

RESPONSE TO OFCOM

FUJITSU RESPONSE TO CONSULTATION ON WLR/LLU CHARGE CONTROL

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The glossary lists the terms and abbreviations that apply specifically to this document.

Note: The terms and abbreviations used in this document may have different meanings in other contexts.

TERM	DESCRIPTION

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1. BACKGROUND

On 13th April, Fujitsu UK announced its plans to invest up to £2bn building an open access next generation broadband infrastructure¹. The proposed network will be truly open access to all ISPs offering the end customer an unrivalled choice of services over a single physical connection. The network will provide superfast broadband services to at least 5 million households that would otherwise be unlikely to benefit from commercial investment. This has the potential to transform rural broadband in the UK.

In response to Fujitsu's announcement, Communication Minister Ed Vaizey said:

"Superfast broadband is already helping businesses grow and improving the lives of those able to access it. But many rural and hard to reach areas are missing out. The whole of the UK should be able to share in the benefits of broadband and we are determined to make that happen by the end of the Parliament. That is why the Government is investing over £500m in taking superfast broadband to everyone.

"I am delighted that Fujitsu along with Virgin Media, TalkTalk and Cisco share the Government's vision. The collaboration between these companies was exactly the sort of ambition and innovation the Government wanted to stimulate by removing barriers to broadband rollout. Fujitsu and their industry partners are pledging a substantial investment in the UK and it represents a deep commitment to the future success of this country."

The planned network architecture is based on fibre-to-the-home (FTTH) for the vast majority of homes and businesses using either regulated Physical Infrastructure Access (PIA) services from Openreach or self-build, and in the remainder of cases Fujitsu will use sub-loop unbundling.

The viability of any next generation access (NGA) network using PIA depends on the terms on which these wholesale access services are supplied. The current set of PIA services from Openreach (as defined in the reference offer) will not enable financially viable NGA networks, nor will they support an industrial and efficient scale of network. The services, and the manner in which Openreach is negotiating the development of the services, are almost identical to Local Loop Unbundling before Ofcom intervened through the Telecoms Strategic Review. A similar effort is now required from Ofcom to ensure that PIA services are fit-for-purpose: capable of supporting industrial scale operations, and of delivering a high quality of service of service to consumers.

The current level of PIA pricing, in particular, threatens not just the Fujitsu plans, but also other competing NGA investments and the Government's broadband strategy. Fujitsu believes that these prices are well in excess of efficiently incurred costs, and since Openreach also competes in downstream markets through GEA, it faces strong commercial incentives to maintain PIA prices at this high level.

The only solution is stronger regulatory intervention: Ofcom must set a charge control for PIA services. In the BDUK process companies will, in effect, be competing against BT for public funds. This process will help to determine the shape of the fixed communications market for the foreseeable future. It is vital, therefore, that funds are awarded to the companies which will deliver the greatest value to the public. In order to support this part of the Government's broadband strategy, and thereby fulfil its principal duty to further the interests of citizens and consumers, Ofcom must act quickly to ensure that fair, reasonable and non-discriminatory PIA terms and conditions can be taken into account during the BDUK process.

2. COMMENTS ON THE CHARGE CONTROL CONSULTATION

Fujitsu is interested primarily in PIA services and its pricing. We have therefore focussed on issues which relate directly to PIA in this response. As noted above, we believe that Ofcom needs to set a charge control for PIA services in addition to LLU and WLR. In the future, it may make sense to set these charge controls simultaneously since many of the underlying cost components are shared by all of these services. However, we also note that PIA lies upstream of LLU and WLR. It is important, therefore, that PIA services are developed and priced according to the specific requirements of PIA, and not as an afterthought to LLU and WLR.

In principle, Fujitsu agrees that similar methodologies and costing assumptions should be adopted when assessing the costs of LLU, WLR and PIA. However, there are circumstances in which the assumptions may need to be adjusted given that PIA lies further upstream. For example, the cost of capital estimates set out in the consultation appear to be appropriate for LLU and WLR. However, the low risks associated with the underlying duct and pole infrastructure may justify the use of a lower cost of capital for PIA pricing.

We agree that the same approach to asset valuation should be adopted when assessing the costs for LLU, WLR and PIA. Therefore, the RAV adjustment should be taken into account when assessing duct costs for PIA.

We believe that Ofcom's proposed approach to the treatment of the post-1997 assets is a good compromise given a very difficult asset valuation problem. We believe that for the purposes of setting regulated prices this is far more appropriate than the approach adopted by BT in the preparation of its regulatory accounts. A key consideration is the stability and predictability of the valuation and resulting regulated

¹ See http://www.fujitsu.com/uk/news/pr/fs_20110413.html

prices. The uncertainty caused by BT's change in valuation assumptions is damaging, and adds weight to the argument that BT's published costs are not an appropriate basis for regulated prices. We believe that a different valuation approach would be justified solely on the basis of reduced volatility in the valuation. However, we also agree with Ofcom's assessment that BT's valuation is no longer consistent with alternative approaches to replacement value. The indexation approach proposed in the consultation provides a much more credible asset valuation, which will be less volatile and more transparent, and is therefore more appropriate as a basis for regulated prices.

We also support the move to an indexation approach as it will lead to greater economic efficiency in the price level. Given the nature of the assets in question, and the likelihood of competition in the provision of these assets, we believe that there are efficiency reasons for greater reliance on historic cost valuations. This is particularly true for PIA services, where the very existence of the regulated product is an acknowledgement of the fact that competing investment in physical infrastructure is unlikely in the foreseeable future. In these circumstances, it is less important that prices are set to encourage investment in competing infrastructure, and more important that the incumbent does not over-recover costs².

Finally, we agree with Ofcom that the valuation should be adjusted to account for the fact that large scale infrastructure projects will be delivered at a discount to small project rates.

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² This can be interpreted in a number of ways. For example, it may imply that sunk costs should not be recoverable through regulated prices.