Narrowband Market Review

Response to Ofcom consultation on the proposed markets, market power determinations and remedies for wholesale call termination, wholesale call origination and wholesale narrowband access markets

Non-Confidential Version

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Foreword

On 1 December 2016, Ofcom published its consultation which covered five of the wholesale markets that underpin the delivery of retail fixed voice telephone services in the UK.

This submission is provided by Openreach, a line of business within British Telecommunications plc ("BT"), in response to proposals related to Openreach's product portfolio, namely wholesale fixed analogue exchange lines (WFAEL) and two digital exchange line markets, ISDN2 and ISDN30.

BT will provide a separate submission in response to proposals related to products within its Wholesale and Ventures line of business, namely wholesale call origination, wholesale call termination and certain interconnection products.

1. Executive Summary

1. In view of the rapid evolution of local access markets in the UK over recent years, Openreach agrees with Ofcom that deregulation in the traditional fixed voice markets is appropriate. We maintain in this response that Ofcom could and should go further by removing all regulation around the supply of Wholesale Line Rental (WLR) lines.

2. Openreach has been instrumental in the development of local access markets through its continued network investment and the development of its portfolio of services to meet the needs of Communications Providers (CPs) and their customers. Openreach currently provides copper based products to 443 CPs directly, and to many others indirectly via other CPs but Openreach faces clear commercial constraints in supplying WLR on terms that support the strategic ambitions of its customers, both the retail lines of business within the BT Group and other CPs, particularly given that regulation of the Wholesale Local Access (WLA) market supports competition in the supply of lines capable of making and receiving calls

3. Customers can now access services from a vast number of providers, over a range of network technologies including copper, fibre, cable and mobile. Furthermore, Ofcom cite the importance of **fixed and mobile networks becoming more and more interchangeable[1].** Ofcom's own research suggests the total number of fixed voice lines decreased by 0.3 million (1.0%) to 33.2 million in 2015, while the total number of mobile subscriptions, including handset, dedicated mobile data and machine-to-machine (M2M) connections, increased by 1.6 million (1.8%) to 91.5 million during the year.[2] It also shows that only a very small proportion of customers rely solely on fixed voice lines for their communications. Openreach therefore supports Ofcom's strategy as set out in the Digital Communications Review (DCR) that **deregulation of legacy services is appropriate when competition is effective[3].**

4. Whilst we understand why Ofcom has separated WLR from the WLA market review (i.e. for the purposes of separately considering the voice market), the forthcoming WLA consultations, which will include the review of charge controls on unbundled copper loops and revised QoS targets, will impact on the provision of WLR and ancillary services. Similarly Ofcom's Standalone Fixed Voice (SFV) consultation[4] has only recently been issued and it appears that these proposals will have a direct impact on the pricing of WLR services. It is vital that Ofcom takes account of the linkages across different policy reviews in reaching its conclusions. Until the impacts of these other consultations are fully understood, we reserve our position on commenting on the full impact on the Openreach portfolio.

5. **In summary:**

   - **Openreach agrees that Ofcom should remove the cost based charge control on wholesale fixed telephone lines (Openreach's WLR service)**. However the route to enabling this should be the removal of the finding that BT has Significant Market Power (SMP) on the defined Wholesale Fixed Access Exchange Line (WFAEL) market. Most UK households and businesses buy lines that provide the capability to make and receive calls at

[1] 2016 NBMR Consultation, para. 1.3.

[2] Ofcom, "*The Communications Market 2016*" (4 August 2016).

[3] DCR Statement, paragraph 1.65.

[4] Published on 28 February 2017

a fixed location as well as a broadband connection. It is accepted that these customers are served by suppliers using regulated WLA inputs as well as alternative access networks such as Virgin Media. This constrains the terms on which Openreach supplies WLR: our customers need to be able to compete effectively against WLA-based suppliers and Virgin Media. Ofcom has then wrongly suggested that Openreach could and would use the supply of WLR to distort competition for the supply of voice services to certain customer segments e.g. to SFV customers. Ofcom understates the competitive pressures applying to these segments. The additional impact of the launch of Openreach's Single Order Generic Ethernet Access (SOGEA) product during the review period should also be factored into Ofcom's assessment: it will offer an alternative to WLR as a means of providing a broad range of options to consumers about how they communicate i.e. whether by voice calls or other forms of direct messaging.

- **If Ofcom does find that BT has SMP in the WFAEL market, Openreach is concerned about how the "fair and reasonable charges" remedy might be applied, especially in light of the SFV proposals**. Ofcom proposes that the "fair and reasonable charges" remedy would prevent the imposition of a price squeeze in downstream markets. Ofcom is now also proposing to define a market for retail supply of SFV access and calls and to require BT to reduce its prices and not to increase them in real terms for the next three years. Ofcom suggests that the reduced prices would be the minimum necessary to support competition. This may imply that any increase in the WLR charge would create a price squeeze for competitors. However, significant inflationary pressures on WLR pricing are likely to arise within the control period, for example, cost increases arising from the need to achieve higher service standards and from changes to business rates. Ofcom must change or clarify their proposals across the reviews in order to avoid the risk that Openreach faces a squeeze on its ability to recover efficiently-incurred costs of supply as a result of the interworking of an inflexible downstream control on prices and the newly proposed upstream 'fair and reasonable' remedy.
- **Openreach welcomes Ofcom's proposals to remove regulation from the new supply of digital voice lines (known as ISDN)**. This recognises the vast degree of substitution between the ISDN portfolio and IP-based and other services.
- **In terms of regulatory reporting, we would have expected Ofcom to follow a clear policy of flowing through the proposed deregulation to reporting requirements**. However, Ofcom is not proposing any significant changes to reporting requirements. An example of this is WLR moving to 'fair and reasonable', which is not based on fully-allocated cost (FAC), but still requires the FAC to be published. We recommend that Ofcom should relax the reporting requirements in line with the proposed deregulation of prices.

2. Market definition and three-criteria test: WFAEL

Question 4.1: Do you agree with our provisional conclusion regarding market definition for WFAEL? Please provide reasons and evidence in support of your views.

Question 4.2: Do you agree with our provisional conclusion regarding the three criteria test for WFAEL? Please provide reasons and evidence in support of your views.

6. Ofcom proposes to define a market for Wholesale Fixed Analogue Exchange Lines (WFAEL): i.e. lines that are capable of making and receiving traditional calls at a fixed location. Ofcom then provisionally concludes that this market passes the three criteria test given, amongst other things, high barriers to entry.

7. WFAELs are used to supply voice services at the retail level. Data from 2015 suggests that 87% of households and 85% of businesses with fixed lines had a fixed access exchange line *and* a fixed broadband connection. The large majority of these customers also had access to mobile services. In fact, only 5% of households have been identified as only having access to a FAEL compared to 15% of households identified as mobile only (with no fixed connection).

8. As Ofcom acknowledges, given that customers are effectively required to purchase a FAEL in order to receive a fixed broadband connection[5], it is difficult to distinguish the extent to which customer demand for a FAEL is driven by their demand to make and receive calls and the extent to which it is driven by their demand for high speed broadband access. This presents significant practical difficulties in considering the strength of indirect constraints on the provision of a wholesale FAEL and, therefore, on defining markets.

9. However, we recognise that market definition is very much a means to an end in considering what, if any, regulation may be necessary to support effective customer choice in the supply of services. It is clear that while demand for fixed broadband lines is increasing, demand for fixed calls is falling. These trends are related; by having access to a broadband line and to mobile services the vast majority of customers face a wide choice of alternatives in how they choose to communicate with others: mobile calls, VOIP calls, OTT applications, email and social media are all clearly substituting voice calls, explaining ongoing falls in fixed calls and, since 2011, in total call volumes across fixed and mobile. The focus of regulation - the purpose for which markets are being defined in the first place - should be on supporting this customer choice.

10. Openreach's position is, therefore, that the precise market definition adopted in this review matters less than ensuring that full account is taken of the fact that competition in the supply of fixed voice services and alternative means of direct communication is primarily driven by regulation of the wholesale local access (WLA) market.

11. This has relevance both to the three criteria test applied to the defined WFAEL market i.e. in that barriers to entry in such a market are addressed by WLA regulation and to the finding of SMP.

12. In both regards, Ofcom's provisional position that the three criteria test is passed and that BT holds SMP in the defined WFAEL market is driven by concerns with competition for the supply of voice services to a minority of customers i.e. by customer segments or Groups of Interest whom Ofcom

[5] With only one low-volume exception identified in the consultation.

considers are *__not__* effectively served by Virgin Media and/or CPs using regulated WLA inputs.

13. Ofcom suggests that 38% of customers could fall into these segments. This appears to be based on an assessment of customers who are currently served by suppliers using WLR and who Ofcom assumes could not or would not be supplied by suppliers using WLA. We challenge these assumptions and the relevance attached to the percentage of customers categorised within these segments.

14. The majority of customers within these groups *__could__* be served by LLU based suppliers and/or by Virgin Media within their network footprint. In particular, the 13% of households identified by Ofcom as split purchasers (i.e. those who purchase a FAEL and broadband from different suppliers) and the 85% of business customers with fixed and broadband connections could clearly be supplied with a combined FAEL/broadband connection where competition is driven by WLA regulation. The presence of suppliers using WLA will therefore directly impact supply of WLR to any supplier wishing to provide service to these customers.

15. Even for those customers who currently do not purchase a broadband access line, Ofcom has not fully considered and analysed the forward-looking scope for competition and the competitive pressures this creates. Voice-only customers represent a shrinking customer segment; a proportion of households and businesses with voice only services at any point in time will choose to add broadband. This means that any CPs who supply combined FAEL/broadband lines are active in competing for the voice only segment at any point in time, albeit by offering customers an upgraded proposition, usually at low incremental charges. It is notable that CPs such as Sky and TalkTalk offer keenly priced entry level FAEL/broadband offerings to customers looking to upgrade.

16. Furthermore, even if the concern is that LLU providers are currently less active in directly competing for voice only customers who do not wish to add broadband, this does not mean CPs are incapable of serving this group nor that they will not become more active during this market review period. LLU providers have equipment in BT exchange buildings (MSANs) that allows them to supply FAEL voice only lines to customers if they choose. They may prefer to fully utilise their assets and extract higher value from customers by persuading customers to purchase a combined FAEL/broadband line rather than just a FAEL without broadband. However the incremental cost of connecting a standalone voice customer using spare MSAN capacity in exchanges would be low and acquisition of these customers will drive long term incremental value (especially given the potential for them to extend their services in the future). Ofcom should therefore assess the scope for increased competition for this segment based on regulation of WLA inputs.

17. Finally, to the extent that Ofcom believes that there are some customers for whom competition relies on access to WLR, Ofcom must recognise that a hypothetical monopolist supplier of WLR could not discriminate in the charges applied to customers on a line by line basis based on the segments they were looking to serve. Ofcom provisionally accepts this point when considering whether to segment the WFAEL market. This is also relevant in considering SMP in the defined market.

18. There is therefore a clear route for CPs to enter and/or expand the provision of services into the defined WFAEL and WCO markets by using regulated WLA inputs or – as Virgin is doing via their large investment in broadband digital infrastructure (Project Lightning) – in expanding network footprints.

19. As such, and contrary to Ofcom's proposal, it is clear that the three criteria test is not passed for the

defined WFAEL product markets:

a. Barriers to entry are low because suppliers can and do use regulated WLA inputs, as well as self-supply of WFAEL services to support competition at the retail level;

b. The market is clearly tending to effective competition - Ofcom itself accepts that SMP is 'weakening' but fails to reflect this trend in assessing this part of the test;

c. Competition law would be sufficient to address any concerns that might arise in this area.

20. As noted in response to Ofcom's question 6.1, many of these points are also relevant in considering whether Openreach has SMP in the WFAEL market.

3. Market Definition and three-criteria test: ISDN30 and ISDN2

Question 5.1: Do you agree with our provisional conclusion regarding market definition for wholesale ISDN30? Please provide reasons and evidence in support of your views.

Question 5.2: Do you agree with our provisional conclusion regarding the three criteria test for wholesale ISDN30? Please provide reasons and evidence in support of your views.

21. In summary, Openreach broadly agrees with Ofcom's provisional conclusion regarding market definition for wholesale ISDN30 but believes that Ofcom understates the degree of substitution and impact that IP-based services are having in the marketplace.

22. Openreach agrees with Ofcom that the most significant constraint on the supply of ISDN30 lines is from IP-based substitutes. In particular, and in relation to IP-based substitutes, Ofcom's own analysis and the wider supporting reports in support of this consultation suggests the following:

- More than 10% of respondents are already planning to migrate to IP-based services[6] (the implication being that in the next 3 to 4 years a large proportion of the existing base is likely to switch);
- If customers faced a SSNIP, 51%[7] would definitely or be more likely to switch away from ISDN30.
- 54% [8]of respondents said they would stop using ISDN30 before the start of the next market review period (September 2017).
- The prime substitute IP-based services, Hosted VoIP and SIP Trunks, have grown significantly (from 0.7m to 4.3m channels)[9] at the same time that the volume of Openreach's supply of wholesale ISDN30 channels has declined significantly (from 2.9m to 2.3m channels)[10].
- The strong growth of Hosted VoIP and SIP Trunks is forecast to continue[11] whilst the decline in wholesale ISDN30 is forecast to continue[12]. Ofcom should note that the rate of decline has increased over the first 9 months of 16/17, with rate of decline increasing 20% year on year and at its highest rate since the creation of Openreach.
- New businesses adopt IP-based services in the vast majority of cases in preference to ISDN30 services[13]. Openreach's research suggests that of those adopting SIP/Hosted Voice

[6] 2016 NBMR Consultation, footnote 246
[7] 2016 NBMR Consultation, footnote 244
[8] 2016 NBMR Consultation, para. 5.26
[9] 2016 NBMR Consultation, para. 5.28
[10] 2016 NBMR Consultation, figure 5.1
[11] 2016 NBMR Consultation, para. 5.28
[12] 2016 NBMR Consultation, paras. 5.24 and 5.25
[13] 2016 NBMR Consultation, para. 5.33

only 21% considered ISDN as an alternative.[14]

- Concerns about the quality, security and reliability of IP-based alternatives compared to ISDN30 services continue to reduce with less than 20% of respondents citing any concerns, 19% reliability,13% quality of service, 13% resilience and 11% security[15].
- 54% of ISDN30 users were aware of IP-based alternatives and 50% of those who were aware were planning to move to IP-based services.[16]

23. Ofcom's key reason for questioning the strength of the constraint offered by IP-based alternatives is an apparent lack of awareness by customers of the availability IP-based alternatives to ISDN30[17] and that although there is no doubt that demand for ISDN30 will continue to decline, there is uncertainty about the rate of decline in wholesale ISDN30[18]. Of those only with ISDN (56% of our sample of companies with multiple voice lines), only 40% were unaware of SIP and 35% unaware of Hosted Voice.[19]

24. As evidenced by the data provided in Ofcom's consultation and associated supporting supplemental reports, it is clear that the provision of IP-based alternatives provides a powerful constraint on the supply of ISDN30 services. The vast majority of ISDN30 customers see IP-based alternatives as direct substitutes and once customers become aware of the existence of IP-based alternatives, half make plans to switch. Awareness of IP-based alternatives will continue to grow as demand for Host Voice and SIP trunking services continues apace. Further, any significant price increase of ISDN30 would influence at least half of customers to switch, if they have not already done so. Moreover, new businesses now see IP-based alternatives as the standard service to purchase to fulfil ISDN30 type requirements.

25. Openreach accepts that for traditional ISDN30 new entry is unlikely given the infrastructure required to supply ISDN30 exchange lines[20] but that more competitive entry is certain in the provision of IP-based alternatives to ISDN30, given the high growth rates forecast for IP-based substitutes.[21] It is evident that Openreach is likely to maintain a high share in the supply of ISDN30 services[22], but a high market share in a terminally declining product could be viewed as a condition that often exists in a competitive market as demand for alternate substitutes grows and aggregate service volumes declines.

[14] Openreach market research, March 2016
[15] 2016 NBMR Consultation, para. 5.41
[16] Fig 104, Jigsaw market research report
[17] 2016 NBMR Consultation, para. 5.32
[18] 2016 NBMR Consultation, para. 5.30.
[19] Openreach market research, March 2016
[20] 2016 NBMR Consultation, para. 5.70
[21] 2016 NBMR Consultation, para. 5.28
[22] 2016 NBMR Consultation, para. 5.73

Question 5.3: Do you agree with our provisional conclusion regarding market definition for wholesale ISDN2? Please provide reasons and evidence in support of your views.

Question 5.4: Do you agree with our provisional conclusion regarding the three criteria test for wholesale ISDN2? Please provide reasons and evidence in support of your views.

26. In summary, Openreach broadly agrees with Ofcom's provisional conclusion regarding market definition for wholesale ISDN2 but as with ISDN30 believes that Ofcom underplays the degree of substitution and impact that IP-based services are having in the marketplace. .

27. Openreach agrees with Ofcom that the most significant constraint on the supply of ISDN2 lines is from IP-based substitutes.

28. In particular, and in relation to IP-based substitutes, Ofcom's market research suggests:

- more than 55% of respondents are already planning to migrate to IP-based services[23] ;
- if customers faced a SSNIP 49%[24]of respondents would definitely or be more likely to switch;
- 57%[25]of respondents said they would stop using ISDN2 before the start of the next market review period;
- a large proportion of respondents who are already considering migrating to IP alternatives cited, in addition to a lower cost, greater functionality and better service features[26]; and
- in common with ISDN30, growth of alternatives is expected to be very strong and ISDN2 decline is set to continue.[27] Openreach considers the rate of decline in ISDN2 will accelerate (which seems is consistent with Ofcom's analysis that 57% of respondents intend to switch during the market review period). Our most recent analysis of the decline in base volumes over the first 9 months of 2016/17 reveals that the decline in the base has increased 32% year on year compared to the first 9 months of 2015/16. This is the highest rate of loss over the first 9 months of financial year since 2008/09.

29. Ofcom should note that Openreach's market research[28] suggests that less than 12% of the ISDN2 base in survey sample had purchased the product in the previous two years compared to 41-45% for SIP/Hosted Voice. Moreover, only 14% of existing ISDN2 users plan to extend usage beyond their current ISDN2 installed estate. Further, of those adopting SIP/Hosted Voice only 21% considered ISDN as an alternative. These findings point to a very limited new demand for ISDN2 services. In common with its ISDN30 analysis, Ofcom's key reason for questioning the strength of the constraint offered by IP-based alternatives is an apparent lack of awareness of IP-based alternatives to ISDN2, and, concerns from a minority of customers over reliability and quality of IP-based alternatives[29].

30. Openreach considers that the supply conditions for ISDN2 are similar to those of ISDN30. It is clear

[23] 2016 NBMR Consultation, footnote 287
[24] 2016 NBMR Consultation, footnote 285
[25] 2016 NBMR Consultation, para. 5.94
[26] 2016 NBMR Consultation, para. 5.89
[27] 2016 NBMR Consultation, para. 5.102
[28] Openreach ISDN Market Research, March 2016
[29] 2016 NBMR Consultation, para. 5.101

from Ofcom's evidence that the provision of IP-based alternatives provides a powerful constraint on the supply of ISDN2 services. The vast majority of ISDN2 customers see IP-based alternatives as direct substitutes. Once ISDN2 customers become aware of the existence of IP alternatives more than half of them make plans to switch. Awareness of IP-based alternatives will continue to grow as demand for alternatives services continues apace. Furthermore, any significant price increase of ISDN2 would influence around half of customers to switch, if they have not already done so. Moreover, a significant proportion of those considering IP alternative deem them to be superior to ISDN2 services for their purpose.

31. Openreach accepts that traditional ISDN2 new entry is unlikely given the infrastructure required to supply ISDN2 exchange lines[30] but believes that more competitive entry is certain in the provision of IP-based alternatives to ISDN2, given the high growth rates forecast for IP-based substitutes. It is evident that Openreach is certain to maintain a 100% share in the supply of wholesale ISDN2 services [31] as it is the only operator which has invested in a platform to supply exchange line based ISDN2 service. However, Openreach does not accept that this indicates a lack of countervailing buyer power given the ready availability of superior IP-based alternatives for the majority of customers. Whilst we understand Ofcom's viewpoint as proposed in their consultation regarding the three-criteria test, Openreach considers that the competitive constraints are stronger than Ofcom suggests and even if not part of this review, will definitely change during the subsequent market review period.

[30] 2016 NBMR Consultation, para. 5.133
[31] 2016 NBMR Consultation, para. 5.137

4. SMP analysis: WFAEL, ISDN30 and ISDN2

Question 6.1: Do you agree with our provisional conclusion that, during the period covered by this market review, BT and KCOM will have SMP in the WFAEL markets? Please provide reasons and evidence in support of your views.

32. We agree with Ofcom that mobile and other services outside the market are a greater competitive constraint than at the time of the last Narrowband Market Review[32]. However Ofcom could and should have gone further in concluding that BT (Openreach) does not hold SMP in the defined market; we do not have the ability to act independently of other suppliers.

33. BT's market share in the WFAEL market has declined from 68% to 55% between Q1 2012/13 and Q4 2015/16[33]. This trend reflects the extensive rollout of LLU-based networks, the increased capability of Virgin Media's cable network and increasing take-up of FAEL/broadband bundles.

34. Ofcom's concern seems to be that Openreach could supply WLR on terms that will benefit downstream BT by reducing the ability of other CPs using WLR and WCO to compete. Putting aside the fact that Openreach sets its own commercial policy without influence from other parts of BT, Ofcom has not attempted to identify what net benefit would be seen by BT at the Group level if Openreach attempted to pursue a distortionary/exclusionary strategy in the supply of WLR. There is a clear risk that any end customer who is currently served by or could potentially be served by a CP using WLR would, if that CP had to increase its prices to remain profitable, divert to being served by Virgin Media or an LLU-based provider. This would result in lower volumes of services utilising our voice assets.

35. There is no question that competition for the provision of combined FAEL/broadband connections (and calls over those connections) is effective. So a distortionary pricing strategy would not be rational. The stated concern must therefore only relate to the supply of services to the customer segments/Groups of Interest currently being served by WLR connections. We have shown above that Virgin Media and/or LLU-based operators will have the ability to compete for many, if not all, of the customers in these Groups. This would make the pursuit of a distortionary pricing strategy on WLR and/or WCO irrational for these customers. Furthermore, notwithstanding the degree of competition for these groups, it would require discriminatory supply at the wholesale level in relation to lines used to supply these groups – something Ofcom rightly considered unlikely when assessing whether to segment defined product markets.

36. For these reasons, Ofcom should revisit its provisional decision on SMP in the WFAEL market.

Question 6.3: Do you agree with our provisional conclusion that, during the period covered by this market review, BT and KCOM will have SMP in the wholesale ISDN30 market? Please provide reasons and evidence in support of your views.

37. Openreach broadly agrees with Ofcom's provision conclusions that BT will have SMP in the wholesale ISDN30 markets during the market review period.

[32] Ofcom, 2014 FAMR Statement
[33] 2016 NBMR Consultation, para. 6.7

38. Openreach agrees that there is an increasing level of substitutability with IP-based services and that these alternatives limit the extent of BT's power in the ISDN2 and ISDN30 markets.[34] Openreach also agrees that the constraint exerted by these "out of market" substitutes is increasing over time and will diminish BT's market power over the period of the review and beyond[35], especially for new supply[36].

Question 6.4: Do you agree with our provisional conclusion that, during the period covered by this market review, BT and KCOM will have SMP in the wholesale ISDN2 market? Please provide reasons and evidence in support of your views.

39. Openreach broadly agrees with Ofcom's provision conclusions that BT will have SMP in the wholesale ISDN2 markets during the market review period. However, it is clear that the increasing supply and demand for IP-based substitutes during the review period will significantly constrain BT's ability to act independent of the market.

[34] 2016 NBMR Consultation, para. 6.88
[35] 2016 NBMR Consultation, para. 6.88
[36] 2016 NBMR Consultation, para. 6.78

5. Remedies on BT: WFAEL, ISDN2 and ISDN30

Question 7.1: Do you agree with the remedies that we propose for BT in the WFAEL, WCO, wholesale ISDN30 and wholesale ISDN2 markets? Please provide reasons and evidence in support of your views.

40. Ofcom's proposed remedies are summarised in Tables 7.1 (WFAEL) and 7.2 (ISDN30 and ISDN2) of the Consultation Document.[37]

41. Notwithstanding our view that a finding of SMP is inappropriate as per our comments above, if Ofcom does find that BT has SMP in the WFAEL market as defined in the proposals, then Openreach broadly agrees with the proposed remedies for WFAEL. In relation to Wholesale ISDN30 and Wholesale ISDN2 we broadly agree with the proposed remedies. Subject to the comments below, Openreach generally welcomes the proposals to reduce regulation on BT in recognition of market developments and the reducing SMP that Ofcom has observed, in particular (paragraph 7.6 of the Consultation Document):

- Removal of charge controls and replacing these with fair and reasonable charges obligation in the WFAEL market;
- Removal of most remedies on newly installed lines in the wholesale ISDN30 and ISDN2 markets (after a transitional period);
- Removal of the new forms of access requests remedy in all three markets; and
- Removal of the requirement to notify technical information in all three markets.

42. Ofcom also proposes to include a requirement to provide general network access on fair and reasonable terms, and specific access in the form of WLR in those three markets, as well as charge controls for ISDN30 and ISDN2 for existing lines, and quality of service (QoS) remedies in all three markets (paragraphs 7.4-7.5 of the Consultation Document).

43. In this section 5, we set out Openreach's comments on Ofcom's proposed remedies (set out in Section 7 of the Consultation Document). Openreach's specific comments on the proposed charge controls, QoS and regulatory financial reporting remedies[38], are covered respectively in sections 6, 7 and 8 below.

Competition concerns

44. Ofcom's proposed remedies are aimed at addressing the competition concerns it identified in the narrowband markets where it proposes that BT has SMP, these include (paragraphs 7.9-7.10 of the Consultation Document):

    a. Refusing to supply access at the wholesale level and thus restricting competition in the provision of products and services in the relevant downstream markets;

    b. Setting charges that, in combination with retail prices, amount to a price squeeze;

[37] BT's comments on Ofcom's proposals for remedies in the WCO market are covered in BT's separate response related to products within its Wholesale and Ventures line of business.
[38] Set out in Sections 8, 9 and 19 of the Consultation Document.

c. Providing access on less favourable terms compared to those obtained by BT's own downstream business; and

d. (in relation to existing wholesale ISDN30 and ISDN2 lines) setting excessive charges.

45. We disagree that, if such competition problems existed, competition law remedies would be insufficient to address those (paragraph 7.11 of the Consultation Document). If BT had SMP (which we dispute for the reasons set out in Section 4 above), competition law already prohibits refusal to supply, discriminatory dealings, excessive pricing and prices that result in margin squeeze, set by dominant firms. Moreover, Ofcom's concerns expressed in the Consultation Document pre-date BT's notification of 10 March 2017 under Article 13b and Section 89C Communications Act 2003, under which Openreach Limited will be formed as a functionally separate legal entity subject to the obligation to treat all customers equally ("BT's Section 89C Notification"). We consider that Ofcom's concerns in relation to access, discrimination and restricting competition cannot subsist in light of BT's Section 89C Notification. Furthermore, we do not accept that Ofcom's analysis in Sections 4, 5 and 6 of its Consultation Document established that these are legitimate competition concerns. In particular:

a. Putting aside issues with market definition and the finding of SMP, it is accepted that Openreach supplies WLR to a wide range of customers in competition with, among others, Virgin Media and suppliers using unbundled copper loops, such as Sky and TalkTalk. Refusing to supply WLR to those wholesale customers, or supplying on charges that amount to a price squeeze or on less favourable commercial terms to those obtained by BT's own downstream businesses, has not been shown by Ofcom as a strategy that would be beneficial to BT. We consider that this could be demonstrated by Ofcom carrying out an analysis of propensity to switch. An end-customer being served by the WLR CP might move to a downstream BT business, but might also move to an LLU CP, or off the Openreach network altogether. Openreach's ability and incentive to distort downstream competition via WLR supply and/or pricing is not properly examined or evidenced by Ofcom.

b. Ofcom has not proposed to segment the WFAEL market, on the basis that Openreach sets standard charges for all WLR customers, whether they serve standalone fixed voice customers or dual play customers or residential or business customers. However, Ofcom's competition concerns appear to be based on an underlying assumption that Openreach could pursue an exclusionary strategy on WLR, driven by its ability to derive benefits for sales to these segments. Again, Openreach's ability and incentive to act in this way is not examined or evidenced in any detail.

c. Ofcom has not considered the constraints on Openreach's decision-making arising from the BT Undertakings and, following their removal, BT's Section 89C Notification[39]. Undertakings. The competition concerns are all based on supposed advantages that would arise in other BT lines of business over the longer term as a result of Openreach's behaviour. This implies alignment between different parts of BT in deciding Openreach's Commercial Policy. This disregards the prohibition to influence or attempt to influence,

[39] Ofcom proposes to remove the BT Undertakings on the basis of BT's Section 89C Notification. See https://www.ofcom.org.uk/consultations-and-statements/category-3/delivering-a-more-independent-openreach

the Commercial Policy of Openreach (section 5.38.1 of BT Undertakings). Moreover, BT's Section 89C Notification requires Ofcom to carry out co-ordinated market reviews to assess the impact of BT's plans for enhanced functional separation.[40] Given that Ofcom considers that BT's Section 89C Notification addresses its competition concerns concerning Openreach's independence and potential incentives to discriminate, it would be appropriate for Ofcom to revisit the competition concerns expressed in its Consultation Document and review the need for a fair and reasonable condition in the WFAEL market.

Approach to imposing remedies in the wholesale ISDN30 and ISDN2 markets

46. Ofcom's proposals distinguish between existing ISDN lines (installed before the end of the transitional period) and new ISDN lines (installed after the transitional period). For the former, it proposes remedies to address its concerns relating to excessive wholesale pricing, price squeeze and ensuring continues access. For new ISDN lines, after a transitional period, Ofcom proposes to remove all remedies, other than regulatory financial reporting remedies (paragraphs 7.15-7.18 of the Consultation Document).

47. Openreach agrees with the distinction between existing and new services, and that relaxing regulation on new services after the transitional period is appropriate, in particular given the number of substitute products that are available. We would expect that in the next charge control, regulation would reduce even further and also be removed from existing services.

48. It is clear from Table 7.2 that after the transitional period, charge controls and fair and reasonable remedies will only apply to existing ISDN lines. This is confirmed in paragraph 7.18 of the Consultation Document: *"With regard to new lines, we propose to remove most remedies, including network access requirements and all charge controls, after a transitional period. The only remedies that we proposed to apply to new lines following that transitional period are regulatory financial reporting remedies, as we propose accounting separation and cost accounting obligations in respect of all ISDN lines for the whole period of the review."*

49. Ofcom proposes to define new lines as *"lines which require new installation at the end user's premises, rather than the connection of additional channels to an existing installed line*" (paragraph 7.19 of the Consultation Document). We understand and agree with this definition, not least for practical implementation purposes.

50. However, some confusion is introduced by paragraph 7.60: *"Our proposed fair and reasonable obligation in the wholesale IDSN30 and ISDN2 markets would also apply in the event that no other control does i.e. on new services not subject to the proposed charge control…".* We understand that here "new services" relates to new product features that are purchased alongside the charge controlled ISDN2 or ISDN30 products, and does not refer to new services connected after the transitional period. We would welcome greater clarity on this in the final statement.

51. Ofcom is seeking views on the proposed 12 month transitional period for new ISDN lines (paragraphs 7.21-7.24 of the Consultation Document). As set out in section 6 below, we believe it would be beneficial to align price reviews across market reviews and therefore we propose the first control period ends on 31 March 2018, with the second period starting on 1 April 2018. We suggest that the transitional period is limited to the first six month period of the control. We believe this would provide a sufficient transitional period for CPs to amend their plans and commence any necessary

[40] Section 89C(4) Communications Act 2003 and Article 13b.2 Access Directive**.**

contract negotiations. Given that this Consultation Document already gives CPs direction to inform their planning, ending the transitional period on 31 March 2018 gives CPs over 15 months to adjust their plans to the new regulation.

Requirement to provide network access on reasonable request on fair and reasonable terms

52. Ofcom proposes an SMP condition requiring BT to provide network access where a third party reasonably requests it, in the WFAEL, wholesale ISDN30 and wholesale ISDN2 markets (for all ISDN lines in the transitional period, and subsequently for exiting lines only). The proposed condition will require BT to provide network access on fair and reasonable terms and conditions (paragraph 7.31 of the Consultation Document).

53. Ofcom also proposes that all WLR charges (including ancillary services), and all charges for existing ISDN lines (and for all ISDN lines during the transitional period) will be subject to an SMP fair and reasonable pricing obligation (paragraphs 7.52 and 7.57 of the Consultation Document), without corresponding reporting obligations (paragraph 7.53 of the Consultation Document).

54. Openreach agrees with Ofcom's proposals to remove the cost based charge control on WFAEL (paragraph 7.42 of the Consultation Document) and its non-application to new ISDN lines after the transitional period (paragraph 7.49 of the Consultation Document). Our comments on the proposed charge controls for existing ISDN2 and ISDN30 lines and regulatory financial reporting remedies are set out in sections 6 and 8 below.

55. In respect of WFAEL, at paragraph 7.42 of the Consultation Document, Ofcom states: "*A charge control on BT might be appropriate if our primary concern was to address the risk of excessive wholesale pricing. However, our competition concern is… to protect against a price squeeze and protect downstream competition. Given BT's weakened SMP, we consider it appropriate to permit BT some flexibility in wholesale pricing.*" This indicates that Ofcom's primary concern is not with the absolute level of the WLR charge per se (which will be constrained by the market given the presence of Virgin and LLU-based operators), but with its level relative to prevailing downstream charges.

56. Ofcom adopts a similar position in relation to ISDN2 and ISDN30, albeit where the absolute price level would also be constrained by the proposed charge control e.g. at paragraph 7.59 of the Consultation Document, Ofcom states: *"We do not intend the requirement for fair and reasonable charges to establish any additional constraint **over and above the proposed charge control remedy** on the maximum wholesale prices that BT can charge in relation to the products and services to which the charge controls specifically apply, except in as far as lower prices might be necessary to satisfy the requirement not to impose a price squeeze."* (Emphasis added).

57. Notwithstanding our position that it is inappropriate for Ofcom to impose any remedies on the defined WFAEL market, Ofcom should confirm that although the fair and reasonable charges remedy is proposed primarily in order to prevent an *ex ante* margin squeeze (paragraph 7.50 of the Consultation Document), this would be applied flexibly. [CONFIDENTIAL]

58. However, we are concerned about the way Ofcom may assess BT's compliance with such fair and reasonable charges remedy in particular in relation to the supply of WLR taking into account its proposals in relation to the supply of Standalone Fixed Voice (SFV) services, published for consultation on 27 February 2017.

59. In the Consultation Document, Ofcom states[41] that "*… our primary ex ante concern is in relation to the risk of adverse effects arising from BT fixing and maintaining its wholesale charges at a level that creates a price squeeze, thus undermining effective competition in downstream markets*." Ofcom goes on to state that "… *we propose adopting an approach to the evaluation of costs and margins consistent with that which would be adopted under ex post competition law*".

60. The concern with price squeeze under competition law is that margins between wholesale input prices and downstream retail prices are insufficient to allow profitable competition between the vertically integrated supplier and other competitors reliant on the wholesale input. Competition may be distorted by the pricing of the wholesale input product. Under competition law, the margin is usually assessed on an "equally efficient operator" (EEO) basis – i.e. by reference to the vertically integrated suppliers' retail level costs. In the case of WFAEL, this would imply that if the margin downstream parts of BT make on top of the WLR charge is sufficient to cover the retail costs of supplying a relevant line rental package, then the WLR charge must be fair and reasonable. Other efficient downstream players could purchase WLR and compete profitably against BT.

61. Beyond the general statement about consistency with competition law, Ofcom does not set out detail of how compliance with the fair and reasonable charges SMP obligation would be assessed. As noted, WLR is used by a wide range of customers to compete in the supply of different downstream services e.g. to provide different WFAEL, calls and broadband packages to residential and business customers. We would expect the focus of any margin assessment to be on defined downstream markets and that, where bundles of services from across markets are supplied, Ofcom would look at the combined costs and revenues across all elements of the bundle. For example, WLR charges are already included in Ofcom's assessment of margins made on the supply of superfast broadband packages as part of the "VULA margin" SMP remedy but margin is calculated by reference to all the costs and revenues associated with BT's superfast bundles i.e. lines, calls, superfast broadband, BT TV, BT Sport and BT mobile. We again note here that Openreach would not have the ability and/or incentive to set WLR charges in a way that distorts competition in the supply of bundled services given that competition in the downstream markets is from Virgin Media and LLU-based operators.

62. However, Ofcom has now published its proposals in relation to the supply of Standalone Fixed Voice (SFV) services i.e. analogue access lines and calls to residential customers and proposes to define distinct markets for SFV access and SFV calls services. We will respond to Ofcom's proposed market definitions as part of that consultation, but – as proposed – this would suggest Ofcom may focus on potential distortive effects of WLR charges on competition in SFV markets – i.e. Ofcom may assess whether a price squeeze arises in the supply of SFV services.

63. However at the same time, Ofcom is also proposing to require BT Consumer to immediately reduce the retail price of SFV access lines and to keep average call charges flat in real terms in the first year of the new regulatory rules. In the second and third years, Ofcom proposes to require BT Consumer to keep average prices across a basket of SFV access and calls services flat in real

[41] The review of the market for standalone landline telephone services published 28 February 2017 para 7.50

terms. Ofcom's recommended approach is to require BT Consumer to set prices at a level at which Ofcom believes effective retail competition would be profitable.

64. Again, BT will respond to the specific detail of Ofcom's SFV proposals as part of that consultation. However, Openreach is concerned that the effect of Ofcom's retail level proposals could be to place a solid upper bound on the level of WLR prices for the duration of this market review. This is because Ofcom's proposals around the minimum level of retail charges for SFV services that would support effective competition are based on *current* WLR (and WCO) charges. If prices of SFV services are then constrained at that level for the three years of this market review, there would be limited flexibility for Openreach to increase WLR charges before margin was reduced to levels that did not support competition.

65. This then raises potential concerns about Openreach's ability to ensure WLR charges are set at levels that allow recovery of the efficiently incurred costs of supply. By proposing not to set a charge control in the WFAEL market, Ofcom has not assessed future cost movements for WLR. However there are potentially significant inflationary pressures over the period of this market review which should not be ignored. In particular, we are expecting a significant increase in BT's annual cumulo business rates which will apply across all market sectors during this market review period. Similarly we could face higher costs of meeting any increases in minimum service levels.

66. Ofcom's consultation on the future price regulation of LLU is expected at the end of March 2017. This is expected to consider the future costs of providing such loops and will need to take account of higher cumulo rates and service costs. Subject to consultation responses, Ofcom will need to decide whether this could mean the costs of supplying LLU increased by more than CPI each year. If it did, it would imply that the cost of WLR would also rise. Under these circumstances, Openreach should not be required to keep WLR prices below cost because of the combined requirements to set fair and reasonable WLR charges and for BT Consumer to set SFV prices in line with remedies arising in that review . It is therefore critical that Ofcom's proposals across three separate reviews – this narrowband market review, the SFV review and WLA market review (and associated charge control) – are fully aligned. [CONFIDENTIAL]

67. In light of the above, we reserve our position to make further comments on the specific fair and reasonable charges remedy proposed in the WFAEL market in light of full consideration of the evidence, analysis and proposals within the other reviews, and BT's Section 89C Notification.

68. In conclusion, Ofcom should reconsider its position in relation to a fair and reasonable remedy in light of weakening SMP and the changes arising from BT's Section 89C Notification. In relation to SFV customers (where Ofcom has a residual concern), the flexibility of a fair and reasonable remedy could be illusory if downstream BT were to be subject to a charge control, and lead to conflicting regulation if WLR prices have to increase to keep pace with costs. If notwithstanding the above Ofcom is minded to impose a fair and reasonable condition as well as downstream conditions on BT, Ofcom should acknowledge the tension and set out the circumstances in which it would enforce a margin squeeze, e.g. only where there is strong evidence of actual harm.

69. Finally, noting all the points above, if BT is found to have SMP for WLR services, and if a fair and reasonable condition is imposed, then we would agree with Ofcom that ancillary charges should be subject to the same fair and reasonable pricing obligation as the WLR product. However, this should apply only to those ancillary products that are reasonably necessary for the provision of network access or for the use of these services[42].

[42] Given that there are products covered by the NBMR which are very similar in nature to products in the WLA, it is possible that regulation under the WLA could constrain products in the NBMR. We would expect that Ofcom will apply consistent remedies across these charge controls.

6. Remedies on BT: ISDN30 and ISDN2 charge controls

Question 8.1: Do you agree with our charge control proposals for BT in the wholesale ISDN30 and ISDN2 markets? Please provide reasons and evidence in support of your views.

70. Openreach broadly agrees with Ofcom's proposals for charge controls in the wholesale ISDN30 and ISDN2 markets, subject to the comments below.

71. We understand that Ofcom is seeking to reflect the competition in the demand for new services by removing price regulation on new services, whilst protecting existing customers who may have barriers to switch by charge controlling existing services. We agree that such relaxation of regulation is appropriate.

72. However pricing should only be subject to one form of regulation. The existing services are proposed to be subject to a charge control and fair and reasonable charges. We do not believe the double obligation provides any additional benefit for the customers and would suggest removing the fair and reasonable charges obligation. This approach was used by Ofcom for many services in the FAMR in 2014[43].

73. In purely practical terms, given the low volume of new services forecast it is unlikely Openreach could justify the necessary investment in billing systems that would allow new and existing services to be identified and then priced separately. As a result, the different regulatory approach for new and existing services is expected to have little practical impact.

74. Regarding the structure of the proposed charge control, this follows the current structure. We have not identified any particular problems arising from this structure to date.

Aligning Regulatory Charge Control Periods

75. Charge controls will be in place on ISDN2 and ISDN30 from 1 October 2017 (according to Ofcom's timetable for the NBMR). The WLA charge control is expected to commence in early 2018. There will be products across both charge controls where there are valid reasons to align prices. If prices change for the ISDN related products in October and for the MPF related products in April, prices could be pushed out of alignment. Given this, Ofcom should align the charge control periods to Openreach Financial Years. This would have the benefit of better aligning any future WLA charge control (were Ofcom to conclude that this is required as part of the relevant process), meaning that linked products would have price reviews at the same time.

76. Openreach therefore recommends that Ofcom sets the first regulatory period under the NBMR to end on 31 March 2018 and thereafter follows Openreach's financial years. This will allow Openreach to undertake annual price reviews for WLR/ISDN2/ISDN30 and LLU at the same time, based on inputs taken from the same year's Regulatory Financial Statements (RFS), ensuring that the relative prices do not cause any inefficient activity within the market.

[43] See condition 1,3 (b) (i) of the FAMR legal instrument.

7. Quality of service remedies on BT: WFAEL, ISDN2 and ISDN30

Question 9.1: Do you agree with our quality of service proposals for BT in the WFAEL, wholesale ISDN30 and wholesale ISDN2 markets? Please provide reasons and evidence in support of your views.

Proposed remedies – Quality of Service

77. Ofcom is proposing a Quality of Service SMP condition for WFAEL requiring BT to comply with such conditions relating to quality of service as Ofcom directs from time to time.

78. Under this condition, Ofcom is proposing to:

- retain the existing provision and repair QoS standards for WLR, pending a comprehensive review of those standards that will be consulted on through the WLA market review;
- retain the existing directions setting KPIs for WLR (including the requirement for BT to publish a sub-set of those KPIs on a publicly accessible website), pending a comprehensive review of those KPIs in the WLA market review.

79. Openreach agrees that Ofcom should look at QoS issues across the WFAEL and WLA markets as part of a comprehensive review. Openreach will address any QoS issues in its response to the WLA market review

80. Openreach agrees that there is no need for any specific QoS standards to be imposed on wholesale ISDN30 and ISDN2 via SMP conditions.

81. Finally, Ofcom considers that the 2008 SLG direction is still appropriate and should therefore continue to apply in all three markets, namely WFAEL, ISDN 30 and ISDN 2 (see para 9.50).

Proposed remedies – KPIs

82. As mentioned above, Ofcom is also proposing to keep the requirement to publish KPIs in the WFAEL market (WLR) unchanged pending a comprehensive review of reporting requirements as part of the WLA QoS review[44].

83. Ofcom is proposing to maintain the SMP condition regarding the publication of KPIs in the ISDN2 and ISDN30 markets and to remove the requirement to publish provision KPIs[45]. This is in line with Ofcom's intention to focus regulation in that market on existing lines rather than new lines[46]. Publication and monitoring of performance indicators ensures that any potential issues in these markets are identified and addressed quickly.

84. Whilst we have set out above our position regarding Ofcom's proposed finding of SMP, we do not object to Ofcom's proposals.

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44 2016 NBMR Consultation, para. 9.54
45 2016 NBMR Consultation, para. 9.2
46 2016 NBMR Consultation, para. 9.57

8. Regulatory financial reporting

Q19.1: Do you agree with our proposals for BT and KCOM's regulatory financial reporting? Please provide reasons and evidence in support of your views.

85. In terms of regulatory reporting, we would have expected Ofcom to follow a clear policy of flowing through the proposed deregulation to reporting requirements. However, Ofcom is not proposing any significant changes to reporting requirements. An example of this is WLR moving to 'fair and reasonable', which is not based on fully-allocated cost (FAC), but still requires the FAC to be published. We recommend that Ofcom should relax the reporting requirements in line with the proposed deregulation of prices. We consider that such association between pricing remedies and reporting remedies could be best achieved via an overall framework for regulatory financial reporting.

86. Our comments on Ofcom's proposals are set out below. Please note that should Ofcom propose to re-introduce regulatory financial reporting for retail services, we will review such proposals in the context of the relevant consultation[47].

87. Before we comment on Ofcom's specific proposals, we make introductory comments on the need for a framework for regulatory reporting.

A framework for regulatory reporting

88. We propose that Ofcom should create a framework for regulatory financial reporting (the 'framework'), which defines the information provided to Ofcom and published for other stakeholders. Such a framework should be relevant in the context of all market reviews, providing a clear association between pricing remedies and reporting remedies, giving stakeholders clarity and certainty over the information required to be disclosed.

89. In addition to ensuring that stakeholder needs are consistently met, such framework should lead to a reduction in the complexity and volume of regulatory financial reporting. Specifically, removing the obligation to provide stakeholders with information which adds no or little value, or relates to items which are not material, will improve transparency for stakeholders and reduce the cost of compliance, to the benefit of all stakeholders.

90. We consider that such framework would complement Ofcom's review of regulatory financial reporting which began with a call for inputs on 8 November 2011. The conclusions of the review were published in Ofcom's statement of 20 May 2014, followed by its statement of 30 March 2015 on Directions for Regulatory Financial Reporting. We consider that in order to complete the work of the reporting review, Ofcom should develop a framework that covers reporting (including criteria for publication).

Proposed Directions to implement regulatory accounting requirements

91. We do not agree with Ofcom's view that an Adjusted Performance Schedule is not required for the markets considered in this review. We set out our views on each market in turn below.

[47] The review of the market for standalone landline telephone services published 28 February 2017 para. 9.33

Proposed Direction specifying requirements in relation to the preparation, delivery, publication, form and content of the RFS

Distinction between public and private information

92. Ofcom's proposals relating to reporting requirements and the distinction between public and private information are based on the approach set out in the 2014 Regulatory Financial Statement, which Ofcom reiterates here[48].

93. In particular, Ofcom considers that the public information category should include information that would give stakeholders reasonable confidence that BT has complied with its SMP conditions, allow them to contribute to the regulatory regime, and "is consistent with the level of the remedy"[49]. On the other hand, private information provided by BT to Ofcom may be required in order for Ofcom to make informed regulatory decisions, monitor compliance with SMP conditions, ensure those SMP conditions continue to address the underlying competition issues, and investigate potential breaches of SMP conditions and anti-competitive practices.

Private information

94. BT is required to provide Ofcom with a 'Data File[50]', which includes a large amount of granular financial data. This should be the starting point for Ofcom to assess the need for any additional information to be provided to Ofcom privately by BT.

95. We consider that any additional private information should be limited and justified as follows:

- there is a clear need for the required information in order for Ofcom to meet its regulatory duties, in particular where that information is required annually, rather than for example for input to market reviews and charge controls;
- the requirement for additional information is proportionate for that purpose; and
- the information cannot be extracted from the Data File.

96. For example, we recognise that there are a number of existing additional information requirements[51], including LRIC information and billed hours for TRCs, that may be justified on the above basis.

97. We are proposing to continue to work with Ofcom to make sure that the Data File continues to meet its needs in terms of scope and content.

Public information

98. In line with its approach in the 2014 Regulatory Financial Reporting Statement, Ofcom reiterates in this consultation that there should be a link between the information published and the remedy imposed:

> *"cost, volume and revenue information published in the RFS should reflect the level of the remedy"*[52]

[48] 2016 NBMR Consultation, paragraphs 19.34-19.36.
[49] 2016 NMBR Consultation, para 19.36.
[50] 2016 NBMR Consultation, Annex p203 para 18 a xii
[51] 2016 NBMR Consultation, Annex p202 para 18
[52] 2016 NBMR Consultation, para 19.35

99. The key requirements for publication are summarised in paragraph 19.38 of the Consultation by reference to 3 categories: (i) market level information, (ii) service level information, and (iii) cost components for reported services. Ofcom's specific proposals are set out in paragraphs 19.40-19.78 of the Consultation.

100. BT agrees that Ofcom's reporting proposals should strictly reflect the pricing remedies imposed. Therefore, BT considers that:

- Performance Summary by Market (e.g. as most recently published on page 21 of the 2015/16 RFS), should be required to be published for all markets where we have SMP *and* prices are set by reference to our incurred costs. Conversely, market performance should not be required to be published where either there are no pricing remedies in place, or pricing remedies are not related to our incurred costs,

- Service volumes and revenue should only be required to be published when required to demonstrate compliance with a charge control or safeguard cap. The split between internal and external revenue should only be required to be published when required to demonstrate compliance with no undue discrimination obligations. Where publication requirements are justified as above, volumes and revenue should only be required to be published as part of the market summary (e.g. as shown, for example, in the WFAEL Summary on page 32 of the 2015/16 RFS) or, preferably, as part of a non-confidential compliance statement. In any event, there should not be a requirement for overlapping information to be published,

- Fully allocated cost (FAC) by service and component (as shown, for example in the 'WFAEL calculation of FAC based on component costs and usage factors' on page 33 of the 2015/16 RFS), should only be required to be published where prices are set by reference to our incurred costs by service and component (e.g. this may apply in case of a CPI-x charge control or cost orientation obligation). Conversely, where prices are not set by reference to our actual incurred by service and component, this information should not be required to be published,

- Where service volumes or fully allocated cost (FAC) justify a requirement for publication, as noted above, this should be at no lower level than the level at which prices are regulated (basket or sub-basket) and subject to a level of materiality.

101. We set out in the Table below our proposed approach, which makes a clear link between any pricing remedy imposed and the information we are required to publish, in line with Ofcom's statement in paragraph 19.35 of the Consultation.

Table 1: BT's proposed approach to Pricing and Publication remedies

Pricing remedy	Reporting obligation			
	Performance summary	**Adjusted performance schedule**	**Market summary**	**FAC by service and component**
No remedy	None	None	None	None
Bottom up charge control	None	None	None (revenues and volumes in a compliance statement)	None
Fair and reasonable	Published	As appropriate	None	None
Safeguard cap	None	As appropriate	None (revenues and volumes in a compliance statement)	None
CPI-X charge control	Published	As appropriate	Published	Published
Cost orientation / basis of charges	Published	As appropriate	Published	Depends upon specific nature of cost orientation requirement

102. The rationale behind BT's proposed approach is provided in Annex A.

103. In Table 1 below, we set out Ofcom's specific proposals and assess whether those proposals are consistent with its aim to ensure that reporting obligations reflect the pricing remedy.

104. Table [53]1 Ofcom's proposed reporting obligations

[53] _Notes_:

*1 '**Basket'** refers to the level at which prices are regulated.*

*2 '**Obligation'** refers to the level of reporting obligation proposed by Ofcom:*

*'**Performance summary'** means only the Performance Summary schedule, Attribution of Wholesale Current Costs, Attribution of Wholesale Current Cost Mean Capital Employed and Adjusted Financial Performance Schedule (if relevant),*

*'**Market summary**' means the information required for 'performance summary' plus the Market Summary schedule,*

*'**FAC by component and service**' means the information required for 'market summary' plus analysis of service level FAC by component.*

*3 '**Level'** refers to the level at which results are disclosed, specifically 'Basket' means that results are disclosed at the level shown in the 'Basket' column, at which prices are regulated.*

*4 '**Consistent'** is our assessment of whether Ofcom's proposed reporting obligation is consistent with the pricing remedies.*

Market	Remedy	Basket[1]	Obligation[2]	Level[3]	Consistent[4]
WFAEL	Fair and reasonable	Service	FAC by component and service	Basket	No – we consider there should only be a requirement for a Performance Summary
ISDN2 existing lines pre-transition	Charge cap and fair and reasonable	Transfers; rentals; connections	Market summary (revenue and volumes)	Basket	Yes
ISDN2 existing lines post-transition	Charge cap and fair and reasonable	Transfers; rentals	Market summary (revenue and volumes)	Basket	Yes
ISDN2 new lines post-transition	No price regulation	Single service	Market summary (revenue)	Basket	No – we consider there should be no reporting obligation
ISDN 30 existing lines pre-transition	Charge cap and fair and reasonable	Transfers; rentals; enhanced care; direct dialing	Market summary (revenue and volumes)	Basket	Yes
ISDN30 existing lines post-transition	Charge cap and fair and reasonable	Transfers; rentals; enhanced care; direct dialing	Market summary (revenue)	Basket	Yes
ISDN30 new lines post-transition	No price regulation	Single service	Market summary (revenue)	Basket	No – we consider there should be no reporting obligation

WFAEL

105. Ofcom is proposing to impose a fair and reasonable charging obligation in the WFAEL market. As Ofcom notes[54], "the fair and reasonable charging obligation is not a cost-based remedy", prices are therefore not directly linked to our actual costs. However, Ofcom proposes to require publication of service level FAC information, because many costs are shared with those in other regulated markets, and Ofcom considers it is important for stakeholders to see the effects of BT's attribution of costs between markets, to ensure they are appropriate and add credibility to the financial reporting regime.

106. Our proposal is that, consistent with the Ofcom's stated aim of consistent reporting and pricing remedies, only the market return should be published in the Performance Summary – not the service level revenues, volumes and FAC as part of the Market Summary and the FAC by service and component, which Ofcom proposes.

107. Ofcom would receive this information privately as part of the Data File, which would enable Ofcom

[54] 2016 NBMR Consultation, para. 19.44

to make the comparison between costs in WFAEL and WLA. This information however should not be published.

108. In the event that Ofcom requires publication of service level information for WFAEL, we agree with Ofcom's proposal that such information would only be required for principal WFAEL services[55].

109. We should be grateful for a clarification of the proposed treatment of WLR Simultaneously, Provided Connections and Conversions[56]. Ofcom states that they no longer need to be disclosed separately as part of the WFAEL market, but that they will be considered as part of the WLA market review. We assume that these services should be moved to be included in 'Other WLR', which we agree would be proportionate.

110. We welcome Ofcom's proposals[57] to remove the requirement to publish a schedule of volumes and direct costs for TRCs associated with the fixed access markets, to reflect the proposal to impose a fair and reasonable charging obligation, rather than any form of cost-based control.

111. We note, however, that the requirement to produce this information has not been removed. Instead Ofcom proposes[58] that the schedule will be provided privately to Ofcom as an AFI.

ISDN2 and ISDN30

112. We welcome Ofcom's proposal[59] not to impose reporting of FAC for ISDN2 and ISDN30 at the individual service level. We agree that CPs do not need this information, for example, to be assured of our compliance with price regulation, and the disclosure would be disproportionate.

113. We consider the published information for existing lines, both pre- and post-transition, which are subject to a charge cap and fair and reasonable terms, should consist of:

- Market performance and
- Revenues, volumes and average prices at the level at which prices are regulated.

114. This will provide stakeholders with the information they need to assure themselves that we are complying with our SMP obligations. This is consistent with Ofcom's proposal[60].

115. In principle, we do not agree with Ofcom's proposal that costs and revenues for new ISDN lines, which are not subject to price regulation, should continue to be published for the whole of the next market review period, in order that the market total reconciles with the 'summary performance by market' schedule[61]. We do not consider this justifies an exception to Ofcom's stated aim to ensure consistency between pricing and reporting remedies. .

116. However, we recognise the practical difficulty for Ofcom and other stakeholders, given Ofcom's proposal to partly deregulate the ISDN markets, of aligning the ISDN market summaries and the performance summary by market.

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55 2016 NBMR Consultation, paras. 19.45 and 19.46
56 2016 NBMR Consultation, para. 19.46
57 2016 NBMR Consultation, para. 19.47
58 2016 NBMR Consultation, para. 19.86
59 2016 NBMR Consultation, paras. 19.53 and 19.55 (ISDN2), 19.59 and 19.61 (ISDN30)
60 2016 NBMR Consultation para. 19.51 and 19.57
61 2016 NBMR Consultation, para.19.54.

117. In addition, we are concerned that Ofcom's proposed reporting obligations requiring the publication of revenue, volume, and the average price for existing lines of ISDN2 and ISDN30 services, split between internal and external customers, at the level that they are regulated, may make the RFS more complex, more difficult to prepare and less transparent for the reader. In particular, the proposal requires[62]:

- The separate recording of revenue arising from new connections,
- Potential complication to reporting during the transitional period if this is not aligned with our financial year end[63].

118. We note that the assets in the ISDN2 and ISDN30 markets are heavily depreciated, which may make market returns potentially misleading. Although there is no longer a charge control in these markets, we believe that the performance in these markets should be adjusted for in the Adjusted Performance Schedule. We are proposing to work with Ofcom on how this adjustment should be calculated.

[62] 2016 NBMR Consultation para 19.54 for ISDN2 and 19.60 for ISDN30
[63] 2016 NBMR Consultation para 7.24

Annex A: BT's proposed approach to the Regulatory Financial Reporting

We set out below, additional information on BT's proposed approach to regulatory financial reporting, which aligns with Ofcom's aim of consistent pricing and reporting remedies.

Publication of Market Returns

119. As a general principle, we support the publication of market returns, including revenue, costs and capital employed in the Performance Summary by Market, and details of the Attribution of Wholesale Current Costs and the Attribution of Wholesale Current Cost Mean Capital Employed to markets.

120. In supporting this principle we concur with one of Ofcom's arguments for publishing market level information[64]:

> *'trends in market level financial performance are informative in the context of considering the impact and effectiveness of the remedies'*

121. However, this principle is not relevant where the nature of the pricing remedy is such that the costs (including the cost of capital employed) are not related to the prices set. In these cases, the market return provides no useful information to the reader on our compliance with (or the appropriateness of) the SMP obligations and publication is therefore not appropriate.

122. The SMP remedy creates a connection between prices and costs, indicating that publication of market level information may be justified, in particular for:

    - A CPI-X charge control where Ofcom has forecast costs from our costs or
    - A cost orientation remedy where the costs are to be based on a forward-looking long run incremental approach and allowing an appropriate mark up for the recovery of common costs and an appropriate return on capital employed.

123. However, there is no significant benefit to stakeholders in the publication of market level information in the following cases:

    - there is no pricing remedy; or
    - the charge control is based on Ofcom's 'bottom-up' cost modelling which is not based on our incurred costs; or
    - a safeguard cap has been set without reference to our incurred costs.

124. Where the pricing remedy is not based on our incurred costs, the market level information, including the return, is not relevant in demonstrating to stakeholders our compliance with (or the effectiveness of) the pricing remedy. We therefore do not accept Ofcom's reasons[65] for publication of this information in these circumstances:

    - Ofcom argues that 'market level cost information also provides transparency regarding how

[64] 2016 NBMR Consultation, para.19.40
[65] 2016 NBMR Consultation, para 19.40

BT has allocated costs between regulated markets (and also between regulated and unregulated markets)'. However, we publish (amongst other documents) the Accounting Methodology Document which describes how we have attributed costs. And market level information is only relevant (and of benefit to stakeholders) where pricing remedies are based on our incurred costs.

- Similarly, Ofcom's argument that publication of market level information 'mitigates against the risk of double recovery of costs or that costs might be unreasonably loaded onto particular services or markets' also requires that all charge controls are based on our incurred costs. Ofcom departed from basing charge controls on our incurred costs to set WCT prices at LRIC with common costs recovered through WCO, leading to a very low return in WCT (-53.7%) and a very high return in WCO (51.9%). The risk of double recovery is mitigated through the reconciliation statement, which demonstrates that costs are attributed only once.

- In the absence of a remedy which links prices to our incurred costs, market level information is not relevant to stakeholders and, instead of helping to 'demonstrate the overall reliability and robustness of the RFS' will tend to undermine confidence. Mobile call termination provides an example of a market in which the pricing remedy is not based on the incurred costs of the provider and there is no requirement to publish market level information.

Publication of revenues, volumes and costs

125. As a general principle, we support the publication of a market summary including revenues, volumes, average prices and unit costs where this is relevant to the pricing remedy which Ofcom has imposed, provides useful information to stakeholders and is proportionate.

126. In particular, we consider that the publication of a Market Summary schedule is relevant to stakeholders where this is needed to demonstrate compliance with SMP pricing remedies, for example:

    - CPI-X charge control, based on our incurred costs, where publication of revenues, volumes and average prices is needed to demonstrate compliance. Although publication of unit costs is not needed to demonstrate compliance, it may be published to provide stakeholders with assurance on the effectiveness of the pricing remedy. This is in line with the existing obligations for WFAEL. Cost orientation, where the specific publication obligations to demonstrate compliance will depend on the form of the cost orientation remedy and take account of the need to maintain confidentiality.

    - Safeguard cap, where revenue, volumes and average prices (but not costs) need to be published to demonstrate compliance.

127. Our preference, however, is for these reporting obligations to be met through the publication of a non-confidential compliance statement where possible rather than a Market Summary.

128. However, we do not consider that the publication of any of this information (revenue, volumes, average prices or costs), is of benefit to stakeholders, where the pricing remedy is not linked to our incurred costs, in particular where:

    - No pricing remedy is imposed; or

- Only fair and reasonable charges obligation is imposed, where we agree with Ofcom that the reporting of FAC is not appropriate[66]..

129. Where Ofcom has not imposed a 'no undue discrimination' obligation, we would not support the publication of the analysis of volumes, revenues and costs split into internal and external.

Publication of FAC by component

130. We recognise that, where Ofcom imposes an obligation to publish the market calculation of FAC based on component cost and usage factors, it will be of benefit to some users of the RFS for this to be at unit costs in £, rather than total costs in £m. However, we note that stakeholders can calculate unit costs themselves from the information in the published Excel workbooks.

131. We support the publication of the calculation of FAC based on component costs and usage factors where the remedy is applied to our component costs and would therefore be of value to stakeholders. However, this does not apply to any of the remedies Ofcom are proposing, so we believe that Ofcom should make a compelling case for publication of component costs and in any event publication should be restricted to the following cases:

    - CPI-X charge control where Ofcom has forecast costs based on our incurred costs. This is in line with the existing obligations for WFAEL; and
    - Cost orientation, where the form of cost orientation makes component FAC relevant.

132. However, we do not consider there is significant benefit to stakeholders and therefore do not support the publication of the calculation of FAC based on component costs and usage factors in the following cases:

- There is no pricing remedy;
- the charge control is based on Ofcom's 'bottom-up' cost modelling not on our incurred costs;
- fair and reasonable charges only obligation; or
- there is a safeguard cap and the price has been set without reference to our incurred costs.

Other considerations

133. Where more than one SMP pricing remedy is imposed, we support publication of information required to demonstrate compliance with the more demanding remedy, considering each type of information in turn.

134. We agree with Ofcom that the level of detail published should be limited to what is required to demonstrate compliance with the SMP pricing remedy imposed. Specifically, this means publication at the level at which prices are regulated.

135. In order to avoid publishing excessive quantities of information, we propose that Ofcom should take account of materiality and only require publication of an individual service or a market above an appropriate threshold.

136. We also propose that, when Ofcom seeks to make changes to the reporting requirements, the timing of the implementation of these changes should take account of the practical considerations in

66 2016 NBMR Consultation, para 19.64

making changes to our reporting systems, processes, resourcing and governance.

137. Finally, the framework should be consistently applied, but, if Ofcom determines that there should be exceptions, then any differences between the costs considered as part of the charge control and our actual costs should be reflected in the Adjusted Financial Performance Schedule.

Annex B: Comments on Legal Instruments

Condition 5

138. Openreach has the following specific comments:

- Condition 5A.5 should be amended so that the references to Condition 5A.2A(b) and 5A.2A(c) are corrected in bullets (ii) and (iii).
- In the 5A.10 the list of defined terms refer at various points to "Existing ISDN30 Rental", capitalised as a defined term in itself. However it is not included or defined in this section. For clarity, we believe it would be useful to define the term "Existing ISDN30 Rental". (Item k is almost referring back on itself, which doesn't add any clarity to the meaning of "Existing".) Similarly, it would be useful to define "Existing ISDN2 Rental".
- Condition 5B.1 contains the price of £26.49 and says that "in the First Relevant Year the Dominant Provider must not charge more than" this figure. However as this is the quarterly charge this could be misconstrued as the total amount that can be charged in a year. For clarity, we believe that 5B1 (a) should be amended to say "£26.49 for ISDN2 Rental Services per channel per quarter". The same amendment should also be reflected in 5B.2.

Condition 7

139. We believe that in the current legal instrument, the distinction between Existing and New ISDN Services is not always clear and could be improved in the final drafting. For example, Condition 7.4B requires 28 days' notice for an ACCN, but applies only to services in the transitional period and existing services after the transitional period (as it applies only to network access pursuant to conditions 1B and 1C). We interpret this as meaning there is no requirement to notify prices in advance for ISDN new services. However as the rest of Condition 7 refers only to ISDN30 and ISDN2, we assume this also applies to new services, meaning that there is still a requirement to issue ACCNs, even though there is no minimum notice period.

Condition 9

140. Condition 9.4(b) – reference to "November 2016 Quality of Service Statement" – the definition appears incorrect, Ofcom has just copied the same definition for the October 2016 Quality of Service Statement and changed the date to November 2016 rather than actually revising the title of the document. See https://www.ofcom.org.uk/__data/assets/pdf_file/0016/94300/Further-QoS-Statement.pdf. The correct definition would appear to be "means the statement entitled Quality of service for WLR: Direction setting further minimum standards for WLR provisions under the SMP conditions imposed in the 2014 Fixed Access Market Reviews published on 22 November 2016".

Condition [10.4] setting the requirements in relation to preparation, delivery, publication, form and content of the Regulatory Financial Statements

141. Performance Summary by Market/Technical Area: We request that the following four rows are included, in line with the format for the 2015/16 RFS:

- EoI Eliminations and Roundings between Wholesale Residual and Total Wholesale Markets;

and

- Eliminations and Roundings between Retail Residual and Total Markets.

142. Attribution of Wholesale Current Cost Mean Capital Employed: We request that the following column is included, in line with the format for the 2015/16 RFS:

- EoI Eliminations as part of Total Wholesale Markets (after Wholesale Residual)

143. Market/Technical Area Summary: We note that the 'sub-basket' rows which were included in the proforma provided in the BCMR determination have been omitted in this consultation. We request clarification of any change in requirements this represents.

144. We request that the following row is included, in line with the format for the 2015/16 RFS:

- Roundings

145. Ofcom proposes to continue to require reporting of total FAC in £m in this report. We note that this will be useful to stakeholders for comparison with revenue, but will not easily enable a comparison with average price, which would provide stakeholders with assurance that BT is complying with its SMP obligations in cases where price is derived from our FAC. If price is not derived from our FAC, then there would be limited value for stakeholders in including service level FAC in any case.

146. Market/Technical Area calculation of FAC based on component costs and usage factors: We note that the 'sub-basket' rows which were included in the proforma provided in the BCMR determination have been omitted in this consultation. We request clarification of any change in requirements this represents.

147. Ofcom proposes to change the figures reported in the table on this report from total FAC in £m for the service and component to unit FAC in £. We note that where there the service has no volume a meaningful unit cost cannot be provided. In these cases the services will need to be omitted from the table. Examples of this from the 2015/16 RFS in the WFAEL Market are WLR TRCs and Other WLR.

148. For WFAEL, we note that the service 'WLR Premium Transfers' has been renamed 'WLR Premium Conversions'.

149. For ISDN30, we note that the service 'ISDN30 Enhanced Care' has been renamed as 'ISDN30 SML 3 and 4'. Also, as there is only a single service for all new connections following the transitional period, we assume that it will include any new direct dialling revenue although this is not stated.

150. Market/Technical Area calculation of FAC based on component costs: For WFAEL, we note that a number of services have been omitted when compared with the 2015/16 RFS. The omission could have occurred because only the services from the first page of the report have been included. We assume the following services should be included:

- Analogue Premium Rentals – Internal
- Analogue Premium Rentals – External
- WLR Premium Connections – Internal
- WLR Premium Connections – External
- WLR Premium Conversions – Internal (renamed from WLR Premium Transfers – Internal)

- WLR Premium Conversions – External (renamed from WLR Premium Transfers – External)
- Caller Display – Internal
- Caller Display – External

151. We assume that the following services should be omitted from the report on the grounds that there is no volume to provide a meaningful unit cost:

- Time Related Charges – Internal
- Time Related Charges – External
- Other WLR – Internal
- Other WLR - External

Direction under section 49 of the Communications Act 2003 and Condition [10.4] specifying network components

152. We note that a number of components have been renamed when compared to the 2015/16 RFS, as listed in the table below.

From	To
TISBO Excess Construction	TISBO Excess Construction
Combi card broadband	Combi Card – Broadband
Customer Sited Interconnect cct CSI 2Mbit/s link	Interconnect extension circuits (IEC) 2Mbit/s link
Interconnect Extension Circuits IEC 2Mbit/s link	Customer Sited Interconnect cct (CSI) 2Mbit/s link
Customer support - partial private circuits	Customer support - partial private circuits

Paragraph 15 of both draft directions (pages 141 and 152)

153. We note that the draft directions (requiring the publication of KPIs by BT for specified wholesale ISDN2 and ISDN30 exchange line services) do not reflect the modification of 19 October 2016 with regard to the publication of volume KPI(iii) (volume of repairs impacted by MBORC declarations). The modification extends the deadline for reporting the volume of repairs impacted by MBORC declarations by one month.