set an aligned charge control ceiling. Specifically, the charge control requires BT (Openreach)<sup>3</sup> under paragraphs FAA4(A).1 and FAA4.2 of SMP services Condition FAA4(A) to set the charges for MPF Transfer and SMPF Connection in the First Relevant Year both at £33.54. In the Second Relevant Year of the charge control (2013/14) BT is required not to increase the charges for MPF Transfer and SMPF Connection by more than the Controlling Percentage. The Controlling Percentage applicable to MPF Transfer and SMPF Connection is specified by paragraph FAA4(A).8 as RPI decreased by 11.3 percentage points.

In the Statement, we set out our approach to setting the charge controls for MPF Transfer and SMPF Connection and, in particular, our rationale for aligning the charge controls for the two products.<sup>4</sup> We noted that the relative level of MPF Transfer and SMPF Connection affects the level of competition between CPs using MPF and WLR+SMPF to provide retail services and we justified our decision to align the charge controls based on the similar underlying engineering activities associated with these services. We noted that although there was some evidence for a very marginal difference in LRICs between MPF and SMPF variants (based on the CCA FAC information), the risk of wider unintended consequences to Openreach’s pricing structure as a result of our alignment approach was likely to be extremely low.<sup>5</sup>

MPF Transfer and SMPF Connection are also subject to SMP services Condition FAA4.1 (imposed as in the statement “Review of the wholesale local access market” of 7 October 2010) which requires that each of these charges is 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 including an appropriate return on capital employed (referred to as the “cost orientation obligation” in this document). This cost orientation obligation may be disapplied by a direction from Ofcom.

### Decision

Since the Statement, information has become available that indicates that by complying with its obligations in respect of MPF Transfer and SMPF Connection under SMP services

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<sup>1</sup> Referred to as “MPF Single Migration” in the Statement.

<sup>2</sup> Referred to as “SMPF Single Migration/Provide” in the Statement.

<sup>3</sup> Openreach is the access division of BT established by Undertakings in 2005. Whilst the proposed SMP services Condition in the Statement formally apply to British Telecommunications plc, Openreach is the division of BT which provides the LLU and WLR services we regulate. Therefore, we refer to Openreach as the supplier of wholesale LLU and WLR services.

<sup>4</sup> See paragraphs 4.25-4.87 of the Statement.

<sup>5</sup> See paragraphs 4.53-4.54 of the Statement.

Condition FAA4(A) in relation to the second year of the control, BT will be in breach the cost orientation obligation in respect of MPF Transfer and SMPF Connection under SMP services Condition FAA4.1. The definitive position will not be known until the 2013 Regulated Financial Statements are available, however, this will be after the start of the second year of the control.

When we made the decisions set out in the Statement, it was not our intention that the cost orientation obligation should impede BT's ability to set charges for each of MPF Transfer and SMPF Connection in accordance with SMP services Condition FAA4(A). Had we been aware of this risk at the time of the Statement, we would have expected to have disapplied the cost orientation obligation under SMP services Condition FAA4.1 in respect of these two products<sup>6</sup>. Accordingly, in order to achieve what we intended in the Statement, we are now making a direction that SMP service Condition FAA4.1 shall not apply to MPF Transfer and SMPF Connection in the Second Relevant Year. We are making this Direction now rather than waiting until the 2013 Regulated Financial Statements become available in order to remove the risk that BT will breach from the start of the second year of the control.

### **Legal Framework**

Sections 49A and 49B of the Communication Act 2003 (the "Act") set out the relevant procedures that must be followed for domestic and EU consultations respectively on directions. However, it is our view that these do not apply in this case.

Section 49A of the Act applies where the proposals are for the purposes of:

- (a) an SMP apparatus condition; or
- (b) any other condition set under section 45 where what is proposed would, in Ofcom's opinion, have a significant impact on a market for any of the services, facilities, apparatus or directories in relation to which Ofcom has functions under Chapter 1 of Part 2 of the Act.

We consider that Section 49A(1)(a) does not apply in this case because we are not proposing to give a direction for the purposes of an SMP apparatus condition. Section 49A(1)(b) also does not apply because in our view the Direction would not have a significant impact on a market for any of the services, facilities, apparatus or directories in relation to which we have functions under Chapter 1 of Part 2 of the Act. The Direction gives effect to our intention in the Statement which was fully consulted on and evaluated as part of our process in reaching that decision.

Section 49B of the Act applies where the proposals are of EU significance. Section 150A(2) of the Act sets out the cumulative criteria that must be satisfied in order for a proposal to be of EU significance.

We further consider that Section 49B does not apply because our decision to give a direction is not of EU significance, as defined under section 150A(2), in particular because in our opinion, given the nature and limited extent of the Direction we are giving, this decision

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<sup>6</sup> We note that as part of the decisions set out in the Statement, we waived the application of SMP services Condition FAA4.1 in relation to WLR Transfer and the main rental products (albeit for different reasons).

would not affect trade between Member States.<sup>7</sup> Again, the Direction gives effect to our intention in the Statement which was fully consulted on and evaluated as part of our process in reaching that decision.

## **Legal tests**

We set out below the basis on which we are satisfied that the legal tests applicable to the Direction we are making are satisfied, including our duties under sections 3, 4 and 49(2) of the Act.

### Sections 3 and 4 of the Act

Our general duties are set out in Section 3 of the Act. These include our principal duty in carrying out functions to further the interests of citizens in relation to communications matters and to further the interests of consumers in relevant markets, where appropriate by promoting competition.

Section 4 of the Act sets out our duties for the purposes of fulfilling Community obligations. In summary, these require that Ofcom acts in accordance with six Community requirements for regulation, namely: the promotion of competition; the development of the European internal market; the promotion of the interests of all EU citizens; non-discrimination; promoting efficiency and sustainable competition and the maximum benefit for consumers; and facilitating service interoperability and securing freedom of choice for consumers.

We consider that the Direction is consistent with our duties under sections 3 and 4 of the Act. In particular, we consider that the Direction is giving effect to the charge control for MPF Transfer and SMPF Connection imposed in the Statement.

We explained in section 8 of the Statement why we considered that the charge control will, in particular further the interests of citizens and of consumers in the relevant markets by the promotion of competition in line with section 3 of the Act. In particular, we outlined that the charge control seeks to ensure the availability throughout the UK of a wide range of electronic communications services. In imposing the charge control, we had regard to the desirability of promoting competition in relevant markets, the desirability of encouraging investment and innovation in relevant markets and the desirability of encouraging the availability and use of high speed data transfer services throughout the United Kingdom.

Further, we considered that, in line with section 4 of the Act, the charge control will, in particular, promote competition in relation to the provision of electronic communications networks and will encourage the provision of Network Access for the purpose of securing efficiency and sustainable competition in downstream markets for electronic communications networks and services, resulting in the maximum benefit for retail consumers.

### Section 49(2) tests

Ofcom may only make a direction where it is satisfied that the Direction is objectively justifiable, not unduly discriminatory, proportionate and transparent, in accordance with

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<sup>7</sup> The cumulative criteria that must be satisfied in order for a proposal to be of EU significance include the criterion that the proposal would, in Ofcom's opinion, affect trade between Member States (see section 150A(2)(d) of the Act).

section 49(2) of the Act. We set out below why we consider that the Direction fulfils those tests.

*Objective justification*

For MPF Transfer and SMPF Connection it is necessary to disapply the cost orientation obligation under SMP services Condition FAA4.1 since Openreach's compliance with the charge controls under SMP services Condition FAA4(A) will, on the basis of the information currently available, lead to it breaching the cost orientation obligation under SMP services Condition FAA4.1.

*Undue discrimination*

The Direction applies only to products provided by Openreach, so it affects all communication providers and therefore their customers equally.

*Proportionate*

We consider that the Direction is proportionate. We have limited the disapplication of the cost orientation obligation to the services affected (i.e. MPF Transfer and SMPF Connection) for the Second Relevant Year only.

*Transparent*

We consider that the Direction clearly sets out the position as to how the cost orientation obligation applies to this market. We consider that we have clearly identified the services that we consider should be exempted from the obligation in order to ensure that it is clear and unequivocal as to when the obligation does not apply.