



# Wholesale Line Rental: Reviewing and setting charge ceilings for WLR services

Statement

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## Section 1

# Summary

### Wholesale Line Rental – regulatory history

- 1.1 Wholesale Line Rental (WLR) allows alternative suppliers to rent access lines on wholesale terms from BT, and resell the lines to customers, providing a single bill that covers both line rental and telephone calls. Its introduction has been a significant stage in the development of competition in retail markets in the UK. A fully effective WLR product will bring major benefits to consumers in terms of increased choice, innovation and lower prices. WLR services give consumers in all parts of the country the opportunity to choose alternative suppliers who could provide them with access and call services.
- 1.2 On 20 June 2002, the Director General of Telecommunications (the “DGT”) published the statement entitled *Protecting consumers by promoting competition: Of tel’s conclusions*<sup>1</sup> in which he modified BT’s licence to, amongst other things, require BT to provide WLR services and also set the charges for certain WLR services. The first basic WLR product (WLR1) was available from September 2002. WLR1 was not, however, sufficiently developed for it to be an effective mass-market product at that stage and, therefore, further work was required to improve upon its capabilities.
- 1.3 On 11 March 2003, therefore, the DGT published a statement entitled *Wholesale Line Rental: Of tel’s conclusions*<sup>2</sup> in which he set out what BT needed to do to improve WLR (WLR2).
- 1.4 On 28 November 2003, the DGT published the conclusions of the *Review of the fixed narrowband wholesale exchange line, call origination, conveyance and transit markets* (the “Call Origination Market Review statement”)<sup>3</sup>, which, among other things, restated the requirement on BT to offer analogue WLR services and additionally placed a requirement on BT to offer digital WLR services equivalent to ISDN2 and ISDN30.
- 1.5 WLR2 was available from 29 March 2004. BT had simultaneously been carrying out work in relation to the digital products and informed Ofcom in January 2005 that it considered that the ISDN2 and ISDN30 WLR products substantively met the requirements of the Call Origination Market Review statement.

### Reason for review

- 1.6 The charges for WLR have not been reviewed since the starting charges were set by the DGT in June 2002. At that time, the rental charges for residential and business analogue WLR products were set at £28.00 per line per quarter (£112.00 per line per year) and £29.87 per line per quarter (£119.48 per line per year) respectively. These charges were also subject to a charge control set at RPI-2%.
- 1.7 On 19 December 2003, the DGT opened an own-initiative investigation into BT’s charges for business ISDN2 WLR. On 1 October 2004, BT reduced the charge for business ISDN2 WLR to £55.00 per quarter. Ofcom considered that this voluntary

<sup>1</sup> <http://www.ofcom.org.uk/static/archive/oftel/publications/pricing/2002/pcr0602.pdf>

<sup>2</sup> [http://www.ofcom.org.uk/static/archive/oftel/publications/whole\\_line/2003/wlr\\_1\\_0303.htm](http://www.ofcom.org.uk/static/archive/oftel/publications/whole_line/2003/wlr_1_0303.htm)

<sup>3</sup> [http://www.ofcom.org.uk/consult/condocs/narrowband\\_mkt\\_rvw/nwe/](http://www.ofcom.org.uk/consult/condocs/narrowband_mkt_rvw/nwe/)

reduction in charges was sufficient for it to close the own-initiative investigation opened by the DGT. Ofcom stated, however, that it would review charges for business ISDN2 WLR once it had completed its investigation into the value of BT's copper access network and it had more evidence on the take up of business ISDN2 WLR<sup>4</sup>.

- 1.8 On 18 August 2005, Ofcom published the statements entitled *Valuing BT's copper access network*<sup>5</sup> and *Ofcom's approach to risk in the assessment of the cost of capital*<sup>6</sup> respectively. The significance of these documents in this context is that a high proportion of the total cost of WLR products is determined by the cost of laying and maintaining the copper loop.
- 1.9 BT had, prior to these two statements, reduced the residential analogue WLR charge from £9.24 per month (£110.88 per year) to £8.74 per month (£104.88 per year). It did not, however, change its charges for either the business analogue or business ISDN2 products.
- 1.10 Ofcom did not consider that the residential analogue charge change was sufficient in itself to provide industry-wide certainty in relation to WLR charges and nor was it clear that the reduced charge actually reflected the costs that BT incurs. Ofcom considered, therefore, that it was appropriate to review the charges for the residential and business analogue products and the digital access products to ensure that they were cost reflective. In addition, Ofcom considered that it might be necessary to cap the maximum level of WLR charges. For the reasons set out below, Ofcom has concluded that it is necessary to set charge ceilings for certain WLR products.

### The November consultation

- 1.11 On 9 November 2005, Ofcom published the consultation document entitled *Wholesale Line Rental: Reviewing and setting charge ceilings for WLR services*<sup>7</sup> (the "November consultation") in which it proposed to set charge ceilings for certain WLR products. Ofcom has considered the responses to that document in coming to the final conclusions that it has set out here.

### Approach to setting the WLR charge ceilings

- 1.12 Ofcom's overall approach is little different to that set out in the November consultation. It has, however, accepted that the provision of pair gain equipment (the Digital Access Carrier System or DACS) can be an efficient way to deploy a local access network. In summary, therefore, Ofcom has:
  - used cost data for 2004/05 from BT's audited regulatory financial statements, which were published on 2 September 2005;
  - used the same methodology for projecting cost as used in setting the charges for local loop unbundling, i.e. projecting costs for 2005/06 (for further details see the statement entitled *Local loop unbundling: setting the fully unbundled rental charge*

<sup>4</sup> [http://www.ofcom.org.uk/bulletins/comp\\_bull\\_index/comp\\_bull\\_ccases/closed\\_all/investigation\\_closed/#content](http://www.ofcom.org.uk/bulletins/comp_bull_index/comp_bull_ccases/closed_all/investigation_closed/#content)

<sup>5</sup> <http://www.ofcom.org.uk/consult/condocs/copper/value2/statement/#content>

<sup>6</sup> [http://www.ofcom.org.uk/consult/condocs/cost\\_capital2/statement/#content](http://www.ofcom.org.uk/consult/condocs/cost_capital2/statement/#content)

<sup>7</sup> <http://www.ofcom.org.uk/consult/condocs/wlrcharge/>

*ceiling and minor amendment to SMP conditions FA6 and FB6, which was published on 30 November 2005<sup>8</sup>);*

- applied an efficiency factor of 1.5% to 2005/06 operating costs;
  - used the £58.51 estimate of copper costs (see footnote 5);
  - applied a 10.0% rate of return on capital employed (see footnote 6);
  - disallowed some of BT's drop costs and excluded others which are already being recovered through residential retail prices in order to ensure no double recovery; and
  - applied a cost volume elasticity (CVE) factor to BT's selling and general administration (S&GA) costs.
- 1.13 Ofcom has not set charge ceilings for business ISDN2 WLR because it has concluded that BT's charges are reasonable when compared to the cost stack for this product. In addition, Ofcom did not wish to increase regulation especially given that it was unnecessary to do so.
- 1.14 On the basis of the approach set out above, Ofcom has set charge ceilings as set out in Table 1.1.

**Table 1.1 – charge ceilings for analogue WLR services**

	<b>New line installation charge ceiling</b>	<b>Transfer charge ceiling</b>	<b>Line rental charge ceiling</b>
Residential WLR	£88.00	£2.00 per line	£100.68 per line per year
Business WLR	£88.00	£2.00 per line	£110.00 per line per year

- 1.15 The Direction which sets in place these charge ceilings is at Annex 1. The Direction also states that BT need not set charges for these services on the basis of its long-run incremental costs including an appropriate mark-up and a reasonable return on its investment (LRIC+) because these charge ceilings have been set following Ofcom's valuation of BT's copper access network and cannot said to be based on LRIC+, as required by SMP services condition AA3. In addition, Ofcom has disapplied SMP services condition AA4 (the charge control condition) in relation to WLR products (see Annex 2) and has given its consent for BT to introduce these charges on 1 March 2006 and, therefore, give less than the ninety days' notice as it would otherwise be required to do by SMP services condition AA6. The consent is set out at Annex 3.

## **Equivalence**

- 1.16 Ofcom may reassess the charge ceilings for WLR products should it be necessary to do so. For instance, WLR products will be provided by Openreach, and Ofcom understands that this change and the development of equivalence of inputs for WLR may lead to significant changes in the costs of and charging structure for WLR

<sup>8</sup> <http://www.ofcom.org.uk/consult/condocs/llu/statement/>

products (paragraph 3.4 provides further details on equivalence of inputs). Therefore, Ofcom considers that it may be necessary to reassess the level of the charges at that time, i.e. in time for the launch of the equivalence of input WLR product in the first half of 2007.

- 1.17 Ofcom may also find that it is appropriate to apply a charge control which would be set for a predefined period and could be set in a manner which would have a similar effect to the charge ceilings set out in this statement (for example, each product could be individually indexed).

## Section 2

# Background and introduction

## WLR prior to the 2003 Market Reviews

- 2.1 Wholesale Line Rental (WLR) allows alternative suppliers to rent access lines on wholesale terms from BT, and resell the lines to customers, providing a single bill that covers both line rental and telephone calls provided using carrier pre-selection for example. Its introduction has been a significant stage in the development of competition in retail markets in the UK. A fully effective WLR product will bring major benefits to consumers in terms of increased choice, innovation and lower prices. WLR services give consumers in all parts of the country the opportunity to choose alternative suppliers who could provide combined access and call services.
- 2.2 On 20 June 2002, the Director General of Telecommunications (the “DGT”) published the statement entitled *Protecting consumers by promoting competition: Oftel’s conclusions*<sup>9</sup> (the “June 2002 statement”) in which he modified BT’s licence to, amongst other things, require BT to provide WLR services and it also set the charges for certain WLR services. The first basic WLR product (WLR1) was available from September 2002. WLR1 was not, however, sufficiently developed for it to be an effective mass-market product at that stage and, therefore, further work was required to improve upon its capabilities.
- 2.3 On 14 November 2002, therefore, the DGT published a consultation document entitled *Wholesale Line Rental*<sup>10</sup> in which he set out proposals on the nature of the enhancements required and how related costs should be recovered. This consultation document was followed by a statement entitled *Wholesale Line Rental: Oftel’s conclusions*, which was published on 11 March 2003<sup>11</sup>. This statement set out Oftel’s conclusions on the requirements for WLR2 (i.e. the enhanced automated WLR product) and the cost recovery principles that should apply. WLR2 was launched by BT on 29 March 2004.

## Regulatory framework

- 2.4 The current regulatory framework for electronic communications networks and services entered into force on 25 July 2003. The framework is designed to create harmonised regulation across Europe and is aimed at reducing entry barriers and fostering prospects for effective competition to the benefit of consumers. The basis for the new regulatory framework is five EU Communications Directives<sup>12</sup>.

<sup>9</sup> <http://www.ofcom.org.uk/static/archive/oftel/publications/pricing/2002/pcr0602.pdf>

<sup>10</sup> [http://www.ofcom.org.uk/static/archive/oftel/publications/whole\\_line/2002/wlr1102\\_1\\_4.htm](http://www.ofcom.org.uk/static/archive/oftel/publications/whole_line/2002/wlr1102_1_4.htm)

<sup>11</sup> [http://www.ofcom.org.uk/static/archive/oftel/publications/whole\\_line/2003/wlr\\_1\\_0303.htm](http://www.ofcom.org.uk/static/archive/oftel/publications/whole_line/2003/wlr_1_0303.htm)

<sup>12</sup> Directive 2002/21/EC on a common regulatory framework for electronic communications networks and services

Directive 2002/19/EC on access to, and interconnection of, electronic communications networks and associated facilities

Directive 2002/20/EC on the authorisation of electronic communications networks and services;

Directive 2002/22/EC on universal service and users' rights relating to electronic communications networks and services

Directive 2002/58/EC concerning the processing of personal data and the protection of privacy in the electronic communications sector

- 2.5 This framework was implemented in the UK by the Communications Act 2003 (the “Act”).

### Review of the fixed narrowband wholesale exchange line markets

- 2.6 The regulatory framework requires national regulatory authorities (NRAs), such as Ofcom, to carry out reviews of competition in communications markets to ensure that regulation remains appropriate and proportionate in the light of changing market conditions.
- 2.7 The DGT, therefore, carried out reviews of competition in various markets including the wholesale exchange line market and published his conclusions in the statement entitled *Review of the fixed narrowband wholesale exchange line, call origination, conveyance and transit markets*, on 28 November 2003 (the “Call Origination Market Review statement”)<sup>13</sup>.
- 2.8 In the Call Origination Market Review, the DGT determined that BT had SMP in, amongst others, the markets for wholesale residential analogue exchange line services, wholesale business analogue exchange line services, wholesale business ISDN2 exchange line services and wholesale ISDN30 exchange line services in the UK excluding the Hull Area. Kingston was found to have SMP in comparable markets in the Hull Area. As a result of the DGT’s findings, BT was required, amongst other things, to provide WLR.
- 2.9 The Call Origination Market Review defined the WLR service as follows:

“7.1 Wholesale line rental (“WLR”) is a service whereby competing providers effectively lease an exchange line and decide how best to route the customer’s calls. Providers therefore take on the full retail relationship with the customer and offer a “single bill” to end-users for all basic communications services.”

### Relevant SMP services condition

- 2.10 The following SMP services conditions, among others, have been imposed on BT in the relevant exchange line services markets:
- Basis of charges (AA3) – which requires that charges are based on long-run incremental costs including an appropriate mark-up and return;
  - Charge control (AA4) – which included an RPI-2% control on WLR services; and
  - Requirement to offer WLR (AA10) – which extended the obligation to supply to digital products (ISDN2 and ISDN30).
- 2.11 In addition, the Call Origination Market Review statement set out the functional specification for Wholesale ISDN Line Rental in relation to ISDN2 and ISDN30 (WLR functional specification).

### Historic pricing of WLR products

- 2.12 In the June 2002 statement, the DGT set the starting charges for WLR. These are shown in Table 2.1.

**Table 2.1 – starting charges for analogue WLR services**

<sup>13</sup> [http://www.ofcom.org.uk/consult/condocs/narrowband\\_mkt\\_rvw/nwe/](http://www.ofcom.org.uk/consult/condocs/narrowband_mkt_rvw/nwe/)

	<b>New line installation</b>	<b>Transfer</b>	<b>Line rental</b>
Residential WLR	£92.89	£1.41 per transaction or multiples thereof	£28.00 per line per quarter (£112.00 pa)
Business WLR	£92.89	£1.41 per transaction or multiples thereof	£29.87 per line per quarter (£119.48 pa)

2.13 These charges were also subject to a charge control.

2.14 On 19 December 2003, the DGT decided to undertake an own-initiative investigation into the price charged by BT for its wholesale business ISDN2 exchange line services (i.e. business ISDN2 WLR). The quarterly charge for business ISDN2 WLR was then £71.88 per quarter (£287.52 per year).

2.15 On 17 June 2004, BT announced that it was reducing the price of its business ISDN2 WLR product to £55.00 per quarter (£220.00 per year). At this time, Ofcom announced that there were two major issues that would determine whether or not this new charge accurately reflected BT's costs in providing business ISDN2 WLR. These were: (a) the cost of the copper loop; and (b) the actual take-up of business ISDN2 WLR. Ofcom had already commenced its review of the cost of copper and it did not have substantial evidence regarding the take-up of business ISDN2 WLR. Ofcom decided, therefore, to close its investigation pending the outcome of the cost of copper review and once more information became available<sup>14</sup>.

2.16 On 1 August 2005, BT reduced the residential analogue WLR line rental charge from £27.72 per quarter (£110.88 per year) to £26.23 per quarter (£104.92 per year).

2.17 The starting point for Ofcom's review of the charges for WLR was, therefore, the charges set out in Table 2.2.

**Table 2.2 – charge for analogue and digital WLR services, August 2005**

	<b>New line installation</b>	<b>Transfer</b>	<b>Line rental (per line per year)</b>
Residential WLR	£91.99	£1.41 per transaction or multiples thereof	£104.92
Business WLR	£91.99	£1.41 per transaction or multiples thereof	£119.40
Business ISDN2 WLR	£232.98	£11.30 per line	£220.00

### **Reason for review**

2.18 As explained in paragraph 2.12, the DGT set the starting charges for certain WLR products in the June 2002 statement. He also applied a charge control to them. The

<sup>14</sup>

[http://www.ofcom.org.uk/bulletins/comp\\_bull\\_index/comp\\_bull\\_ccases/closed\\_all/investigation\\_closed/#content](http://www.ofcom.org.uk/bulletins/comp_bull_index/comp_bull_ccases/closed_all/investigation_closed/#content)

charges for WLR products have not, however, been reviewed since to ensure that they adequately reflect the costs that BT incurs in providing each WLR product.

- 2.19 On 18 August 2005, Ofcom published the statements entitled *Valuing BT's copper access network*<sup>15</sup> (the "valuation of copper statement") and *Ofcom's approach to risk in the assessment of the cost of capital*<sup>16</sup>. The significance of these documents in this context is that a high proportion of the total cost of WLR products is determined by the cost of laying and maintaining the copper loop and the return that BT should be allowed on the capital invested in the access network.
- 2.20 As explained in paragraph 2.16, BT reduced the residential analogue WLR charge on 1 August 2005. It did not, however, change charges for either business analogue WLR or business ISDN2 WLR.
- 2.21 Ofcom did not consider that the residential analogue charge change was sufficient in itself to provide industry-wide certainty in relation to WLR charges and nor was it clear that the reduced charge actually reflected the costs that BT incurs. Ofcom considered, therefore, that it was appropriate to review the charges for the residential and business analogue products and the digital access products to ensure that they were cost reflective. In addition, Ofcom considered that it might be necessary to cap the maximum level of WLR charges. For the reasons set out in Section 3, Ofcom has concluded that it is necessary to set charge ceilings for certain WLR products.
- 2.22 On 9 November 2005, therefore, Ofcom published the consultation document entitled *Wholesale Line Rental: Reviewing and setting charge ceilings for WLR services*<sup>17</sup> (the "November consultation") in which it proposed to set charge ceilings for certain WLR products. Ofcom has considered the responses to that document in coming to the final conclusions which are set out in this statement.

<sup>15</sup> <http://www.ofcom.org.uk/consult/condocs/copper/value2/statement/#content>

<sup>16</sup> [http://www.ofcom.org.uk/consult/condocs/cost\\_capital2/statement/#content](http://www.ofcom.org.uk/consult/condocs/cost_capital2/statement/#content)

<sup>17</sup> <http://www.ofcom.org.uk/consult/condocs/wlrcharge/>

## Section 3

# Wholesale line rental charge ceilings

## Introduction

- 3.1 BT has SMP in the separate markets for residential and business analogue exchange line products and also in the markets for the digital exchange line products (ISDN2 and ISDN30). The European Commission's guidelines on market analysis and the assessment of significant market power (SMP) state that NRAs should impose one or more regulatory remedies to counteract SMP in any market. Ofcom, therefore, imposed a number of remedies on BT and these included a charge control. These charge controls were set to end on 31 August 2006. BT's voluntary charge change (see paragraph 2.16) reduced the charge for the WLR residential analogue exchange line product by more than required by the control. But in itself this did not give any certainty that the charges would not rise thereafter and nor did it provide any guarantee that the revised charges reflected accurately BT's reasonably incurred costs.
- 3.2 Therefore, Ofcom decided that in the interests of transparency and certainty, it needed to review the analogue and digital WLR charges to ensure that they were reasonable. Ofcom also wished to ensure that the charges for WLR products were consistent with the results of Ofcom's analysis of the value of BT's copper access network and its assessment of the appropriate rate of return that would be required to encourage inward investment in its access network (the applicable cost of capital). The voluntary reduction applied to the residential analogue WLR rental charge only and, therefore, charges for the other services remained the same.

## Charge ceilings for WLR rental and transfer charges

- 3.3 In the November consultation, Ofcom explained that it believed that it was necessary to implement charge ceilings for WLR analogue exchange line products to ensure that BT's charges were based on its reasonably incurred costs. Charge ceilings also provide greater certainty to WLR providers who could then base their business plans on the basis of a charge that will not increase beyond a certain level.
- 3.4 Charge ceilings have similar properties to charge controls in that they allow BT flexibility to vary charges within the ceiling. This means, for example, that reductions in cost may be followed by reductions in charges. Establishing an exact charge would not allow for this. Changes in cost may come about for a number of reasons. For example, BT's undertakings in lieu of a reference under Part 4 of the Enterprise Act 2002 require BT to ensure that there is 'equivalence of inputs' for WLR<sup>18</sup>. There may be cost reductions as a result of this and if Ofcom were to determine the precise level of a charge, BT's flexibility to reduce the charge to reflect reduced costs would be

<sup>18</sup> "Equivalence of Inputs" or "EOI" means that BT provides, in respect of a particular product or service, the same product or service to all Communications Providers (including BT) on the same timescales, terms and conditions (including price and service levels) by means of the same systems and processes, and includes the provision to all Communications Providers (including BT) of the same Commercial Information about such products, services, systems and processes. In particular, it includes the use by BT of such systems and processes in the same way as other Communications Providers and with the same degree of reliability and performance as experienced by other Communications Providers.

limited. Ofcom considered that setting charge ceilings would thus provide benefits to industry whilst not imposing an undue burden on BT.

### **Responses to the November consultation**

- 3.5 Respondents agreed with Ofcom's proposal to set charge ceilings rather than determine exact charges. They did, however, have a number of concerns in relation to the treatment of some of the different costs that were used to set the proposed charges ceilings. Ofcom has responded to these below.
- 3.6 Therefore, Ofcom has proceeded to set charge ceilings for residential and business analogue exchange line services and for new line installations and transfers of service. The Direction setting charge ceilings is set out in Annex 1.

### **Cost recovery**

- 3.7 The DGT set out his decision on the recovery of WLR service costs in the Call Origination Market Review statement. This decision was also set out for ease of reference in paragraph 3.7 of the November consultation document. Ofcom considers that the principles set out therein remain appropriate.
- 3.8 Table 3.1 summarises how WLR costs should be recovered.

**Table 3.1: Application of the principles of cost recovery to WLR per service and system set-up costs**

	<b>Suggested mechanism of recovery</b>			
<b>Principle</b>	<b>System set-up costs</b>	<b>Per provider set-up costs</b>	<b>Per provider ongoing costs</b>	<b>Per customer line set-up costs</b>
Cost causation	Neutral	Per SP	Per SP	Per SP
Distribution of benefits	Across all BT lines	Per SP	Per SP	Per SP
Effective competition	Across all BT lines	Across all BT lines	Across all BT lines	Across all BT lines
Cost minimisation	Across all BT lines	Across all BT lines	Across all BT lines	Across all BT lines
Practicability	Across all BT lines	Across all BT lines	Across all BT lines	Across all BT lines
Reciprocity	Not relevant	Not relevant	Not relevant	Not relevant

### **LRIC+ methodology**

3.9 The Call Origination Market Review statement set out the requirements placed on BT to set charges for, amongst others, WLR services on the basis of its long run incremental cost (LRIC). It also allowed BT to recover common costs through an appropriate mark-up and to earn an adequate return on capital employed (ROCE) (SMP services condition AA3). An appropriate mark-up would cover a reasonable share of common costs consistent with the overall recovery of these costs given that a proportion of them are covered by charges for local loop unbundling services and the wholesale narrowband interconnection services covered by the network charge controls (“NCCs”) <sup>19</sup>. The ROCE should be equal to the cost of capital.

### **CCA FAC**

3.10 Current cost accounting with fully allocated costs (CCA FAC) and LRIC+ are two different ways of apportioning common costs. While LRIC+ has been preferred in the past, it has the disadvantage of involving a time consuming operation which BT carries out on an irregular basis. Ofcom has little visibility of how BT generates costs from its LRIC model, and this extra iteration by BT of its financial data is not subject to external audit scrutiny. Performance monitoring on a LRIC basis against BT’s actual financial performance is not straightforward, as routinely prepared wholesale service profitability information is prepared on a CCA FAC basis. CCA FAC data, on the other hand, can be reconciled to the audited regulatory financial statements.

3.11 In setting the NCCs and local loop unbundling charges <sup>20</sup>, Ofcom used CCA FAC as the appropriate basis for setting charges (with the exception of certain copper costs). CCA FAC was preferred to LRIC+ because of the transparency benefits described

<sup>19</sup> <http://www.ofcom.org.uk/consult/condocs/charge/statement/>

<sup>20</sup> <http://www.ofcom.org.uk/consult/condocs/llu/statement/>

above and because LRIC+ is not conceptually superior to CCA FAC as a cost basis for setting charges. Ofcom has, therefore, set WLR charge ceilings on a consistent basis with the charge ceilings set for local loop unbundling, particularly given that many components are shared by local loop unbundling and WLR and to avoid overall under- or over-recovery of costs.

### **The regulatory asset valuation**

- 3.12 In the valuation of copper statement, Ofcom concluded that it was no longer appropriate to value BT's pre-1 August 1997 copper access network assets on the basis of CCA FAC (or LRIC+). This was because to do so would have allowed BT to over-recover the costs of those assets which had been valued under the historical cost accounting ("HCA") convention. In order to avoid the potential for such over-recovery, and given that it is unlikely that any operator will build a new nationwide access network in competition with BT in the near future, Ofcom decided to create a regulatory asset value (RAV) to represent the remaining value of the pre-1997 copper access network assets rather than continuing to value those assets at their current cost. The value of the RAV is set to equal the closing historical cost accounting value for the pre-1 August 1997 assets for the 2004/05 financial year and increased in each year thereafter by RPI to ensure that it is not eroded by inflation. The RAV will disappear gradually as the pre-1997 assets are replaced with new assets. Assets that have been valued consistently throughout their lives to date on a CCA FAC basis will continue to be valued using the CCA convention.
- 3.13 Therefore, the costs of the local loop – which are an important component of total WLR costs – reflect an average of the costs associated with pre-1 August 1997 assets, based on the RAV, and the costs associated with post-1 August 1997 assets, calculated using CCA FAC. The other components of the WLR rental charges are based on CCA FAC.

### **BT cost data**

- 3.14 Ofcom has used BT's audited 2004/05 regulatory accounting cost data for the proposed WLR charge ceilings.
- 3.15 Ofcom has assessed BT's cost data and made adjustments to ensure that:
- only relevant costs are included;
  - no double counting takes place; and
  - costs are based on efficiently incurred cost levels.

### **Rate of return on capital employed**

- 3.16 The appropriate rate of return that Ofcom has included in the charges for WLR services is the cost of capital BT is currently allowed on its regulated copper access activities. This cost of capital is equal to the weighted average cost of capital for the activities assessed using the capital asset pricing model.
- 3.17 As a result of Ofcom's review of BT's cost of capital (see footnote 5), Ofcom concluded that the appropriate rate of return on capital employed for BT's access network is 10.0%. This percentage has been used in setting the WLR charge ceilings.

## Charge control

- 3.18 Costs are likely to increase or decrease over time and charges for regulated services should reflect these movements in costs. Ofcom has chosen to attempt to reflect movements in cost by determining charges periodically or by setting charge controls which include an estimate of movements in cost. Charges that are re-determined regularly have a number of positive properties, but provide the dominant provider with limited incentives towards cost minimisation and provide little predictability for competing providers. Charge controls, on the other hand, provide predictability in that they are set for a specified period and might be expected to reflect the way efficiency gains are reflected in prices in competitive markets. In general, a charge control constrains the movement of regulated charges so that they reflect any cost savings derived from expected volume increases, expected reductions in asset and input prices and expected efficiency improvements (assessed via benchmarking). A charge control also allows the retention of all gains from unanticipated efficiency improvements for the period of the control, thus providing the dominant provider with incentives towards cost-efficiency.
- 3.19 In the Call Origination Market Review statement, the DGT set a charge control that applied to residential analogue WLR and business analogue WLR services (SMP services condition AA4). The charge control was set at RPI-2% and was due to expire on 31 August 2006.
- 3.20 The residential WLR analogue rental charge is now significantly below the maximum allowed by the RPI-2% control. Ofcom has, therefore, needed to consider whether it should: (a) amend the charge control; (b) set a new charge control; or (c) amend SMP services condition AA4 to disapply the charge control obligations to the extent that they apply to WLR services. Although demand for WLR services is growing, the take-up of WLR in the medium- to long-term is not sufficiently certain (especially given the changes to the charges) to set a sufficiently robust charge control. The implementation of 'equivalence of inputs' will add further uncertainty to the costs, as this will require the development of entirely new systems which will be used by both WLR providers and BT's retail activities.
- 3.21 For those reasons, Ofcom has decided that it should disapply the charge control obligations in relation to WLR services. This is set out at Annex 2. Ofcom will review the need for a charge control the next time that it reviews the markets in which the WLR products reside or it otherwise needs to review the charges, e.g. as set out at 1.16. Therefore, the charge ceilings will remain in place until any such time.

## Cost categories for the wholesale line rental charge

- 3.22 The following cost categories are included in the wholesale line rental charge ceilings:
- **E-side and D-side capital and maintenance** – the exchange side (E-side) and distribution side (D-side) infrastructure, which were considered in the valuation of copper statement;
  - **MDF (main distribution frame) capital and maintenance** – the equipment where local loops terminate and cross connections to competing providers' equipment can be made;
  - **Drop capital and maintenance** – the drop wire from the street to the customer premises;

- **Selling and general administration costs** – these costs are the administrative costs BT incurs in providing WLR;
- **Line cards** – the electronic cards in the exchange that provide connectivity to the switch;
- **Line test costs** – the costs of the functionality required to test lines provided to WLR providers; and
- **Costs of transfers not recovered in the transfer charge** – in the interest of minimising barriers to switching Ofcom considers that some of the costs associated with transfers should be recovered in the line rental.

### Assumptions applied to the cost categories

- 3.23 The assumptions used for each of the cost categories are set out below. In each case, unless stated otherwise, BT has provided Ofcom with cost data for 2004/05 from its regulatory accounts.
- 3.24 Except where otherwise identified below, Ofcom considers that the cost data provided by BT includes relevant costs only, contains no double counting and is based on efficiently incurred cost levels.

### Forecasting costs

- 3.25 Ofcom explained in the November consultation that it intended to follow the same approach as that which it took in establishing the charge ceilings for local loop unbundling, i.e. to base the charge ceilings on projected costs for 2005/06. For those costs not covered by the copper cost review, Ofcom has applied an RPI of 2.5% to BT's 2004/05 operating costs to calculate its costs for 2005/06.

### Responses to the November consultation

- 3.26 In the main, respondents did not comment on Ofcom's approach. However, BT argued that Ofcom should not forecast costs for 2005/06 in setting the charge ceilings, as these forecast costs could not be expected to reflect BT's likely costs in providing the relevant products thereafter (that is, in the following years). BT stated that Ofcom should review the charge ceilings based on the latest data set available in about 12 months. In terms of the level of the RPI, BT stated that Ofcom should take an average value for the last 12 months.

### Ofcom's response

- 3.27 Ofcom has considered both forecasting costs beyond 2005/06 and setting a charge control. However, Ofcom considers that present costs are not sufficiently stable to forecast costs beyond 2005/06 or for a charge control to be imposed, especially given that charge controls are generally set for a period of four years. Further, where a charge is below the charge ceiling, BT is able to set a cost oriented price at or below the ceiling without needing to seek Ofcom's permission. As such, BT has some flexibility to both increase and decrease its charges in line with cost movements. If in the future BT believes that it is no longer able to materially recover its relevant costs and charge below the ceiling, then it should make representations to Ofcom that a review of the ceiling is necessary. Additionally, as noted at paragraphs 1.16 and 3.21, Ofcom considers that it may be necessary to reassess the WLR charge ceilings in light of significant changes in cost.

- 3.28 In the valuation of copper statement, Ofcom explained that it had calculated the RAV for 2005/06 on the basis of an average RPI of 2.5% over the year and that it intended to incorporate the conclusions of that review in the normal cycle of price reviews of the relevant products. Ofcom has therefore based the WLR charge ceiling on the value of the RAV as set out in that statement. Ofcom believes that 2.5% remains a reasonable assumption for RPI in 2005/06. At the end of each financial year, the RAV will be recalculated on the basis of the actual rate of RPI in the financial year, on a backward looking basis. The impact of actual RPI rates will therefore be reflected when prices are set for future periods.
- 3.29 For reasons of consistency, Ofcom considers that the same RPI should be applied to non-copper costs to avoid copper and non-copper costs in the same charge being forecast on a different basis.

### **The efficiency factor**

- 3.30 Ofcom explained in the November consultation that it intended to use the same efficiency factor (1.5% per annum reduction in real unit access costs) to calculate the charge ceilings for WLR as that which it used to establish the charge ceilings for local loop unbundling. Ofcom applied this efficiency factor to the operating costs that it forecast that BT would incur in 2005/06 in comparison to those it actually incurred in 2004/05. The estimated efficiency gain expected was based on a number of factors including various studies carried out by NERA on behalf of Ofcom<sup>21</sup> in which BT's relative efficiency was considered.

### **Responses to the November consultation**

- 3.31 Respondents' views contrasted. BT stated that the efficiency target was too challenging whereas other respondents argued that it was not challenging enough. BT's argument focussed on known increases in its costs (e.g. in terms of the rateable value of its network) that might undermine any efficiency gains that might otherwise be expected. Other respondents suggested that competition has driven down BT's costs in parts of the business which do not constitute part of the access network and, therefore, the efficiency factor applied to the access network should be higher.

### **Ofcom's response**

- 3.32 As explained in the November consultation, Ofcom wished to ensure that it treated WLR and local loop unbundling consistently. For local loop unbundling, Ofcom stated that a 1.5% annual rate of real unit cost reduction was a reasonable assumption for BT's access network and this was reflected in the charge ceilings. Ofcom does not, therefore, intend to adjust the efficiency factor applied in this case. Forward-looking efficiency assessments require a certain amount of judgement on the likely scope of potential efficiency gains. Respondents' contrasting views reflect that this is the case.
- 3.33 Therefore, Ofcom has set the charge ceilings for WLR on the basis that BT's access network can increase its efficiency by 1.5% in 2005/06.

### **D-side and E-side capital and maintenance**

- 3.34 As explained in the November consultation, Ofcom set out its methodology for assessing and apportioning costs between the distribution side (D-side) and the

<sup>21</sup> <http://www.ofcom.org.uk/consult/condocs/charge/main/nera.pdf>

exchange side (E-side) of BT's network in the valuation of copper statement. On the basis of this, Ofcom concluded that a reasonable estimate of these costs for WLR is £58.51 per line for the financial year 2005/06.

### Responses to the November consultation

- 3.35 BT made two comments in relation to the relative costs associated with the D-side and E-side of its network and the interrelationship between those costs, local loop unbundling and WLR. BT argued, first of all, that as an adjustment had been made to the D-side line length for local loop unbundling due to distance limitations of broadband this implied that, on average, there is a longer line length for lines that are not used for broadband. Second, BT argued that, as broadband lines experience a higher incidence of fault rates than narrowband lines, and this was not reflected in the permitted maintenance costs used to set the charge ceiling for local loop unbundling, it would be appropriate to recognise these costs across the combined local loop unbundling and WLR system size.

### Ofcom's response

- 3.36 For local loop unbundling, Ofcom made the line length adjustment to reflect the technical limitations of broadband and it was not based on the actual average cost of such lines based, for example, on an assessment of the probable location of such lines (paragraphs 4.23 and 4.24 of that statement refer). As such, Ofcom is of the view that no adjustment is required for WLR.
- 3.37 Ofcom has used the average fault rate for all lines in setting the charge ceilings for both local loop unbundling and WLR. This implies that all costs are recovered in total and that the approach taken is consistent across both products.
- 3.38 The valuation of copper statement stated an indicative cost of the in-scope assets relevant to a WLR line of £58.51 (the corresponding figure for local loop unbundling was £60.11). These figures did not take into account differing fault rates but were calculated based on averaged maintenance costs taking into account the presence of pair gain equipment (Digital Access Carrier System (DACs)) on some WLR loops.

### Pair Gain equipment

- 3.39 Pair gain technology is used to provide two PSTN lines over a single pair of copper wires. The technology is used by BT to provide an additional line without needing to lay additional copper wire. BT has provided Ofcom with data which suggest that a small proportion of lines are provided by pair gain technology. Therefore, BT's figures for the cost stack for WLR included costs for such equipment and it also made an adjustment to reduce the copper costs in line with the proportion of the relevant lines being provided by this equipment.
- 3.40 Ofcom proposed in the November consultation to exclude these costs and the adjustment from the WLR cost stack on the grounds that the benefits appeared to accrue to BT.

### Responses to the November consultation

- 3.41 BT argued that the use of pair gain equipment should not be excluded from the WLR cost stack as its utilisation has benefited all customers as, amongst other things, BT has been able to provide service more rapidly and avoided additional capital

investment by deploying such equipment and therefore the average cost of a line is lower than it otherwise would have been. BT claimed that therefore these costs are those that would be incurred by an efficient operator. It also explained that, in any case, the difference in costs between the two options set out in the November consultation – that is, including the costs and the adjustment or not – was slight.

3.42 Two other respondents agreed with Ofcom's proposal without explaining why.

### **Ofcom's response**

3.43 In the light of BT's arguments, Ofcom accepts that the utilisation of pair gain equipment can be an efficient method to provide a second line over a single copper pair and it has, therefore, reinstated the relevant costs and adjusted costs in the manner described in the November consultation. The difference that this makes in terms of the cost stack is, however, immaterial and does not, therefore, alter the charge ceiling set out in the November consultation.

### **MDF capital and maintenance costs**

3.44 The costs associated with MDF capital and maintenance have been spread over all loops which use the MDF to give a unit cost. For each specific product, BT has calculated costs using the unit cost multiplied by a usage factor. The costs are apportioned across products that utilise the MDF to a greater or lesser extent as appropriate. For example, on this basis, PSTN and WLR services take a smaller proportion of MDF costs compared to local loop unbundling services. Ofcom considers that BT's costs and approach appear reasonable.

### **Drop wire capital and maintenance costs**

3.45 Drop wire is the name given to the part of BT's network linking the distribution point to the end-user's premises. The name is derived from the line that linked (formerly) telegraph poles (the distribution point) to the end-user's premises. More often than not, this is now delivered underground.

3.46 The proposed approach that was set out in the November consultation is consistent with that taken in the calculation of the local loop unbundling charge ceilings (see paragraphs 3.33 and 3.34 of that statement). There are, however, distinct charges for business and residential WLR lines and this reflects the different way in which the costs of business and residential drop wires are recovered in WLR charges (see paragraph 3.49). In terms of the physical delivery mechanism, there is, however, no difference between a single residential and single business line.

3.47 In the main, the costs associated with a drop wire are incurred in one of two circumstances. These are: (a) the new installation of a drop wire (capital expenditure); and (b) the ongoing maintenance and replacement of a drop wire (operating expenditure). For drop wires installed prior to the financial year 2001/02, BT expensed them or, in other words, wrote them off within the year. Since then BT has chosen to write-off drop wire costs over their average life (i.e. 10 years). Ofcom considers, therefore, that any drop wire capital costs incurred prior to 2001/02 have already been recovered.

3.48 As explained in the local loop unbundling statement, the current retail price control (which is due to end on 31 July 2006) was set at its current level on the basis that historic drop wire costs were expensed and that capital and operational costs for installing and maintaining drop wires for the period of the price control were also

treated as expensed (in other words, the cap was set to cover these costs in the year that they were incurred). Ofcom considered, therefore, that it was not appropriate to include these costs in setting the charge ceiling for WLR as they were recovered elsewhere. The retail price control, however, does not cover business lines and, as a consequence, capital and operational expenditure on drop wire costs for business customers were not included in the cost base used to inform the setting of the retail price control.

- 3.49 The drop wire capital and operating expenditure costs for business customers were, therefore, incorporated in the charge ceiling for unbundled local loops on an averaged basis. For WLR, however, there are separate residential and business products. The essential difference between the two products relates to the associated service levels, with the latter receiving a higher quality of service, particularly in relation to the speed of fault repair, and a higher charge. Ofcom considers, therefore, that it is appropriate for the costs of business drop wires to be included in the charge ceiling for the analogue business WLR product. The different treatment of drop wire costs explains the difference between the charge ceilings for the retail and business analogue WLR rental products.
- 3.50 In addition, an allowance was made in the local loop unbundling rental charge ceiling for the cost of new provide local loop unbundling drop wires, i.e. those which have never been BT retail lines. A similar allowance is appropriate for WLR lines. However, the proportion of WLR lines which are new line installations (i.e. new provides) is lower than that for local loop unbundling lines, even allowing for the expected reduction in the use of local loop unbundling for second lines. Given that BT Retail will also pay WLR charges, Ofcom believes that it is appropriate to use the share of new line installations in all BT Retail and WLR lines to calculate the allowance for the cost of new line installation drop wires in the WLR rental. This is approximately 6%. Ofcom has therefore included 6% of the depreciation and annual cost of capital associated with a new drop wire in the WLR charge ceiling.

### **Responses to the November consultation**

- 3.51 BT argued that the way in which the current retail price control was set should not determine whether or not it can recover drop wire costs via the charge for WLR. It stated that by offsetting one against the other Ofcom has understated the charge ceiling for the WLR residential product. BT argued that its retail PSTN customers were contributing to the cost of the drop wire for wholesale products.

### **Ofcom's response**

- 3.52 As explained in the local loop unbundling statement, the principles of cost recovery reflect the assumption that costs should not be over-recovered. As such, because the current retail price control includes the full costs associated with residential drop wires, to include them in setting a ceiling for the WLR analogue exchange line product would result in an over-recovery of these costs. If, in the event of a change to the treatment of drop costs in any successor to the retail price control, BT finds that it is no longer able to materially recover its relevant costs and charge below the ceiling, then it should make representations to Ofcom on this basis.
- 3.53 Any change in the internal structure of BT would not alter Ofcom's present views in relation to the principles of cost recovery and the need to ensure that BT does not over-recover its costs.

### **Selling and general administration (S&GA) and ASD development costs**

- 3.54 Ofcom explained in the November consultation that the proposed charge ceilings for WLR products included the relevant wholesale costs incurred by BT in providing WLR products. These costs include relevant systems costs and costs for activities such as billing and customer support, all of which are required to support WLR.
- 3.55 BT did not provide regulatory accounting data for these S&GA costs. Instead, it estimated what these costs were likely to be following the implementation of equivalence of inputs. BT based its estimates on two inputs:
- the current per line S&GA costs for BT's wholesale broadband services; and
  - the costs BT expects to incur in developing the new equivalence of input systems to be used spread across all PSTN lines over five years.
- 3.56 BT's approach to the development costs of equivalent systems appears reasonable and it also appears reasonable that these costs should be recovered across all lines given that all consumers benefit.
- 3.57 Ofcom explained, however, that economies of scale mean that the average SG&A cost for all lines should be less than the amount calculated for wholesale broadband lines only, which use a separate system. Ofcom, therefore, applied a cost volume elasticity (CVE) factor of 0.45 in calculating the S&GA costs appropriate for WLR. This means that for each 1% increase in volume the S&GA costs for WLR will only increase by 0.45%.

### Responses to the November consultation

- 3.58 BT argued that the application of a CVE to SG&A costs was inconsistent with the approach taken in setting charge ceilings for local loop unbundling and that it was inappropriate to apply such a factor now because the charge ceiling should reflect the costs that BT actually incurs. BT recognised, however, that in the long run the application of a CVE may be appropriate. BT also stated that the value of the CVE applied was not based on any direct evidence. The latter point was also made in another response.

### Ofcom's response

- 3.59 Ofcom applied a CVE to the S&GA costs to take into account the greater economies of scale likely to exist in WLR in comparison to local loop unbundling given the comparative number of narrowband and broadband lines. The CVE factor applied in this case is not unreasonable and represents economies of scale that are likely to exist and is significantly higher than that used in setting the NCCs.

### Line cards

- 3.60 The costs associated with line cards are only applicable to PSTN and WLR products. Ofcom explained in the November consultation that it had, therefore, pooled and spread these costs over PSTN and WLR volumes to derive a unit cost.

### Responses to the November consultation

- 3.61 BT explained that it has not replaced the majority of its PSTN line card set because it is waiting for a suitable broadband and voice card to be developed and it will, therefore, increase its investment in line cards significantly once this dual purpose card becomes available. BT stated that this means that the average age of its current

stock of line cards is higher – and its value, therefore, lower – than it would be in normal conditions. It suggested, therefore, that basing costs on its current asset base means that the WLR charge ceilings do not take account of forthcoming investment and understate the “normal” level of costs.

### **Ofcom’s response**

- 3.62 Ofcom does not consider that it should take account of forthcoming investment in multi-purpose line cards because this would result in the over-recovery of costs for the present line card set. BT can make representations to Ofcom should it find that it cannot cover its costs and set charges at or below the charge ceiling.

### **TAM and line test costs**

- 3.63 The costs of the local loop unbundling test access matrix (LLU TAM) and PSTN line test costs have been pooled together and spread over all lines.

### **WLR transfer charge ceilings**

- 3.64 Ofcom explained in the November consultation that it has used BT’s residential PSTN takeover activity as a starting point from which to estimate the reasonable cost of analogue WLR transfers. It has, however, made a number of adjustments to this cost stack such as the removal of sales and marketing costs and reduced general management and customer service costs. The reason for these adjustments is to reflect that part of this work would be carried out by BT and the remainder by the WLR provider.
- 3.65 The initial starting charge for a transfer of a line (£1.41) reflected the fact that many of the costs associated with the transfer of a line to a WLR service provider were included in the ongoing rental cost stack because the DGT was concerned that a high transfer charge might act as a barrier to switching. Ofcom considers that this approach continues to remain appropriate. But the appropriate balance between the costs that should be recovered through the ongoing rental charge and those that should be recovered through the transfer charge was not precisely defined.
- 3.66 Ofcom explained, therefore, in the November consultation that it intended to set a transfer charge ceiling slightly above the current charge for residential and business WLR at £2.00 per line, increasing slightly the potential for costs to be recovered in the transfer charge. Other costs associated with a transfer are recovered through the annual analogue WLR rental charges (taking into account inflation, efficiency gains, discounting and churn rates).

### **Responses to the November consultation**

- 3.67 Two respondents expressed concern with the proposed increase to the transfer charge. Both expressed concerns that Ofcom proposed to include additional costs in the WLR transfer cost stack. BT, on the other hand, expressed concern that the artificially low transfer charge has a knock on effect with regard to the pricing of other WLR products.

### **Ofcom’s response**

- 3.68 Ofcom explained in the November consultation that there is no uniquely correct balance between transfer and rental charges. Ofcom has, however, taken the same approach to that which it took when setting starting charges for WLR services (see

footnote 1) which was to keep transfer charges relatively low. Ofcom does not believe that, even if BT increased the transfer charge to the ceiling, it would deter switching. It should be noted that a reduction in the transfer charge would result in an increase in the rental charge and vice versa. BT does not earn more money either way. Ofcom has therefore maintained the split set out in the November consultation.

### **WLR new line installation charge ceilings**

3.69 Ofcom explained in the November consultation that it had calculated the charge ceiling for business and residential analogue WLR connection charges using the costs and volumes for all analogue new line installations (i.e. BT's own new line installations and WLR new line installations). Ofcom considers that this is a reasonable approach as the work involved should be the same regardless of whether it is carried out for BT's downstream business or a WLR provider. Ofcom also intended to use the methodology described above for recovering transfer costs in the rental charge to calculate the new line installation charges for the WLR products. The charge set out in the November consultation, however, did not reflect this. The revised calculation has, therefore, resulted in a reduction of the charge ceilings for new line installations from £90.00 to £88.00.

### **Business ISDN2 WLR**

3.70 Ofcom considered whether it was necessary to set any charge ceilings for business ISDN2 WLR. Ofcom took into account a number of issues including whether the current charge appeared reasonable, existing regulation of ISDN2 charges, the impact of Ofcom's work on the cost of copper on ISDN2 and the characteristics of ISDN2 services.

3.71 Ofcom found that the rental charges (£220 per annum per line) for business WLR ISDN2 were reasonable, even taking into account Ofcom's work on the costs of copper and capital. Ofcom noted that copper costs represent a significantly smaller proportion of digital access products, such as business WLR ISDN2 charges, than of analogue products.

3.72 Ofcom also took into account that it had not in the past set charges or charge ceilings for business WLR ISDN2 and that to do so would extend regulation, which is not in keeping with Ofcom's strategy.

3.73 On the basis of these considerations, Ofcom decided that it need not set a charge ceiling for business WLR ISDN2. Ofcom noted, however, that BT needed to ensure that charges remained cost oriented.

### **Responses to the November consultation**

3.74 Three respondents made substantive points in relation to Ofcom's proposal not to set a charge ceiling for business WLR ISDN2. Two agreed with Ofcom's proposal and one did not. Cable & Wireless stated that it had expected that Ofcom would set a charge ceiling for business WLR ISDN2 charges and that this ceiling would be lower than the present charge. The main basis for this expectation was the work that Ofcom undertook in relation to the valuation of the copper network and the relevant cost of capital for the access network. This work has resulted in lower charges for other regulated access products. In addition, Cable & Wireless explained that it had examined BT's Financial Statements for 2004/05 and these had shown that the charge for WLR ISDN2 for that financial year was cost oriented and that these

statements did not take account of Ofcom's work in relation to the cost of copper and capital applied.

- 3.75 The other respondents agreed that it was not appropriate to set a charge ceiling for WLR ISDN2.

### **Ofcom's response**

- 3.76 The proposed charge ceilings which were set out in the November consultation were based on a detailed study of each of the cost stacks for the various WLR products. Ofcom also examined the cost stack for business WLR ISDN2 on the same basis and took into account its valuation of copper and its assessment of the appropriate cost of capital for access. Ofcom's analysis found that the charge for business WLR ISDN2 is slightly below the ceiling that it might have set based on its assessment of relevant costs. Therefore, in order to avoid extending regulation, Ofcom proposed not to set a charge ceiling for business WLR ISDN2.
- 3.77 Ofcom's view has not changed and it has not, therefore, set charge ceilings for business WLR ISDN2. Ofcom's analysis suggests that the current charges are reasonable.

### **Other matters**

- 3.78 In its response to the November consultation, Easynet explained that there was a clear linkage between WLR and local loop unbundling and that a reduction in charges for the former could have a negative effect on the likelihood of investment in the latter. Easynet explained that the primary purpose of WLR is to enable resellers to provide voice services without needing to invest significantly whereas local loop unbundling, which can be used to provide both voice and data services, requires investment of a significant magnitude. Easynet suggested, therefore, that Ofcom needs to consider each product in the context of its regulatory approach to the other. Easynet recognised, however, that this was not an issue on which Ofcom was seeking views and nor was it something which would be resolved via its response to this discrete exercise the primary purpose of which was to set WLR charge ceilings.

### **Ofcom's response**

- 3.79 Ofcom believes that, by setting cost-based charge ceilings for both WLR and local loop unbundling, it is giving appropriate signals for investment. It has been careful to ensure that the charge ceilings for WLR and local loop unbundling are calculated in a consistent way in order to avoid distorting choice. In addition, as Easynet notes, WLR and local loop unbundling are currently used to provide different services and so are not close substitutes.

### **The Regulatory Asset Valuation and the WLR charge ceilings**

- 3.80 As explained in paragraphs 3.12 and 3.13, for the purposes of calculating the charge ceilings Ofcom considers that it is appropriate to base the value of BT's pre-1 August 1997 copper access network assets on the value of the RAV set out in the valuation of copper statement. The reasons for the adoption of the RAV are set out in full in that statement. Given that BT's pre-1 August 1997 copper access network assets account for a significant proportion of the costs that make up the proposed charge ceiling, the charge ceiling itself cannot be said to be 'based' on LRIC+. On the face of it, the charge ceiling is therefore not consistent with SMP services condition AA3, imposed on BT in November 2003, which requires BT to ensure that its charge for

WLR products are 'based' on LRIC+. For this reason, Ofcom has included specific wording in the Direction set out at Annex 1 to make it clear that the obligation in SMP services condition AA3.1 – which is a requirement for BT to base charges on LRIC+ – does not apply in respect of these charge ceilings.

## Section 4

# Conclusions, charges, and next steps

4.1 For the reasons set out in Section 3, Ofcom has concluded that it is necessary to set charge ceilings for the rental, transfer and connection charges for residential and business WLR products and that BT need not set charges for these products on the basis of its long-run incremental costs including an appropriate mark-up and reasonable return (LRIC+) for the reasons set out in paragraph 4.4. In addition, Ofcom has decided to disapply SMP services condition AA4 (the charge control condition) to the extent that it applies to WLR products. Ofcom also considers that BT should implement the charges set out in the Direction at Annex 1 as soon as possible and has, therefore, given BT consent to do so. This consent is set out at Annex 3.

### Direction setting WLR rental, transfer and connection charge ceilings

4.2 In the Call Origination Market Review statement, Ofcom imposed SMP services condition AA10 on BT. This condition requires BT to offer WLR.

4.3 This SMP services condition also allows Ofcom to set charges for WLR products. That is, SMP services condition AA10(3)(f) states that:

“..the Dominant Provider shall modify any of its charges for the provision of Wholesale Line Rental in the manner in which the Director may direct.”

4.4 Therefore, on the basis of the approach set out in Section 3, Ofcom has set charge ceilings as shown in Table 4.1. The Direction also states that BT need not set charges for these services on the basis of its long-run incremental costs including an appropriate mark-up and a reasonable return on its investment because these charge ceilings have been set following Ofcom’s valuation of BT’s copper access network and cannot, therefore, be said to be based on LRIC+.

**Table 4.1 – charge ceilings for analogue WLR services**

	<b>New line installation charge ceiling</b>	<b>Transfer charge ceiling</b>	<b>Line rental charge ceiling</b>
Residential WLR	£88.00	£2.00 per line	£100.68 per line per year
Business WLR	£88.00	£2.00 per line	£110.00 per line per year

### Communications Act tests

4.5 Ofcom considers that the Direction set out at Annex 1 meets the tests set out in the Act.

- 4.6 Ofcom has considered its duties under section 3 and all the Community requirements set out in section 4 of the Act. In particular, the Direction is aimed at promoting competition and securing efficient and sustainable competition for the maximum benefit of retail consumers by ensuring that charges for WLR services are at a level that enables providers purchasing those services to compete in downstream narrowband markets. BT, however, is still able to make a reasonable return and therefore the Direction should not stop investment.
- 4.7 Section 49 of the Act requires directions to be objectively justifiable, non-discriminatory, proportionate and transparent.
- 4.8 Ofcom considers that the Direction is:
- objectively justifiable as it ensures that BT is unable to exploit its market power and enables competing providers to purchase services at levels that enable them to compete in downstream markets to the benefit of consumers;
  - proportionate as it allows BT a fair rate of return that it would expect in competitive markets;
  - not unduly discriminatory to BT because there is no other provider with significant market power currently specifically required to provide WLR services; and
  - transparent in that the requirements on BT are clearly set out in this consultation document.

### **Direction disapplying the WLR charge control**

- 4.9 In the Call Origination Market Review statement, the DGT set a charge control that applied to residential and business analogue WLR services (SMP services condition AA4). Charges for WLR services were capped at RPI-2%. This charge control was due to expire on 31 August 2006.
- 4.10 Ofcom considers, however, that the charge controls set out in SMP services condition AA4 which relate to WLR services do not retain any significance and, therefore, Ofcom considers that it would be inappropriate for the charge control for WLR services to apply hereafter. Ofcom has disappplied these controls, as set out in Annex 2.

### **Communications Act tests**

- 4.11 Ofcom considers that the Direction set out at Annex 2 meets the tests set out in the Act.
- 4.12 Ofcom has considered its duties under section 3 and all the Community requirements set out in section 4 of the Act. In particular, the Direction is aimed at promoting competition and securing efficient and sustainable competition for the maximum benefit of retail consumers because BT will no longer incur regulatory costs in relation to the requirements of the charge control and this will help to promote competition in downstream narrowband markets.
- 4.13 Section 49 of the Act requires directions to be objectively justifiable, non-discriminatory, proportionate and transparent.
- 4.14 Ofcom considers that the Direction is:

- objectively justifiable as the charge control for WLR was originally set to apply to the starting charges set in June 2002 and these new charges are being set (a) on a new basis following Ofcom's analysis on cost of copper and capital and (b) shortly before the charge control was due to expire in any event, i.e. 31 August 2006;
- proportionate as it does not increase the burden on BT beyond the setting of the charge ceilings;
- not unduly discriminatory to BT because there is no other provider with significant market power currently specifically required to provide WLR services; and
- transparent in that the requirements on BT are clearly set out in this consultation document.

### **Consent to disapply the notification period**

- 4.15 In the Call Origination Market Review statement, Ofcom imposed SMP services condition AA6(a) on BT. This condition requires BT to give advance notification before it can change charges, terms and/or conditions.
- 4.16 The requirement to notify charges and terms and conditions requires BT to notify changes to charges and terms and conditions for WLR products not less than 90 days before any such amendment comes into effect (SMP service condition AA6(a).2(a)).
- 4.17 Ofcom considers that the notification period set out in SMP services condition AA6(a).2(a) could potentially delay the introduction of new charges at or below the WLR charge ceilings where set. Ofcom considers, therefore, that it should consent to disapply the notification period under SMP services condition AA6(a).1.

### **Communications Act tests**

- 4.18 Ofcom considers that the Consent set out at Annex 3 meets the tests set out in the Act.
- 4.19 Ofcom has considered its duties under section 3 and all the Community requirements set out in section 4 of the Act. In particular, the Consent is aimed at promoting competition and securing efficient and sustainable competition for the maximum benefit of retail consumers by ensuring that charges for WLR services are given proper effect.
- 4.20 Section 49 of the Act requires directions to be objectively justifiable, non-discriminatory, proportionate and transparent.
- 4.21 Ofcom considers that the Consent is:
- objectively justifiable as it will ensure the timely implementation of the proposed WLR charges;
  - proportionate as it reduces the notification requirement on BT where it is not necessary and would not be of any benefit to other Communications Providers;
  - not unduly discriminatory to BT because there is no other provider with significant market power currently specifically required to provide WLR services; and
  - transparent in that the requirements on BT are clearly set out in this consultation document.

## Next steps

4.22 The charge ceilings set out in Annex 1 are the maximum charges that BT can set for the following WLR products:

(a) for the annual rental of a Wholesale Analogue Line Rental (residential quality of service);

(b) for the annual rental of a Wholesale Analogue Line Rental (business quality of service);

(c) for the Existing Line Transfer of a single analogue Exchange Line (residential quality of service);

(d) for the Existing Line Transfer of a single analogue Exchange Line (business quality of service);

(e) for the New Line Installation (analogue) (residential quality of service); and

(f) for the New Line Installation (analogue) (business quality of service).

4.23 BT is required to reduce its charges for the products listed to a level which is no higher than the charge ceiling in each case where the charge ceiling is lower than the present charge. Ofcom expects BT to introduce any new charges on 1 March 2006 and it has, therefore, given its consent for BT to introduce these charges without needing to give ninety days' notification.

## Section 5

# Impact Assessment

- 5.1 The analysis presented in Section 3, along with the summary set out below, represents an impact assessment, as defined by section 7 of the 2003 Act. The following is in accordance with the Ofcom's impact assessment guidelines<sup>22</sup>:
- 5.2 Ofcom considers that it was necessary to review the charges for residential and business analogue WLR and business ISDN2 WLR services because:
- charges for the analogue WLR products were last set by the DGT in June 2002, subject to a RPI-2% price cap;
  - when Ofcom closed its investigation into BT's charges for business ISDN2 WLR on 17 June 2004, it noted that it would be necessary to review these charges once its review of the cost of the copper loop was completed and once there was more evidence on the take up of business ISDN2 WLR;
  - on 1 August 2005, BT reduced the rental charge for residential analogue WLR services only; and
  - on 18 August 2005, Ofcom published two statements (the valuation of copper statement and an assessment of the appropriate cost of capital for various parts of BT's network). As a result of the implications of these documents, Ofcom considered that the WLR charges – as set in June 2002 and changed in line with the charge control and the voluntary reduction – do not adequately reflect BT's costs.
- 5.3 Therefore, having reviewed the charges for residential and business analogue WLR and business ISDN2 WLR services, Ofcom has:
- set charge ceilings for business and residential analogue WLR rentals, transfers and new line installations; and
  - chosen not to set charge ceilings for business ISDN2 WLR because from its review of the charges Ofcom considers the existing charges appear reasonable and Ofcom has not set charges for business ISDN2 WLR in the past, and to do so now would be an extension of regulation.
- 5.4 Ofcom has decided that it is necessary to set charge ceilings for business and residential analogue WLR rentals, transfers and new line installations. This decision is based on Ofcom's analysis of the cost stacks for these services (see Section 3) and the results of Ofcom's analysis of the valuation of BT's copper access network and BT's cost of capital
- 5.5 Ofcom considered three main options regarding how to make the appropriate changes to BT's charges, i.e. setting exact charges; setting exact charges and a charge control; and setting charge ceiling. Ofcom considers that in this case it is preferable to set charge ceilings as this gives BT scope to charge below the ceiling should it so wish, which would not be permitted if Ofcom set exact charges. In calculating the charge ceilings, Ofcom has made a number of assumptions. A charge ceiling provides BT with the flexibility to charge below the proposed ceiling in the

<sup>22</sup> *Better Policy Making*, 21 July 2005, which can be found at [http://www.ofcom.org.uk/consult/policy\\_making/guidelines.pdf](http://www.ofcom.org.uk/consult/policy_making/guidelines.pdf)

event that its own assumptions are different to those Ofcom has applied and if costs move over the period in which the ceiling is in place. Determining charge ceilings for WLR line rental, transfer and new line installation services constrains BT's ability to potentially set excessive charges that could hinder the development of competition. Additionally, Ofcom is of the view that although demand for WLR services is growing, the take-up of WLR in the medium- to long-term is not sufficiently certain (especially given the changes to the charges) to set a sufficiently robust charge cap.

- 5.6 Ofcom has also disapplied the RPI-2% charge control with regards to WLR and has given consent to BT to change charges more quickly than allowed for by the 90-day notification period.

## Annex 1

# Direction setting charge ceilings for Wholesale Line Rental Services

**Direction under section 49 of the Communications Act 2003 and SMP services conditions AA3.1, AA10.3(a)(ii) and AA10.3(f) imposed on British Telecommunications plc as a result of the market power determinations made by the Director General of Telecommunications that British Telecommunications plc has significant market power in the markets for wholesale residential analogue exchange line services and wholesale business analogue exchange line services in the United Kingdom, excluding the Hull Area**

WHEREAS:

- A. As a result of a market analysis carried out by the Director General of Telecommunications (the 'Director'), he proposed on 17 March 2003 and on 26 August 2003, in accordance with sections 48(2) and 80 of the Act that the Dominant Provider has significant market power ('SMP') in the markets for among others wholesale residential analogue exchange line services and wholesale business analogue exchange line services in the UK, excluding the Hull Area and the setting of certain SMP services conditions;
- B. The Director having considered every representation duly made, and thereafter on 28 November 2003 pursuant to sections 48(1) and 79 of the Act by way of publication of a Notification identified the relevant services markets, made market power determinations to the effect referred to in recital (A) above and set certain SMP services conditions on the Dominant Provider to take effect on 28 November 2003, unless otherwise is stated in Schedule 1 thereto; including SMP services condition AA3, which requires BT to secure that its charges are reasonably derived from the costs of provision on a forward looking long-run incremental cost approach and allowing an appropriate mark up for the recovery of common costs including an appropriate return on capital employed, and SMP services condition AA10, which requires BT to provide specific Wholesale Line Rental Services on reasonable terms and modify its charges for the provision of Wholesale Line Rental in the manner in which the Director may direct;
- C. This Direction concerns matters to which SMP services conditions AA3 and AA10 relate;
- D. By virtue of the Transitional Provisions the Director was able to exercise the powers under the Act for an interim period. OFCOM assumed those powers as of 29 December 2003;
- E. On 9 November 2005, OFCOM published a Notification of a proposal to give this Direction in accordance with section 49(4) of the Act and invited representations about the proposed Direction by 12 December 2005;
- F. In accordance with section 50 of the Act, a copy of the Notification was sent to the Secretary of State, the European Commission and the regulatory authorities of every Member State;
- G. By virtue of section 49(9) of the Act, OFCOM may give effect to the proposal set out in the Notification, with or without modification, only if –

(a) they have considered every representation about the proposal that is made to them within the period specified in the notification; and

(b) they have had regard to every international obligation of the United Kingdom (if any) which has been notified to them for this purpose by the Secretary of State;

H. For the reasons set out in the explanatory statement accompanying this Direction, OFCOM is satisfied that it is acting in accordance with the relevant duties set out in section 3 and 4 of the Act in giving this Direction;

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

(a) objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;

(b) not such to discriminate unduly against particular persons or against a particular description of persons;

(c) proportionate to what it is intended to achieve; and

(d) in relation to what it is intended to achieve, transparent.

J. OFCOM has considered every representation about the proposed Direction duly made to it and the Secretary of State has not notified OFCOM of any international obligation of the United Kingdom for this purpose; and

**NOW, THEREFORE, PURSUANT TO SECTION 49 OF THE ACT AND SMP SERVICES CONDITIONS AA3.1, AA10.3(a)(ii) AND AA10.3(f), OFCOM HEREBY GIVES THE FOLLOWING DIRECTION:**

1. The Dominant Provider shall not charge more than:

(a) for the annual rental of a Wholesale Analogue Line Rental (residential quality of service), £100.68 (the charge for which shall be pro rated and levied on no less than a quarterly basis);

(b) for the annual rental of a Wholesale Analogue Line Rental (business quality of service), £110.00 (the charge for which shall be pro rated and levied on no less than a quarterly basis);

(c) for the Existing Line Transfer of a single analogue Exchange Line (residential quality of service), £2.00;

(d) for the Existing Line Transfer of a single analogue Exchange Line (business quality of service), £2.00;

(e) for the New Line Installation (analogue) (residential quality of service), £88.00; and

(f) for the New Line Installation (analogue) (business quality of service), £88.00.

2. The obligation on the Dominant Provider by virtue of AA3.1 to secure, and be able to demonstrate to the satisfaction of OFCOM, that each and every charge offered, payable or proposed for Network Access covered by Condition AA1(a) and/or Condition AA10 is based on a forward looking long-run incremental costs approach and allowing an appropriate mark

up for the recovery of common costs including an appropriate return on capital employed, shall not apply in respect of the charge ceilings set out in paragraph 1 above only;

3. For the purposes of interpreting this Direction, the following definitions shall apply:

**(a) "Act"** means the Communications Act 2003;

**(b) "Dominant Provider"** means British Telecommunications plc (BT), whose registered company number is 1800000, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 736 of the Companies Act 1985, as amended by the Companies Act 1989;

**(c) "OFCOM"** means the Office of Communications;

**(d) "The Notification"** means the Notification referred to in recital (B) as amended;

**(e) "Transitional Provisions"** means sections 408 and 411 of the Act, Article 3(1) of the Communications Act 2003 (Commencement No. 1) Order 2003 and Article 3(2) of the Office of Communications 2002 (Commencement No. 3) and Communications Act 2003 (Commencement No. 2) Order 2003;

4. Except insofar as the context otherwise requires, words or expressions shall have the meaning assigned to them in paragraph 3 above and otherwise any words or expressions shall have the same meaning as it has in The Notification or, if the context so permits, in Schedule 1 thereto, as appropriate, and otherwise any word or expression shall have the same meaning as it has in the Act.

5. For the purpose of interpreting this Direction:

(a) the Interpretation Act 1978 shall apply as if this Direction were an Act of Parliament; and

(b) headings and titles shall be disregarded.

6. This Direction shall take effect on the day that it is published.

**Steve Unger**  
**Director of Telecoms Technology**

**A person authorised under paragraph 18 of the Schedule to the Office of Communications Act 2002**

**24 January 2006**

## Annex 2

# Direction disapplying the application of certain paragraphs of SMP services condition AA4

**Direction under section 49 of the Communications Act 2003 and SMP services condition AA4.11 imposed on British Telecommunications plc as a result of the market power determinations made by the Director General of Telecommunications that British Telecommunications plc has significant market power in the markets for wholesale residential analogue exchange line services and wholesale business analogue exchange line services in the United Kingdom, excluding the Hull Area**

### WHEREAS:

A. As a result of a market analysis carried out by the Director General of Telecommunications (the 'Director'), he proposed on 17 March 2003 and on 26 August 2003, in accordance with sections 48(2) and 80 of the Act that the Dominant Provider has significant market power ('SMP') in the markets for among others wholesale residential analogue exchange line services and wholesale business analogue exchange line services in the UK, excluding the Hull Area and the setting of certain SMP services conditions;

B. The Director having considered every representation duly made, and thereafter on 28 November 2003 pursuant to sections 48(1) and 79 of the Act by way of publication of a Notification identified the relevant services markets, made market power determinations to the effect referred to in recital (A) above and set certain SMP services conditions on the Dominant Provider to take effect on 28 November 2003, unless otherwise is stated in Schedule 1 thereto including SMP services condition AA4 which applied a charge control to wholesale line rental services;

C. By virtue of the Transitional Provisions the Director was able to exercise the powers under the Act for an interim period. OFCOM assumed those powers as of 29 December 2003;

D. On 10 February 2005, OFCOM published a notification under sections 48(1) and 86 of the Act at Annex 1 to the accompanying statement entitled 'Modifications to BT's SMP services conditions AA4' with the effect of:

(i) modifying SMP services condition AA4 as set out in Schedule 1 to the November 2003 Notification (as amended), in effect, substituting it for a new Condition AA4;

in relation to all the markets to which those respective SMP services conditions apply for which OFCOM were satisfied, in accordance with section 86 of the Act, that there had been no material change since the relevant market power determinations were made;

E. This Direction concerns matters to which SMP services condition AA4 as amended relate;

F. On 9 November 2005, OFCOM published a Notification of a proposal to give this Direction in accordance with section 49(4) of the Act and invited representations about the proposed Direction by 12 December 2005;

G. In accordance with section 50 of the Act, a copy of the Notification was sent to the Secretary of State, the European Commission and the regulatory authorities of every Member State;

H. By virtue of section 49(9) of the Act, OFCOM may give effect to the proposal set out in the Notification, with or without modification, only if –

(a) they have considered every representation about the proposal that is made to them within the period specified in the notification; and

(b) they have had regard to every international obligation of the United Kingdom (if any) which has been notified to them for this purpose by the Secretary of State;

I. For the reasons set out in the explanatory statement accompanying this Direction, OFCOM is satisfied that it is acting in accordance with the relevant duties set out in section 3 and 4 of the Act in giving this Direction;

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

(a) objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;

(b) not such to discriminate unduly against particular persons or against a particular description of persons;

(c) proportionate to what it is intended to achieve; and

(d) in relation to what it is intended to achieve, transparent.

K. OFCOM has considered every representation about the proposed Direction duly made to it and the Secretary of State has not notified OFCOM of any international obligation of the United Kingdom for this purpose; and

**NOW, THEREFORE, PURSUANT TO SECTION 49 OF THE ACT AND SMP SERVICES CONDITION AA4.11 OFCOM HEREBY GIVES THE FOLLOWING DIRECTION THAT:**

1. Paragraphs AA4.1 (a) and AA4.1 (e) do not apply to the provision of Wholesale Line Rental Services.

2. For the purposes of interpreting this Direction, the following definitions shall apply:

**(a) “Act”** means the Communications Act 2003;

**(b) “Dominant Provider”** means British Telecommunications plc (BT), whose registered company number is 1800000, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 736 of the Companies Act 1985, as amended by the Companies Act 1989;

**(c) “OFCOM”** means the Office of Communications;

**(d) “The Notification”** means the Notification referred to in recital (B) as amended;

**(e) “Transitional Provisions”** means sections 408 and 411 of the Act, Article 3(1) of the Communications Act 2003 (Commencement No. 1) Order 2003 and Article 3(2) of

the Office of Communications 2002 (Commencement No. 3) and Communications Act 2003 (Commencement No. 2) Order 2003;

3. Except insofar as the context otherwise requires, words or expressions shall have the meaning assigned to them in paragraph 2 above and otherwise any words or expressions shall have the same meaning as it has in The Notification or, if the context so permits, in Schedule 1 thereto, as appropriate, and otherwise any word or expression shall have the same meaning as it has in the Act.
4. For the purpose of interpreting this Direction:
  - (a) the Interpretation Act 1978 shall apply as if this Direction were an Act of Parliament;
  - (b) headings and titles shall be disregarded.
5. This Direction shall take effect on the day that it is published.

**Steve Unger**  
**Director of Telecoms Technology**

**A person authorised under paragraph 18 of the Schedule to the Office of Communications Act 2002**

**24 January 2006**

## Annex 3

# Consent

**Consent under section 49 of the Communications Act 2003 and SMP services condition AA6(a).1 imposed on British Telecommunications plc as a result of the market power determinations made by the Director General of Telecommunications that British Telecommunications plc has significant market power in the markets for wholesale residential analogue exchange line services and wholesale business analogue exchange line services in the UK, excluding the Hull Area**

WHEREAS:

(A) as a result of a market analysis carried out by the Director General of Telecommunications (the 'Director'), he proposed on 17 March 2003 and on 26 August 2003, in accordance with sections 48(2) and 80 of the Act that British Telecommunications plc has significant market power ('SMP') in the markets for wholesale residential analogue exchange line services and wholesale business analogue exchange line services in the UK, excluding the Hull Area and the setting of certain SMP services conditions;

(B) the Director having considered every representation duly made, and thereafter on 28 November 2003 pursuant to sections 48(1) and 79 of the Act by way of publication of a Notification identified the relevant services markets, made market power determinations to the effect referred to in recital (A) above and set certain SMP services conditions on BT to take effect on 28 November 2003, unless otherwise is stated in Schedule 1 thereto including SMP services condition AA6(a) which requires BT to send a written notice of any amendment to charges ninety days before those proposed charge changes can take effect;

(C) by virtue of the Transitional Provisions the Director was able to exercise the powers under the Act for an interim period. OFCOM has now assumed those powers as of 29 December 2003;

(D) this Consent concerns matters to which Condition AA6(a).2 relates;

(E) on 24 March 2005, OFCOM published a Notification of the proposed Consent and accompanying explanatory statement in accordance with section 49 of the Act and invited representations about any of the proposals therein by 28 April 2005;

(F) by virtue of section 49(9) of the Act, OFCOM may give effect to the proposal set out in the Notification, with or without modification, only if –

(a) they have considered every representation about the proposal that is made to them within the period specified in the notification; and

(b) they have had regard to every international obligation of the United Kingdom (if any) which has been notified to them for this purpose by the Secretary of State;

(G) for the reasons set out in the explanatory statement accompanying this Consent, OFCOM are satisfied that they have acted in accordance with the relevant duties set out in sections 3 and 4 of the Act;

(H) for the reasons set out in the explanatory statement accompanying this Consent, OFCOM are satisfied that, in accordance with section 49(2) of the Act, this Direction is:

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

(l) OFCOM has considered every representation about the proposed Direction duly made to it and the Secretary of State has not notified OFCOM of any international obligation of the United Kingdom for this purpose; and

**THEREFORE, PURSUANT TO SECTION 49 OF THE ACT AND SMP SERVICES CONDITIONS AA6(a) IN SCHEDULE 1 TO THE NOTIFICATION, OFCOM GIVES THE FOLLOWING CONSENT:**

1. The obligation on BT in SMP services condition AA6(a).2 to give prior notification of amendments to the charges for existing Network Access shall not apply to those charges set by OFCOM in the Accompanying Direction.

2. For the purpose of interpreting this Direction, the following definitions shall apply:

**(a) 'Act'** means the Communications Act 2003;

**(b) 'Accompanying Direction'** means the Direction published by Ofcom on the 24 January 2006 directing BT's charges for the provision of Wholesale Line Rental Services;

**(c) 'The Notification'** means the Notification referred to in recital (B) of this Direction as amended;

**(d) 'OFCOM'** means the Office of Communications;

**(e) 'Transitional Provisions'** means sections 408 and 411 of the Act, Article 3(1) of the Communications Act 2003 (Commencement No. 1) Order 2003 and Article 3(2) of the Office of Communications 2002 (Commencement No.3) and Communications Act 2003 (Commencement No. 2) Order 2003;

3. Except insofar as the context otherwise requires, words or expressions shall have the meaning assigned to them in paragraphs 2 above and otherwise any word or expression shall have the same meaning as it has in The Notification or, if the context so permits, in Schedule 1 thereto, as appropriate, and otherwise any word or expression shall have the same meaning as it has in the Act.

4. For the purpose of interpreting this Consent:

(a) headings and titles shall be disregarded; and

(b) the Interpretation Act 1978 shall apply as if this Consent were an Act of Parliament.

5. This Consent shall take effect on the day that it is published.

WLR: Reviewing and setting charge ceilings for WLR services

**Steve Unger**  
**Director of Telecoms Technology**

**A person authorised under paragraph 18 of the Schedule to the Office of  
Communications Act 2002**

**24 January 2006**

## Annex 4

# Glossary

This glossary is without prejudice to the definitions used in the notifications set out in Annex 1, Annex 2 and Annex 3.

**BT:** British Telecommunications plc.

**Communications provider:** a person who provides an Electronic Communications Network or provides an Electronic Communications Service.

**Hull Area:** the area defined as the 'Licensed Area' in the licence granted on 30 November 1987 by the Secretary of State under section 7 of the Telecommunications Act 1984 to Kingston upon Hull City Council and Kingston Communications (Hull) plc.

**ISDN:** Integrated Services Digital Network. A Network based on the existing digital Public Telephone Network which provides digital links to Customers and end-to-end digital connectivity between them.

**Kingston:** Kingston Communications (Hull) PLC, communications provider which operates in the Hull Area.

**Line card:** the electronic cards in the exchange that provide connectivity to the switch.

**Local loop:** the access network connection between the customer's premises and the local serving exchange, usually comprised of two copper wires twisted together.

**Local loop unbundling (LLU):** a process by which a dominant provider's local loops are physically disconnected from its network and connected to a competing provider's networks. This enables operators other than the incumbent to use the local loop to provide services directly to customers.

**Main distribution frame (MDF):** the equipment where local loops terminate.

**Narrowband:** a service or connection allowing low data transfer speeds.

**Pair gain:** technology used to provide two PSTN lines over a single pair of copper wires. This is also referred to as Digital Access Carrier System (DACs) and is usually used to provide an additional line without laying additional copper wire.

**PSTN:** Public Switched Telephone Network.

**SMP:** The Significant Market Power test is set out in European Directives. It is used by National Regulatory Authorities (NRAs) such as Ofcom to identify those communications providers who must meet additional obligations under the relevant Directive.

**Wholesale Line Rental (WLR):** a service offered by BT Wholesale to other service providers allowing them to offer their own branded telephony service.