



Service level guarantees: incentivising performance

Statement and Directions

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Section 1

Summary

Background

- 1.1 Service Level Agreements (SLAs) form part of commercial contracts and set out a supplier's commitment to provide services to an agreed quality, e.g. within a specified period. The associated Service Level Guarantees (SLGs) specify the level of compensation that the customer would be entitled to should the service not be provided at the quality specified in the SLA, e.g. if delivery of the service was late. Together they are therefore essential elements of any commercial contract as they provide the supplier with an incentive to deliver service to a pre-defined and, potentially, pre-agreed level of performance or compensate their customer accordingly.
- 1.2 Communications Providers (CPs) consider that Openreach's current SLAs and SLGs for Wholesale Line Rental (WLR), Local Loop Unbundling (LLU) and Ethernet services are ineffective because they do not provide Openreach with appropriate incentives to provision or repair services. They consider that, as a consequence, Openreach's service performance has not always been satisfactory and that too often Openreach has failed to deliver in the timeframes set out within the SLAs.
- 1.3 During 2007, the Office of the Telecoms Adjudicator (OTA2) facilitated discussions between CPs and Openreach with a view to reaching a negotiated commercial settlement acceptable to both parties (CPs are considered to be one party for the purposes of this document). These negotiations failed to resolve the differences between the parties, however, and therefore the matter was referred to Ofcom to intervene and impose a regulatory solution.
- 1.4 Both parties came up with differing conclusions as to why the negotiations failed. Openreach suggested that the commercial negotiations were unsuccessful because CPs had no incentive to conclude them knowing that they could refer the matter to Ofcom. CPs, on the other hand, suggested that Openreach had little incentive to conclude the negotiations given that the inadequate compensation arrangements would not change until they were satisfactorily concluded. They argued that their bargaining position was not sufficiently strong and not equal to that which would be found in a competitive market.
- 1.5 Once the matter had been referred to Ofcom, Ofcom made it clear that it would not restrict its review to the elements of the SLG arrangements which had been the focus of the commercial discussions and therefore it would not be bound by those elements that Openreach was willing to concede. On the other hand, it also made it clear that the offer tabled by Openreach would not be the starting point for the review and therefore CPs could not necessarily expect Ofcom to include all of those elements which they considered satisfactory.

The December consultation

- 1.6 On 10 December 2007, Ofcom published the consultation document entitled *Service level guarantees: incentivising performance*¹ ('the December consultation') in which it explained that BT has significant market power ('SMP') in the relevant markets for

¹ <http://www.ofcom.org.uk/consult/condocs/slg/slg.pdf>

the provision of WLR, LLU and Ethernet services and, because of this, is required to provide the products on cost-oriented, not unduly discriminatory and fair and reasonable terms. Additionally, the Undertakings² require Openreach to provide these products to downstream divisions of BT and other CPs on an operationally and functionally equivalent basis.

1.7 The December consultation went on to explain that Ofcom considered that Openreach's contracts for WLR, LLU and Ethernet services did not provide Openreach with sufficient incentive to maintain an appropriate level of performance. Consequently, this contributed to Openreach's customers receiving neither adequate quality of service nor appropriate compensation for late provision or repair of service.

1.8 Ofcom considered that there were two broad concerns with Openreach's SLAs and SLGs and these were that:

- either the processes for claiming compensation were cumbersome and onerous with the result that many CPs did not consider that it would be efficient to attempt to claim compensation; and/or
- the levels of compensation were insufficient to either compensate the CP or incentivise Openreach to provide better service.

1.9 Ofcom therefore proposed to amend Openreach's SLAs and SLGs and the main parts of its proposal were as follows:

- for WLR, make proactive payments for each service failure such as late provision and late fault repair, with compensation at the current level of one month's line rental / day of delay;
- for LLU, make proactive payments for each service failure such as late provision and late fault repair, with compensation at the current level of £8 / day of delay and £16 / day where a non-operational line is provided;
- for Ethernet, make proactive payments (as currently) for each late provision at an increased level of one month's line rental / day of delay to bring it into line with WLR and LLU and for each reported fault at an increased level of 15% of one month's line rental for each hour of downtime to bring it into line with partial private circuit enhanced care; and
- for all the above products, remove caps and other unnecessary restrictions on compensation payments.

1.10 Respondents' views were sought.

Respondents' views

1.11 Openreach considered that the proposals that it had put forward as part of the OTA2 negotiations (*Openreach SLA/SLG Transformation* ('the Openreach proposal')) represented a good overall deal for customers and presented it with a challenge to

² In September 2005, BT Group plc ('BT') gave a set of Enterprise Act Undertakings to Ofcom. The Undertakings included the creation of a new organisation, Openreach, which is separate from the rest of BT and provides wholesale products (such as WLR, LLU and Ethernet) used by other CPs to compete with BT's retail business. Openreach has been referred to throughout this document, although all legal obligations are placed on BT.

<http://www.ofcom.org.uk/telecoms/btundertakings/btundertakings.pdf>

deliver services within a realistic and balanced commercial framework. Openreach went on to explain that it considered that Ofcom's proposals went beyond what it considered to be commercially acceptable. The company also added that service has improved consistently over the last year and therefore the justification for action was reduced.

- 1.12 On a practical level, Openreach stated that it would not be able to implement the proposals in the timescale envisaged because it would need to amend contracts for each relevant SLG and implement processes to enable compensatory payments to be made proactively.
- 1.13 Other respondents were generally strongly supportive of Ofcom's approach and proposals for amending the present set of SLAs and SLGs. They generally considered, however, that Ofcom could and perhaps should have gone further than it did. For that reason, they welcomed Ofcom's commitment to consider the matter further and assess whether the enhancements to the regime prove to be successful in bringing about change.

Ofcom's response

- 1.14 Ofcom acknowledges that the Openreach proposal put forward as part of the OTA2 facilitated negotiations represented an improvement on the SLG regime which it was intended to replace. Indeed, CPs welcomed aspects of the Openreach proposal. Nonetheless, CPs concluded that overall the proposal – which was offered on an 'all-or-nothing' basis – did not go far enough and therefore they referred the matter to Ofcom.
- 1.15 Ofcom considered all the evidence available to it and sought further information from Openreach and CPs and has concluded that the SLGs are not fair and reasonable and need to be amended to strengthen the incentives on Openreach to provide service at an efficient level and, importantly, to ensure that service performance is sustained. Ofcom does not consider that the present SLGs have driven performance.
- 1.16 On a practical level, Ofcom acknowledges that the timescale set out in the December consultation was challenging.

Conclusions

- 1.17 Ofcom remains of the view that the present set of SLGs are not fair and reasonable as they do not provide Openreach with a strong enough incentive to sustain service performance at an efficient level. Ofcom has therefore issued three Directions which require Openreach to amend its SLGs for WLR, LLU and Ethernet services.
- 1.18 Ofcom has, however, reintroduced the concept of compensatory caps on a per product basis because the absence of caps can create uncertainty. Ofcom does not expect that these caps will bite in many cases and therefore, to some extent, they are not material to the overall proposal.
- 1.19 In summary the main changes to the present SLG arrangements are to:
- require Openreach to pay compensation for WLR2 and WLR3 proactively;
 - require Openreach to pay compensation for LLU proactively;
 - require Openreach to pay EMP service credits for LLU proactively;

- introduce EMP service credits for WLR3 and require Openreach to pay these proactively; and
 - re-structure Ethernet service compensation payments for late provision and repair to better reflect CPs' average losses.
- 1.20 Ofcom acknowledges, however, that the timescale set out in the December consultation was challenging and has therefore given Openreach additional time to implement the changes to the compensation arrangements. The Directions therefore require Openreach to implement the changes to the SLGs set out therein within 3 months of the date of publication instead of the 1 month proposed in the December consultation. The new arrangements and associated compensatory payments for failure to meet the SLGs shall therefore be payable from 25 June 2008.

Reviewing the impact of proposals

- 1.21 Ofcom considers that the decisions set out herein will increase the incentive on Openreach to provide and repair service promptly. Ofcom will, nonetheless, carry out a review to assess whether or not the SLGs have been effective in driving improved service performance and have not given Openreach perverse incentives which would allow it to avoid compensation payments by extending lead times. Ofcom will carry out this review once the measures have been in place for six months.
- 1.22 The decisions set out herein will also be taken into account in the broader Openreach Financial Framework Review. In particular, Ofcom accepts, as a general principle, that Openreach should be able to recover in its prices an amount to cover the level of compensation payments that an efficient operator would pay out.

Section 2

Introduction

Introduction

- 2.1 Communications Providers ('CPs') use a range of wholesale products supplied by Openreach to provide electronic communications services to residential and business end-users. The three main products that Openreach supplies are:
- Wholesale Line Rental ('WLR', sometimes referred to by Openreach as Wholesale Access) covering basic analogue access, digital access, ISDN30 and the equivalence of inputs product WLR3;
 - Local loop unbundling ('LLU') covering both shared ('SMPF') and non-shared metallic path facilities ('MPF'); and
 - Ethernet services covering wholesale extension services ('WES'), wholesale end-to-end services ('WEES') and backhaul extension services ('BES').
- 2.2 These wholesale services are not available from any other supplier on a national basis and therefore CPs need to purchase these services from Openreach to extend their presence beyond the confines of their own networks. Openreach is required to provide these products to all CPs on cost-oriented, not unduly discriminatory (that is, they should be treated equivalently unless there is a justifiable reason for not doing so) and fair and reasonable terms because it has SMP in each relevant market. Openreach is also required (under the Undertakings) to ensure that these products are provided to downstream parts of BT and other CPs on an operationally and functionally equivalent basis.
- 2.3 The Undertakings ensure that downstream retail suppliers – and this includes downstream parts of BT – are treated in the same way. They do not, however, ensure that the service quality is of a sufficiently high standard as it is not explicitly regulated and nor has it ever been. Instead, the incentive to maintain service quality was supposed to be driven by downstream parts of BT as they would receive the same level of service – be that equivalently good or bad – as other CPs.
- 2.4 CPs have suggested, however, that the level of service that they have received from Openreach has not been satisfactory³. They consider that, in part, this is a reflection of the inadequacy of the compensatory arrangements for service failure set out in the SLGs for each product. They believe that effective SLGs, which required compensatory payments to be made proactively in the event of service failure, would provide Openreach with a stronger incentive to maintain service quality. Ofcom examined Openreach's performance in the December consultation⁴.

The purpose of SLAs and SLGs

- 2.5 SLAs and SLGs form part of contracts of service and define a contractually agreed deliverable. The SLAs and SLGs are therefore an integral and binding part of the contract and inform the CP about the level of service that they could expect and, if

³ Cable & Wireless wrote to Ofcom on 30 August 2007 on behalf of the industry in which these views, amongst others, were expressed. Respondents to the December consultation expressed similar views.

⁴ <http://www.ofcom.org.uk/consult/condocs/slg/slg.pdf>

this is not met, the compensatory payments which would apply. The performance of the supplier and the compensation payments associated with any failure to meet the performance requirements are also likely to influence directly the downstream contractual terms offered to retail customers.

The December consultation

- 2.6 In the December consultation, Ofcom explained that it did not consider that the SLG regime was working to incentivise Openreach to ensure that it provided good quality service in that Openreach was not providing service on fair and reasonable terms. As such, Ofcom considered that the current arrangements were ineffective. Ofcom provisionally concluded, therefore, that the SLGs needed to be strengthened to ensure that Openreach had adequate incentives to provide a high level of service quality.
- 2.7 The December consultation set out the general principles which Ofcom considered were appropriate for SLGs and, using these as a starting point, it suggested the ways in which it considered that they could be improved to provide Openreach with greater incentives to provide a high level of service quality. Ofcom's proposals were set out in three draft Directions which accompanied the consultation document.
- 2.8 Ofcom explained that effective SLGs would:
- set operationally efficient target service levels below which compensatory payments would be triggered;
 - include compensatory payments set at an estimate of the average loss suffered by a CP in the event of a service failure; and
 - include automatic payments once target service levels have been missed.

Outline of this document

- 2.9 Section 3 of this document sets out the general principles which have guided Ofcom in coming to the conclusions set out in the Directions and sets out respondents' views in relation to these principles. Sections 4, 5, 6 and 7 then set out respondents' views in relation to the proposed changes to the WLR SLGs, the LLU SLG, the Ethernet services SLGs and the proposals in relation to the equivalence management platform (EMP), respectively. Each section then sets out Ofcom's conclusions which, as a result of respondents' views, have been revised in some cases. Each section covers all relevant points relating to the product dealt with and, given that there were similar issues across the products, there is a certain degree of repetition between sections.
- 2.10 Section 8 summarises comments on the impact assessment set out in the December consultation and responds to these comments. Section 9 sets out the Communications Act 2003 ('the Act') tests and explains how the decisions set out herein are consistent with them. Section 10 then summarises the changes that Openreach is required to make to each of the SLGs. The Directions which implement the changes to the SLGs are set out in Annexes 1, 2 and 3.
- 2.11 Ofcom considers that the changes to the SLGs represent a fair deal for all concerned and will provide Openreach with a stronger incentive to maintain an appropriate level of service quality. Additionally, consumers should benefit from increased value for money, in terms of increased service quality, higher compensation or lower prices.

Section 3

General Principles

Introduction

- 3.1 Openreach is required under SMP services conditions AA1(a), FA1 and HH1 to provide WLR, LLU and Ethernet services, respectively, to all CPs on terms which do not discriminate unduly between them and do so on fair and reasonable terms and conditions. CPs consider, however, that the terms and conditions on which these services are being provided do not provide Openreach with a sufficient financial incentive to maintain service quality and are not therefore provided on fair and reasonable terms and conditions.
- 3.2 In the first instance, CPs tried to negotiate improved SLGs with Openreach directly. These negotiations did not achieve a breakthrough and therefore Ofcom asked the OTA2 to facilitate discussions. During these negotiations, Openreach tabled the Openreach proposal which it considered represented a good overall deal for customers and presented it with a challenge to deliver services within a realistic and balanced commercial framework. These negotiations, however, also failed to achieve a decisive breakthrough because CPs did not consider that the Openreach proposal – which was offered on an ‘all-or-nothing’ basis – addressed all their concerns. CPs therefore asked Ofcom to intervene.
- 3.3 Ofcom made it clear, however, that it would not restrict its review to the elements of the SLG arrangements which had been the focus of the commercial discussions and therefore it would not be bound by those elements that Openreach was willing to concede. On the other hand, it also made it clear that the offer tabled by Openreach would not be the starting point for the review and therefore CPs could not necessarily expect Ofcom to include all of those elements which they considered satisfactory.

Effective SLGs

- 3.4 Ofcom explained in the December consultation that effective SLGs would give Openreach an appropriate financial incentive to improve performance and this would, in turn, benefit CPs (who rely on these services) and end users. Ofcom also considered that, for SLGs to be effective, in the event of service failure compensation would need to be paid proactively. It also considered that the amount of compensation should compensate for average loss and the SLG should not restrict additional claims beyond the payment for average loss or an arbitrary cap. Ofcom stated that the principles that it had adopted in reaching the conclusion set out in the December consultation (‘the General Principles’) were as follows:
 - when agreed service levels are not met, make provision for compensation to be made based on a pre-estimate of an average CP’s loss;
 - ensure that CPs are entitled to make a claim for additional loss;
 - pay compensation on a per event basis;
 - ensure that there are no caps on compensation; and
 - ensure that compensation payments are made proactively.

3.5 Ofcom sought respondents' views on the General Principles.

Respondents' views

Question 1: *Do you consider that the General Principles set out above are appropriate or are there other principles which should be considered?*

- 3.6 Openreach did not accept that the entirety of the General Principles were appropriate and stated that there were other principles which also needed to be considered. The main reasons for this view related to inconsistency, as far as it was concerned, with normal commercial practice. Openreach also questioned whether Ofcom had satisfied the tests in Section 49(2) of the Act which require Directions to be proportionate and objectively justifiable. (This issue is considered in Section 9.)
- 3.7 Openreach also stated that the Undertakings made explicit reference to service levels and therefore service quality was an important part of equivalence of inputs. The Undertakings give the BT Group an incentive to ensure that service quality is maintained at a high level because downstream parts of the business are subject to the same levels of service. Openreach suggested that the incentive properties of the Undertakings were clearly working in that service performance had improved considerably over the past 12 months and this had resulted in benefits to CPs and downstream parts of BT.
- 3.8 CPs considered that, in the main, the General Principles captured most of the issues that they considered important and, taken together, constituted a useful starting point for any review of SLG arrangements. They, nonetheless, believed that there were other matters which needed to be addressed to ensure that the new compensation arrangements were successful in delivering appropriate financial incentives and improved service. These are considered below.

Value of compensation

- 3.9 Openreach considered that the value of compensation contained in its contracts, as amended by its proposal to extend the compensation levels for Ethernet services and EMP service credits, was reasonable. Openreach suggested that the primary purpose of the SLG regime was to address the question of compensation for loss of service and it did not consider that Ofcom gave sufficient evidence to show that SLG arrangements could drive behaviour in terms of improved performance.
- 3.10 Openreach also argued that Ofcom had not made it clear whether the average CP's loss referred to was actually suffered and was a genuine pre-estimate of such loss.
- 3.11 Openreach further stated that it should be permitted to recover its costs where these are directly attributable and caused by CPs. Another respondent stated the opposite. They suggested that any costs incurred should not be passed on.
- 3.12 CPs were generally of the view that compensation payments were not sufficient and gave examples which tended to suggest that their losses are likely to be greater than those contained within the SLGs. However, for reasons of confidentiality, it is not possible to show this information here.

Claiming for additional loss

- 3.13 Openreach stated that the compensation levels set out in its SLGs amount to a form of liquidated damages for losses which cannot be assessed in advance. The

compensation is set at a pre-estimate of loss and therefore CPs should not be able to seek compensation beyond that set out and agreed in the SLG. Openreach argued that enabling claims beyond the SLG undermines the regime and leaves it subject to an unquantifiable liability in relation to each service failure.

Compensation per event

- 3.14 Openreach considered that its proposal to, amongst other things, remove the linkage between SLGs and aggregate performance for WLR2 and WLR3 provided a fair and reasonable approach to this issue and therefore regulatory intervention was not required.

Removal of compensation caps

- 3.15 Openreach stated that it was common commercial practice for suppliers to limit their exposure by capping the amount of compensation that they would contractually be obliged to pay in the event of service failure. Removal of the cap would represent an unreasonable level of risk.

Proactive payment of compensation

- 3.16 Openreach considered that its proposal to offer proactive payments for WLR3 and LLU and simplify the claiming processes for WLR2 provided a reasonable and balanced approach to this issue and it did not consider, in principle, that it was right to extend proactive compensation arrangements to legacy products (i.e., WLR2).
- 3.17 Other respondents were strongly of the view that compensation payments needed to cover both WLR2 and WLR3. They stated that currently BT is the main consumer of WLR3 and therefore proactive payments covering WLR3 only would benefit BT and give it a competitive advantage.

Other principles

- 3.18 Openreach stated that, prior to making any decision, Ofcom needed to take account of the following principles: incentives; cost recovery; service innovation; contractual exemptions; forecasting; over-recovery; and cross-project and resource implications. A short summary of Openreach's position on each proposed principle is set out in the following paragraphs.

Incentives

- 3.19 Openreach argued that applying equivalent compensation arrangements across the suite of WLR products provided little in the way of an incentive for CPs to migrate their customers to WLR3.

Cost recovery

- 3.20 Openreach stated that it should be able to recover all reasonable and efficiently incurred costs in implementing tactical and strategic solutions which would be required to provide for proactive compensation payments. Openreach explained that systems were not presently in place to introduce proactive payments and they would therefore need to be designed.

Service innovation

- 3.21 Openreach stated that Ofcom's proposals would lessen its ability to introduce service propositions which vary from the standard product offerings.

Contractual exemptions

- 3.22 Openreach stated that any SLA regime needed to include appropriate contractual exemptions for matters which were beyond the provider's reasonable control. These exemptions needed to be identified and agreed in advance of the regime taking effect.

Forecasting

- 3.23 Openreach stated that removing the linkage between the SLA and forecasting arrangements would make it increasingly difficult to map supply to potential demand.

Over recovery

- 3.24 Openreach was concerned that some of the proposals (principally the LLU proposals) could result in customers receiving multiple compensation payments for the same failure. It suggested that compensation should only apply to the most critical service level.

Cross-project and resource implications

- 3.25 Openreach stated that implementation of strategic systems to implement the new compensation arrangements would have an impact on its existing work stack to deliver enhancements to WLR3.

Other respondents' views

- 3.26 Other respondents, although generally supportive of the overall approach, considered that there were a number of ways in which the proposals outlined in the December consultation could be strengthened. A common theme was the need for compensation payments to be transparent and reconcilable to their service experience (and therefore Openreach needed to provide sufficient data to enable CPs to verify the payments on a line-by-line basis). Some respondents suggested that the compensation processes should be independently audited.
- 3.27 Respondents also suggested that clauses which enabled Openreach to avoid making compensation payments (small print) needed to be reduced to ensure that the enhancements to the compensation regime were not undermined. A number of respondents added that compensation needed to be paid shortly after the event or time-limited and, if not, Openreach should be obliged to pay interest on top of the compensation payment.
- 3.28 One CP also suggested that the General Principle which stated that compensation should only be paid when agreed service levels were not met was inappropriate. They argued that this did not provide Openreach with an incentive to improve service (merely it encouraged it to beat the SLG) and the SLGs might have been inappropriately set in the first place and might not be particularly challenging. They added that CPs' losses commence once the service fails and are not aligned to the SLA.

- 3.29 A number of respondents also suggested that the General Principles should apply to all of Openreach's products (including tie-cables, collocation and space). Some of these respondents suggested that the General Principles should apply also to services offered by BT Wholesale.

Ofcom's response

- 3.30 As explained in Section 2, the Undertakings are designed to ensure that downstream retail suppliers – and this includes downstream parts of BT – are treated in the same way under the principle of equivalence of inputs. They do not, however, ensure that the quality of service is of a sufficiently high standard as service quality is not explicitly regulated. Instead, the incentive to maintain service quality is supposed to be driven by downstream parts of BT as they would receive the same level of service – be that an equivalently good or bad service – as other CPs. CPs consider, however, that service quality has not been good enough and that this has demonstrated that the SLAs are not fair and reasonable.

Value of compensation

- 3.31 Ofcom has not generally revised the compensation payments for delayed repair and provision. Therefore, in most cases the value of compensation remains consistent with that in the Openreach proposal or Openreach's existing contracts. Ofcom considers, however, that compensation should be sufficient to cover an average CP's financial loss.
- 3.32 Ofcom is of the view that effective SLGs would be likely to drive behaviour and considers that this is a well understood and accepted concept. BT Group has, for example, chosen to implement retail and wholesale SLGs and these include performance targets and compensatory payments should these not be met.
- 3.33 Ofcom considers that it is reasonable for Openreach to recover compensation payments that an efficient CP would pay out. Even an efficient CP would not expect to have perfect performance all the time and might therefore expect to make some compensation payments. Ofcom considers that these can be regarded as a cost of doing business just like any other cost. This issue will be dealt with in more detail in the Openreach Financial Framework Review.

Claiming for additional loss

- 3.34 Ofcom recognises that certain commercial contracts include compensatory payments which are set at a level intended to limit exposure beyond that set out therein. There are, however, other contracts which include express provision for the supplied party to claim for additional loss. The contract for LLU is one such example.
- 3.35 Ofcom recognises that SLGs are generally intended to assess a pre-estimate of loss and are supposed to reflect this. Openreach, however, is not subject to normal competitive conditions and the SLGs were not necessarily set on the basis of two parties on an equal footing agreeing upon the terms on which they would do business. Ofcom therefore considers that the SLGs should permit claims beyond those set out therein.

Compensation per event

- 3.36 Ofcom notes that the Openreach proposal included measures to provide compensation per event in many cases and accepts that its proposals on this issue

are largely consistent with those in the Openreach proposal. However, Openreach's proposal was not accepted by industry and the matter was, therefore, referred to Ofcom to consider and if necessary impose a regulatory solution.

Removal of compensation caps

3.37 Compensation caps are intended to limit liability in any given case and therefore compensate the supplied party to the level specified. Ofcom considers that Openreach's concern that the removal of caps would subject it to unlimited financial exposure is not a strong one. Predominantly this is because everything set out in the SLA is within Openreach's control in that (*force majeure* and matters beyond Openreach's reasonable control aside) service could be restored (following elongated service loss) or provisioned (given extended delays). In either case, Openreach could limit its financial vulnerability. Nonetheless, Ofcom acknowledges that caps limiting exposure to compensation – even if set at a level where they are unlikely to bite – aide certainty and provide a level of transparency to both parties subject to the contract.

Proactive payment of compensation

- 3.38 The majority of CPs have not, at this point in time, migrated their customer-base to WLR3. Ofcom understands that this is due to a number of factors and these, in the main, relate to the delivery of the baseline functionality. It is still not clear when the baseline WLR3 product will be delivered and the lack of this diminishes the commercial incentive/imperative to move to the new platform. Also, Openreach has not stated when it will withdraw the Service Provider Gateway ('SPG')⁵ and therefore stop taking WLR2 orders.
- 3.39 Furthermore, currently the main user of WLR3 is downstream parts of the BT Group. Therefore, proactive payments for WLR3 would only be likely to benefit the BT Group and it may therefore gain a competitive advantage as a result. Ofcom does not consider that this would be an acceptable or appropriate outcome.
- 3.40 Ofcom made it clear throughout these discussions that it expected Openreach to provide proactive payments for both WLR2 and WLR3 and that any other proposals were unlikely to be satisfactory. Ofcom does not consider that Openreach's proposal to simplify compensation claiming arrangements therefore went far enough.
- 3.41 CPs have stated that they do not make compensation claims because they cannot justify internal expenditure given that they do not know how many claims would be successful. Ofcom considers that this would be the case even if the claiming process was simplified. Ofcom does not consider, therefore, that equivalent compensation payments on a per event basis would result.
- 3.42 Ofcom also does not accept the argument that system development for so-called *legacy* products should always be avoided. WLR2 remains the main source of fixed-line competition utilising the BT Group network. It is essential that the changes to SLAs and SLGs cover those products, such as WLR2, that are central to current competitive activity as well as those products that will be important to competition in the future.

⁵ The Openreach interface used by CPs for WLR2.

- 3.43 For the reasons set out above, Ofcom agrees with other respondents. It further considers that the lack of movement on proactive payments for WLR2 was one of the prime reasons for the failure of the negotiations facilitated by OTA2.

Other principles

- 3.44 Ofcom has considered each of the additional principles proposed by Openreach in turn and sets out its summary response in the following paragraphs.

Incentives

- 3.45 Ofcom's proposals to amend the SLG compensation arrangements are intended to ensure that compensation payments are paid on a fair and equitable basis following service failure and were never intended to give incentives to CPs to migrate their customer-base to WLR3 and the EMP platform. The EMP platform is intended to provide an equivalent input and output based service to CPs and downstream BT divisions. Furthermore, Ofcom understands that Openreach's intention is to provide functionality that exceeds that available via the SPG principally in terms of automation. Ofcom considers, therefore, that the incentive to migrate customers to the EMP platform should be driven by the performance and ability of the platform and not by differing compensation arrangements or payment mechanisms designed to provide CPs with an additional incentive to migrate.

Cost recovery

- 3.46 As stated above, Ofcom accepts that it is appropriate for Openreach to recover its reasonably incurred efficient costs.

Service innovation

- 3.47 Ofcom does not accept that its proposals would limit Openreach's ability to differentiate between product offerings. CPs could choose to pay for premium products should they consider that the product added value and was appropriately priced. Openreach needs to design or react to CPs' requirements to ensure that there is demand sufficient to justify research and development.

Contractual exemptions

- 3.48 Ofcom acknowledges that appropriate exemptions (such as *force majeure* and matters beyond Openreach's reasonable control) need to be included within contracts. These should, however, be limited to matters that Openreach cannot control.

Forecasting

- 3.49 Ofcom considers that it is important for CPs to forecast accurately and considers that CPs should be encouraged to do so. Ofcom considers that there should be a clear coincidence of interest between Openreach and its customers. That is, Openreach should be able to fulfil their customers' expectations more closely if they have greater visibility of future volumes. To this end, Ofcom has asked the OTA to look into this matter. Nonetheless, Ofcom considers that it is not appropriate or proportionate to contractually link forecasting and compensation arrangements as proposed by Openreach. Ofcom also notes that any such system of forecasting incentives would need to take into account the different business models and behaviours. For example, a CP serving the residential mass-market can probably forecast with more

accuracy than a CP providing services to large businesses where order volumes would inevitably be more irregular.

Over recovery

- 3.50 The provision of unbundled local loops involves a number of stages of development and these include the need for space within the exchange or adjacent to it, the provision of links between the two networks and the provision of the final end-user service. Delayed provision of any of the intermediate steps could result in a loss to the CP. Ofcom is therefore of the view that CPs should receive compensation for each element and not the provision of the most critical service level only.

Cross-project and resource implications

- 3.51 Ofcom accepts that it is probable that Openreach will have to re-prioritise certain parts of work to ensure that it meets the requirements of the Directions. Nonetheless, CPs considered that the SLG arrangements needed to be addressed as a priority. However, Ofcom would still expect BT to meet its obligations.

Other respondents' views

- 3.52 Ofcom agrees that Openreach has to provide sufficient data to justify the amount of compensation that it pays to each CP to enable them to reconcile this to their own records. Ofcom understands that Openreach needs to produce this data in any case to calculate the amount of compensation that it is required to pay out and therefore Ofcom does not consider that it should be an onerous task to pass this on.
- 3.53 On timeliness of payments, Ofcom would expect compensation payments to be made at the first possible opportunity (next billing cycle) post the service failure/delayed provision. This will not be achievable in all circumstances because the event that requires Openreach to pay compensation might occur in close proximity to the next billing cycle. Nonetheless, compensatory payments should not be unduly delayed. Given this, Ofcom does not consider it necessary that Openreach should be required to pay interest should payments be delayed.
- 3.54 Ofcom does not consider, however, that it is necessary or appropriate for Openreach to allow access to its records to external auditors. The Directions are clear in that they require Openreach to pay compensation proactively to CPs in the event that service fails and is not repaired in line with the SLG requirements or is not provided on the date specified. Therefore, Openreach is under an obligation to do this accurately and any failure to do so would breach the requirements of the Directions.
- 3.55 On service quality more generally, Ofcom agrees that service should be provided at an efficient level. Openreach should aim to maintain service and ensure that faults are not a common occurrence. Service failures should be remedied as soon as possible and Openreach should not decide which faults take priority solely on the basis of the SLG. That said, it is inevitable that older faults are likely to take a priority over newer faults. Ofcom, nonetheless, would expect that average performance should improve as a consequence of the incentives implicit in the revised SLG arrangements.
- 3.56 On the General Principles, as set out in paragraph 3.4 of this section, Ofcom did not frame these in a service-specific way. They were, instead, those which Ofcom considered would be a reasonable starting point for any SLG arrangements and

therefore they could be applied equally to other products. The requirements of the Directions, however, relate only to the products specified therein.

Conclusions

- 3.57 There are numerous factors which could be taken into account in establishing appropriate principles to apply to SLGs and Ofcom acknowledges that some of those proposed by respondents have real merit. Ofcom considers, nonetheless, that, in the main, the General Principles which it identified remain appropriate.
- 3.58 Ofcom has, however, concluded that it is not appropriate for it to maintain the General Principle pertaining to compensation caps. This is not to say that compensation caps are necessarily appropriate and some commercial contracts do include open-ended arrangements.
- 3.59 Ofcom also considers that compensation arrangements should allow for efficient cost recovery. The Directions require Openreach to pay compensation on each and every occasion that it does not meet the targets set out in the SLGs. The new arrangements are intended to give Openreach an appropriate financial incentive to maintain and provision service at an efficient level. Openreach should, however, be permitted to recover a level of compensation payments that an efficient operator would incur.
- 3.60 Therefore, following consideration of the consultation responses, Ofcom has amended its General Principles from those set out in the December consultation. The General Principles that Ofcom has taken into account in reaching its final decision are as follows:
- when agreed service levels are not met, make provision for compensation to be made based on a pre-estimate of an average CP's loss;
 - ensure that CPs are entitled to make a claim for additional loss;
 - pay compensation on a per event basis;
 - ensure that compensation payments are made proactively; and
 - efficient cost recovery should be permitted.
- 3.61 Ofcom considers that a service level regime that met these General Principles is likely to be fair and reasonable. Therefore, Ofcom considers that it is appropriate to apply these General Principles in order to assess the fairness and reasonableness of Openreach's service level regime for WLR, LLU and Ethernet, and where necessary to require amendments to these arrangements.
- 3.62 These General Principles were not designed specifically to address the deficiencies with the SLGs considered as part of this review and therefore could apply equally to other products and services.
- 3.63 It is worth emphasising that SLGs need to be challenging to give appropriate financial incentives and that compensatory payments due need to be directly reconcilable to a specific fault or late provision and that they should be paid promptly after the event in question.

Section 4

Wholesale Line Rental

Introduction

4.1 On 28 November 2003, Ofcom identified BT as an operator with significant market power (SMP) in the following UK markets (except the Hull area)⁶:

- wholesale residential exchange line services;
- wholesale residential ISDN2 exchange line services;
- wholesale business exchange line services;
- wholesale business ISDN2 exchange line services; and
- wholesale ISDN30 exchange line services.

4.2 As a result, Ofcom imposed various regulatory obligations on BT, including SMP services condition AA10 – which required BT to offer WLR for analogue, ISDN2 and ISDN30 – and SMP services condition AA1(a), which required BT to supply services in each market on fair and reasonable terms and conditions. Pursuant to the Undertakings, Openreach is the separate organisation within BT Group responsible for providing these products.

The December consultation

4.3 Section 4 of the December consultation explained that CPs considered that the SLGs for wholesale access products were not giving Openreach a sufficient financial incentive to provide good service quality. Ofcom agreed and provisionally concluded that it needed to amend the SLAs for:

- analogue WLR2, which is set out at section A of Schedule 4 of the *Contract for Wholesale Line Rental* ('the WLR SLA')⁷;
- WLR ISDN2, which is set out at section B of Schedule 4 of the *Contract for Wholesale Line Rental* ('the WLR Digital SLA')⁸;
- WLR ISDN30, which is set out at section C of Schedule 4 of the *Contract for Wholesale Line Rental* ('the WLR ISDN30 SLA')⁹;
- WLR3, which is set out in Schedule 3 of the *Contract for WLR3* ('the WLR3 SLA')¹⁰.

4.4 These contracts are collectively referred to hereafter as the "WLR SLA Contracts" unless references relate to specific contracts only.

4.5 In summary, Ofcom proposed that:

⁶ http://www.ofcom.org.uk/consult/condocs/narrowband_mkt_rvw/nwe/fixedenarrowbandstatement.pdf

⁷ <http://www.openreach.co.uk/orpg/products/wlr/pstn/pstn.do>

⁸ <http://www.openreach.co.uk/orpg/products/wlr/isdn2/isdn2.do>

⁹ <http://www.openreach.co.uk/orpg/products/wlr/isdn30/isdn30.do>

¹⁰ <http://www.openreach.co.uk/orpg/products/wlr/wlr3/contracts.do>

- for analogue WLR, ISDN2 WLR and ISDN30 WLR, all transfer orders are to be completed by the 10th SMC Working day and all new provision and conversion orders are to be completed by the stated date or compensation shall be payable;
- for WLR3, all provision transfer and all new provision orders will be available to use by midnight on the date provided in the KCI 2 or on a later date agreed by both parties or compensation becomes payable thereafter;
- CPs should be able to make claims for any downtime of the SPG other than for scheduled outages;
- all caps on compensation for analogue WLR, ISDN2 WLR, ISDN30 WLR and WLR3 shall be removed;
- it does not appear necessary to amend the level of compensation for each event for WLR products at this time;
- the ability for CPs to make claims for additional loss should be made explicit in the WLR SLAs Contracts; and
- Openreach should monitor its performance against the WLR SLA Contracts and, where it fails to meet these service agreements, compensation payments should be made to CPs without any need for the customer to claim.

4.6 Ofcom sought respondents' views on its proposals.

Respondents' views

Compensation per event

4.7 Openreach explained that as part of the Openreach proposals it had stated that it would agree to compensation being payable for each service failure. It stated that this would provide increased transparency and certainty for CPs and would have enabled CPs to link individual service failures to compensation paid out under the SLG.

4.8 Other respondents were generally of the view that they should be compensated for individual service failures.

Removal of caps on compensation

4.9 Openreach reiterated its views, expressed elsewhere in its response, that it was common commercial practice for suppliers to limit their exposure by capping the amount of compensation that they would be contractually obliged to pay in the event of service failure and that removal of the cap would represent an unreasonable level of risk.

4.10 Other respondents were generally supportive of the proposal to remove caps.

Value of compensation

4.11 Openreach agreed that it was unnecessary to change the overall levels of compensation set out in the SLGs because it considered that the amount provided for was fair and reasonable.

- 4.12 Other respondents were generally of the view that compensation levels should be increased. However, most acknowledged that it was appropriate for Ofcom to address the process issues first, and to revisit the value of the compensation payments at a later date if the improved processes had not provided Openreach with sufficient financial incentive to maintain service quality.
- 4.13 Respondents suggested, however, that the final Directions should specify the exact level of compensation that should be paid out under each SLG to prevent Openreach from reducing the amount of compensation on a per event basis from the current levels. They also suggested that where compensation payments were specified (e.g. for EMP downtime) rates should be specified as the minimum that should be paid out to enable Openreach to pay out more should it choose to do so.

Claiming for additional loss

- 4.14 Openreach was of the view that compensatory payments were intended to represent liquidated loss to an average CP. Therefore, its SLGs should not include clauses which might require it to pay compensation beyond that set out within them.
- 4.15 Other respondents were generally supportive of the proposal and a number stated that it was an important principle that the limitations of the SLG do not prevent claims for actual financial loss.

Proactive payment of compensation

- 4.16 Openreach considered that its proposal was a reasonable and balanced approach to the issue. Under the proposal, Openreach stated that it would endeavour to streamline processes to ensure that compensation claiming mechanisms were not onerous. Also, it had offered to pay compensation for WLR3 proactively. Openreach added that it should be able to recover the incremental costs of any service or system developments needed to implement proactive compensation payments for legacy products. Openreach also added that the SLGs should provide CPs with an incentive to migrate services to WLR3.
- 4.17 Openreach also stated that it should not be required to develop proactive payments for WLR2 as it will be superseded by WLR3. Openreach stated that developing and implementing either a tactical or strategic proactive payment system across the entire WLR product set would incur significant cost.
- 4.18 Other respondents were generally of the view that it was imperative that compensation payments were made proactively for all products (including WLR2) given that WLR3 was predominantly used by the BT Group.

Ofcom's response

Compensation per event

- 4.19 Having considered the responses, Ofcom's view is that compensation for service failures should be paid on a per event basis. SLGs should be designed to provide an appropriate financial incentive to ensure service quality and, because of this, Ofcom considers that compensatory payments reflecting the efficient level of service should be paid on a per event basis. Compensation should not be based on Openreach's average performance and therefore not paid in the event that the average performance is better than the targets established under the SLG. Individual service failures lead to CPs incurring costs and they should be compensated as a result.

Ofcom notes that Openreach agreed with this principle and that it was part of the Openreach proposal.

Removal of caps on compensation

- 4.20 Ofcom has considered the likelihood that the removal of caps could potentially expose Openreach to unlimited financial risk. In general, Ofcom considers that in the vast majority of cases Openreach is in a position to control the amount of compensation that it has to pay out, i.e. by provisioning the service or repairing the fault. However, Ofcom has also considered Openreach's point that many commercial contracts often contain limitations on the amount of compensation that would be paid out in the event of a service failure.
- 4.21 Ofcom considers that there is a balance to be struck between ensuring that appropriate compensation is paid in such a way as to incentivise performance and ensuring that in amending the SLG process Ofcom is not introducing unreasonable burdens on Openreach. Therefore, Ofcom has decided to amend its proposals with regard to WLR and to maintain a maximum limit of compensation on a per line basis.
- 4.22 Currently compensation for WLR is capped at:
- £500 per line per annum for analogue WLR2 and WLR3 for any one failure or series of related failures;
 - £250 per line for ISDN2 WLR for any one failure or series of related failures; and
 - £1,500 per 2Mb bearer per annum for ISDN30 WLR for any one failure or series of related failures, except for those compensation entitlements linked to a particular channel which shall be limited to an amount equal to a full year's rental for that channel up to a maximum of £1500 per 2Mb bearer.
- 4.23 Ofcom considers that the current approach of setting the cap as a maximum sum can lead to undesirable effects. For example, in the worst case the value of compensation for a business WLR2 line is proportionately less than for a residential WLR2 line. For residential analogue WLR2 and WLR3 the £500 limit is equal to a line being provisioned or a fault not being repaired up to 60 days late. It is also the equivalent of five years of line rental. For business analogue WLR2 and WLR3 the £500 limit is equal to a line being provisioned or a fault not being repaired up to 54 days late and is the equivalent of 4.5 years of line rental. It is likely that the losses experienced due to a business failure are likely to be greater than those for a residential failure, as business contracts tend to have stronger SLAs than residential contracts. The value of the service (and cost) being provided is greater and the actual loss suffered by the end-user will almost certainly be greater especially where the business is dependent on the line. Therefore, Ofcom considers that it is inappropriate that the current cap on WLR compensation could lead to lower relative payments for business services.
- 4.24 Therefore, Ofcom considers that the caps should be set on the basis of total full days of compensation payment. That is, Ofcom is requiring that compensation for WLR is capped at:
- 60 full days compensation per line for analogue WLR2 and WLR3 for any one failure;
 - 60 full days compensation per line for ISDN2 WLR for any one failure; and

- 60 full days compensation per 2Mb bearer for ISDN30 WLR for any one failure.
- 4.25 Ofcom considers that this is reasonable as it is based on the current residential analogue WLR2 and WLR3 compensation limits and it addresses the anomaly regarding compensation for business analogue WLR2 and WLR3 lines.
- 4.26 For the avoidance of doubt, Ofcom considers that there should not be a cap on the total value of compensation paid to any one company by Openreach. Ofcom also notes that Openreach's customers will also have the option of claiming for additional loss (see below).

Value of compensation

- 4.27 Ofcom considers that it would not be appropriate to set either new levels of compensation for the WLR product portfolio or to set the existing compensation payments as a floor, i.e. the minimum allowable.
- 4.28 First, Ofcom considers that the amount of compensation specified in the present SLGs could provide Openreach with sufficient incentive to provision and repair service in line with the requirements set out therein should Openreach be obliged to proactively compensate CPs. Currently CPs do not claim all the compensation that they are entitled to because of the cumbersome claiming process and Ofcom considers that this is the main flaw with the present SLGs. Ofcom considers that it is likely that the incentive to provision and repair service will increase once Openreach is required to make compensation payments to other providers, rather than mostly internal transfers to BT Retail.
- 4.29 Second, as Ofcom noted in the December consultation, in standard commercial circumstances, it is possible to use various methodologies to calculate loss to CPs of different failures, including:
- lost/delayed revenue as a result of the failure;
 - lost customers;
 - compensation paid by CPs to their end-users;
 - additional costs of customer service relating to the failure;
 - operational costs to the CP of dealing with Openreach as a result of the failure; and
 - damage to reputation.
- 4.30 Third, Ofcom considers that Openreach does not have the ability to unilaterally reduce compensation payments, as generally it does not have the ability to unilaterally change the relevant contract.
- 4.31 Fourth, as Ofcom stated in the December consultation, Ofcom will review the impact of the changes to assess whether or not the SLGs have been effective in driving improved service performance and have not given Openreach perverse incentives which would allow it to avoid compensation payments by extending lead times. If little or no improvement in service performance is confirmed or observed, Ofcom will review the level of compensation payments. Ofcom plans to carry out this review six months after the changes are implemented, i.e. nine months after the date of the

publication of this document. Ofcom will also consider whether additional performance incentives are required as part of the broader Review of Openreach's Financial Framework.

Claiming for additional loss

- 4.32 The SLGs are intended to compensate an average CP for any loss that is incurred as a consequence of failure or delayed provision of service. There are, however, likely to be circumstances in which the level of compensation specified in the SLG will not adequately compensate CPs. In those cases, CPs should not be prevented from seeking compensation beyond the limitations of the SLG.
- 4.33 However, Ofcom considers that it would only be efficient for a CP to make additional claims in the circumstance where the actual loss was sufficiently greater than the average compensation so as to make the likely gain greater than the cost of claiming. Ofcom also notes that in claiming for additional loss the onus would be on the claimant to reasonably demonstrate the loss.

Proactive payment of compensation

- 4.34 In the December consultation, Ofcom proposed that Openreach should monitor its performance for WLR against its SLAs and, where it fails to meet these service agreements, the payments should be made to CPs without the CP needing to make a claim for compensation and justify the claim (i.e. make proactive payments). Ofcom's proposal was based on its view that:
- the costs of claiming compensation for WLR are disproportionate given the amount of compensation that is actually paid out; and
 - Ofcom considers that the current processes for claiming compensation represent the most significant problem with regard to the SLAs for WLR products.
- 4.35 Ofcom is aware of Openreach's concerns regarding proactive payments for WLR2. That is, WLR2 will be superseded by WLR3 in the future and, therefore, Openreach will incur costs in developing systems or processes for WLR2 that will be redundant in the future. Additionally, Openreach expressed concerns that the existence of proactive compensation payments acts as a disincentive to CPs migrating to WLR3.
- 4.36 Ofcom considers that proactive compensation payments should apply to all WLR, LLU and Ethernet services. WLR2 is the external Openreach product with the largest volumes. There are over 4 million lines or channels of WLR2, generating revenues of £459 million and returns of £92 million in 2006/2007¹¹. In the 12 months from September 2006 to August 2007, Ofcom estimated that the compensation that could have been claimed by external CPs for WLR was \times whereas the actual amount of compensation paid was \times . Ofcom also notes that one of the key reasons for the industry rejecting the Openreach proposal was the absence of proactive payments for WLR2 as this is still the principal product used by CPs. Therefore, Ofcom considers that it is essential that Openreach makes proactive compensation payments for WLR2.

¹¹ Source: BT's Current Cost Financial Statements for 2007 (<http://www.btplc.com/Thegroup/Regulatoryinformation/Financialstatements/2007/CurrentCostFinancialStatements.pdf>). The return on external WLR has been estimated by Ofcom by applying the ratio of internal to external revenues to the total return figure.

- 4.37 Furthermore, Ofcom does not consider that the SLG arrangements should be used as a lever to incentivise CPs to migrate to WLR3. The incentive to migrate to WLR3 will naturally increase once the service advantages of the automated systems are clear.
- 4.38 Ofcom understands that Openreach will develop tactical, i.e. primarily manual, processes to operate proactive payments for WLR2. Openreach has shared its estimated costs for the development of these tactical systems and processes with Ofcom. Ofcom also recognises that tactical processes are unlikely to be as efficient as strategic automated and systematised processes. However, Ofcom considers that these costs are outweighed by the clear need for proactive payments for WLR2 as demonstrated by the current low level of outgoing compensation payments.
- 4.39 Ofcom also considers that Openreach already has in place the information systems to be able to identify and extract information on service failures and calculate compensation for their customers. As noted by several respondents, the claims generated by external CPs are primarily based on information that they receive from Openreach. Additionally, when handling claims for compensation, Openreach validates the claims against its own systems. If it were not for the significant under-claiming Openreach would already be incurring most of these costs in carrying out its current process.

Conclusions

- 4.40 Ofcom considers that the conclusions set out herein would provide Openreach with an appropriate financial incentive to deliver good service quality on fair and reasonable terms. Ofcom will, however, monitor Openreach's service performance to ascertain whether the intended service improvements materialise.
- 4.41 The Direction set out at Annex 1 therefore requires Openreach to amend its WLR SLA contracts as specified therein. The only noteworthy difference between the Direction at Annex 1 and the draft set out in the December consultation is that Ofcom has concluded that compensation caps should be retained. The level of the caps have, however, been amended.
- 4.42 In summary, Ofcom requires Openreach to amend the relevant SLGs to ensure that:
- for analogue WLR, ISDN2 WLR and ISDN30 WLR, all transfer orders are to be completed by the 10th SMC Working day and all new provision and conversion orders are to be completed by the stated date or compensation shall be payable;
 - for WLR3, all provision transfer and all new provision orders will be available to use by midnight on the date provided in the KCI 2 or on a later date agreed by both parties or compensation becomes payable thereafter;
 - there are no caps on total value of compensation paid to any one company;
 - compensation is capped at 60 full days compensation per line for any one failure for analogue WLR2, ISDN2 WLR2 and WLR3 and 60 full days compensation per 2Mb bearer for any one failure for ISDN30 WLR;
 - CPs should be able to make claims for any downtime of the SPG other than for scheduled outages;

- the ability for CPs to make claims for additional loss should be made explicit in the WLR SLA Contracts; and
- Openreach should monitor its performance against the WLR SLA Contracts and, where it fails to meet these service agreements, compensation payments should be made to CPs without any need for the customer to claim.

Section 5

Local Loop Unbundling

Introduction

- 5.1 On 16 December 2004, Ofcom identified BT as an operator with significant market power (SMP) in the following market¹²:
- wholesale local access in the UK except the Hull area.
- 5.2 As a result, Ofcom imposed various regulatory obligations on BT, including SMP services condition FA1 which requires BT to supply services in the wholesale local access market on fair and reasonable terms and conditions. Pursuant to the Undertakings, Openreach is the separate organisation within BT Group responsible for providing these products.

The December consultation

- 5.3 Section 5 of the December consultation explained that CPs considered that the SLGs for local loop unbundling services were not giving Openreach a sufficient financial incentive to provide good service quality. Ofcom agreed and provisionally concluded that it needed to amend the SLA for access network facilities which is set out at Part VI of the *Access Network Facilities Agreement Schedules* ('the LLU SLA')¹³.
- 5.4 In summary, Ofcom proposed that:
- Openreach amends its LLU SLA so as to remove: the link to Openreach's average performance for LLU Repair; the mutual exclusivity between compensation payments for MPF / SMPF and other products; and the link between LLU CPs' forecasting and compensation payments;
 - the caps on compensation of a maximum of 42 working days for MPF and SMPF shall be removed other than for CP step-in;
 - it does not appear necessary to amend the level of compensation for most events for MPF or SMPF at this time;
 - for orders submitted over the EMP, if a CP informs Openreach (within eight working days of Openreach's notification of delivery) that the MPF or SMPF was provided in non-operational state, then Openreach shall pay compensation of £16 each day or part day from the date of the notification of delivery until it is made operational. This proposal relates to DOAs (dead on arrivals) and ELF's (Early Life Failures), i.e. where an SMPF or MPF is provided to the customer, but that it is either non-operational on delivery (a DOA) or fails within the first eight working days of delivery (an ELF); and
 - Openreach should monitor its performance against the LLU SLAs for provision and fault repair and, where it fails to meet these service agreements, compensation payments should be made to CPs without any need for the customer to claim.

¹² <http://www.ofcom.org.uk/consult/condocs/rwlam/statement/rwlam161204.pdf>

¹³ http://www.openreach.co.uk/orgg/products/llu/contracts/downloads/RANF_Part_VI.rtf

5.5 Ofcom sought respondents' views on its proposals.

Respondents' views

Compensation per event

5.6 Openreach considered that Ofcom's proposal to amend the SLG for LLU Repair so that it would be obliged to pay the same level of compensation for MPF and SMPF faults (despite the fact that rental for the latter is significantly less than rental for the former) was inappropriate given that it did not reflect the differential in the price of each product. Openreach also considered that it was inappropriate for compensation for the provision of a circuit not to be offset against compensation already paid for delayed provision of infrastructure such as co-location and tie cables. This could lead to multiple exposures. Openreach also suggested that there were circumstances beyond its control and it should not be required to compensate CPs in these instances.

5.7 Other respondents were generally satisfied that the proposals covered most of the areas which they considered to be of the greatest importance. They were, however, generally disappointed that Ofcom had not made any proposals in relation to delayed provision of co-location and tie cables.

Removal of caps on compensation

5.8 Openreach stated that the cap on compensation payments, in this instance, was introduced as a regulatory mechanism intended to provide an appropriate balance between reasonable compensation payments and the incentive to provision or repair service. It added that removal of the cap would potentially subject it to an unacceptable commercial risk.

5.9 Other respondents were supportive of the proposal to remove the cap.

Value of compensation

5.10 Openreach was generally satisfied with the proposal given that Ofcom did not propose to revise the level of the compensation payments at this point in time. It did, however, consider that the proposal in relation to the requirement to pay a higher level of compensation for DOAs and ELFs was not justified and arbitrary. Openreach was also disappointed that Ofcom proposed to remove the link between compensation payments and forecasting arrangements. Openreach stated that forecasting enabled it to meet demand and that, in the absence of an explicit link between compensation arrangements and forecasts, CPs would not have an incentive to forecast accurately.

5.11 Other respondents were generally of the view that the level of compensation for all components which comprise the LLU product (including tie cables and co-location) should have been increased. They stated that failure of the LLU product was similar to loss of both broadband and narrowband services and therefore compensation levels should reflect this.

5.12 On DOAs and ELFs, a number of respondents suggested that because of the potentially irreparable harm to the customer relationship the losses that they incur as a result of failures which occur immediately post provision are significantly higher than the level of compensation proposed in the December consultation and should therefore be uplifted.

- 5.13 Respondents welcomed the removal of the forecasting and compensation link.

Claiming for additional loss

- 5.14 The LLU SLA already includes provision for claims for additional losses and Openreach had not intended to withdraw the relevant clauses to prevent claims which exceeded the terms of the contract. It stated, however, that this was not consistent with normal commercial practice and that the relevant clauses were included in the LLU contract as a result of regulatory intervention.
- 5.15 Other respondents were of the alternative view (i.e., the SLG should allow them to claim more than the average CP's loss).

Proactive payment of compensation

- 5.16 Openreach explained that the Openreach proposal included proactive payments of compensation for LLU services and therefore acknowledged that Ofcom's proposal for proactive payments was reasonable. It stated, nonetheless, that it would need time to implement proactive compensatory arrangements given that there was other functionality that Openreach had agreed to deliver as part of the ongoing implementation programme for WLR3 to meet the requirements of the baseline.
- 5.17 Other respondents were also supportive of the proposal.

Ofcom's response

Compensation per event

- 5.18 Ofcom considers that compensation for service failures should be paid on a per event basis. SLGs should provide an appropriate financial incentive to ensure service quality and, because of this, Ofcom considers that compensatory payments reflecting the efficient level of service should be paid on a per event basis. Compensation should not be based on Openreach's average performance and therefore not paid in the event that the average performance is better than the targets established under the SLG. Individual service failures lead to CPs incurring costs and they should be compensated as a result.
- 5.19 The current LLU SLA requires Openreach to pay increased levels of compensation for SMPF (at MPF monthly rental rates) should the overall LLU Repair performance fall below 95% and should it exceed that level it is required to pay at SMPF monthly rental rates. MPF receives the same amount of compensation in either case. The LLU SLA therefore gives Openreach an incentive to perform at the higher level. Ofcom proposed to change this and require Openreach to pay at MPF monthly rental rates for any service failure.
- 5.20 On further consideration, as the LLU SLA already gives Openreach an incentive to repair service and it requires Openreach to pay compensation for each and every service failure, the present arrangements remain appropriate. Therefore, Ofcom is not implementing the proposal set out in the December consultation which would have required Openreach to pay compensation at the same rate for each and every service failure. Ofcom considers that the present arrangements, which were agreed with industry, already provide Openreach with appropriate incentives.

Removal of caps on compensation

- 5.21 Ofcom has considered the likelihood that the removal of caps could potentially expose Openreach to unlimited financial risk. In general, Ofcom considers that in the vast majority of cases Openreach is in a position to control the amount of compensation that it has to pay out, i.e. by provisioning the service or repairing the fault. However, Ofcom has also considered Openreach's point that many commercial contracts often contain limitations on the amount of compensation that would be paid out in the event of a service failure.
- 5.22 Ofcom considers that there is a balance to be struck between ensuring that appropriate compensation is paid in such a way as to incentivise performance and ensuring that in amending the SLG process Ofcom is not introducing unreasonable burdens on Openreach. Therefore, Ofcom has decided to amend its proposals with regard to LLU and to maintain a maximum limit of compensation on a per line basis.
- 5.23 Currently compensation for MPF and SMPF services is capped at 42 consecutive working days of compensation per line per event. Many CPs purchase WLR, SMPF and MPF from Openreach and potentially provide services to their customers using combinations of these services, e.g. WLR and SMPF or MPF. However, the difference in underlying wholesale products is not and should not be apparent to the end-user. Therefore, Ofcom considers that there is a benefit to consistency of treatment across the product portfolio and is requiring that compensation is capped at 60 full days' compensation per line per annum for MPF and SMPF for any one failure in line with WLR.
- 5.24 Ofcom considers that this is reasonable as it is consistent with both the existing MPF and SPG caps and the proposed residential analogue WLR2 and WLR3 compensation limits.
- 5.25 For the avoidance of doubt, Ofcom considers that there should not be a cap on the total value of compensation paid to any one company by Openreach. Ofcom also notes that Openreach's customers will also have the option of claiming for additional loss (see below).

Value of compensation

- 5.26 Ofcom considers that in most cases it would not be appropriate to set either new levels of compensation for SMPF or MPF or to set the existing compensation payments as a floor, i.e. the minimum allowable.
- 5.27 First, Ofcom considers that the amount of compensation specified in the present SLGs might provide Openreach with sufficient incentive to provision and repair service in line with the requirements set out therein should Openreach be obliged to proactively compensate CPs. Currently CPs do not claim all the compensation that they are entitled to because of the cumbersome claiming process and Ofcom considers that this is the main flaw with the present SLGs.
- 5.28 Second, as Ofcom noted in the December consultation, in standard commercial circumstances, it is possible to use various methodologies to calculate loss to CPs of different failures, including:
- lost/delayed revenue as a result of the failure;
 - lost customers;

- compensation paid by CPs to their end-users;
 - additional costs of customer service relating to the failure;
 - operational costs to the CP of dealing with Openreach as a result of the failure; and
 - damage to reputation.
- 5.29 Third, Ofcom considers that Openreach does not have the ability to unilaterally reduce compensation payments, as it does not generally have the ability to unilaterally change the relevant contract.
- 5.30 Fourth, as Ofcom stated in the December consultation, Ofcom will review the impact of the changes to assess whether or not the SLGs have been effective in driving improved service performance and have not given Openreach perverse incentives which would allow it to avoid compensation payments by extending lead times. If little or no improvement in service performance is confirmed or observed, Ofcom could review the level of compensation payments. Ofcom plans to carry out this review six months after the changes are implemented, i.e. nine months after the date of the publication of this document. Ofcom will also consider whether additional performance incentives are required as part of the broader Review of Openreach's Financial Framework.
- 5.31 Ofcom notes the anomaly, however, that losses at the retail level following loss of or delayed provision to the wholesale service could be higher than losses for WLR given that CPs have stated that their losses might be equivalent to loss of a narrowband and broadband service and yet the compensation payments at the wholesale level do not reflect this.
- 5.32 On DOAs and ELF, however, Ofcom considers that CPs's losses are greater than for delays in the provision of service in the first place and that they should be compensated accordingly.
- 5.33 For DOAs and ELF, the CP is not in a position to give its end-user advance warning of the potential for delayed provision because they would only know at the point of delivery. Ofcom considers therefore that CPs should be compensated more than for a provision or failure of service. The precise level of compensation that should be paid out for the losses that CPs incur is difficult to quantify and respondents' views on the appropriate level varied significantly. One respondent noted that (excluding reputational damage) the costs it incurred related to a DOA or ELF were twice that of those related to an in-life fault and that their customers were significantly more likely to churn away than after an in-life fault. They also noted that their costs were significantly greater than the value of compensation, even under Ofcom's proposals in the December consultation. Ofcom considers, therefore, that the level proposed is a reasonable proxy for CPs' losses.
- 5.34 With regard to the view of some respondents that Ofcom's proposals should cover the entire LLU portfolio of products, Ofcom recognises that other services, such as co-location and tie cables, need to be provided prior to unbundling of an exchange and therefore delays in the provision of these elements delay the unbundling. Nonetheless, Ofcom does not intend to amend its proposals to specifically consider these elements. Ofcom's focus was on the end-user product.

- 5.35 With regard to respondents' views on forecasting, Ofcom is of the view that it is inappropriate for compensation arrangements to be used as a mechanism to encourage accurate forecasting. Ofcom acknowledges the importance of forecasting and considers that there is no strong reason for forecasts to be wildly inaccurate. Ofcom considers that there should be a clear coincidence of interest between Openreach and its customers. That is, Openreach should be able to fulfil their customers' expectations more closely with greater visibility of future volumes.

Claiming for additional loss

- 5.36 The SLGs are intended to compensate an average CP for any loss that is incurred as a consequence of failure or delayed provision of service. There are, however, likely to be circumstances in which the level of compensation specified in the SLG will not adequately compensate CPs. In those cases, CPs should not be prevented from seeking compensation beyond the limitations of the SLG.
- 5.37 However, Ofcom considers that it would only be efficient for a CP to make additional claims in the circumstance where the actual loss was sufficiently greater than the average compensation so as to make the likely gain greater than the cost of claiming. Ofcom also notes that in claiming for additional loss the onus would be on the claimant to demonstrate the loss.

Proactive payment of compensation

- 5.38 In the December consultation, Ofcom proposed that Openreach should monitor its performance for MPF and SMPF against its SLAs and, where it fails to meet these service agreements, the payments should be made to CPs without the CP needing to make a claim for compensation and justify the claim (i.e. make proactive payments). Ofcom notes that the Openreach proposal included the proactive payment of compensation for MPF and SMPF.
- 5.39 Ofcom considers that proactive compensation payments should apply to all products. LLU is a very significant Openreach product. As of January 2008, there were nearly 4 million lines of LLU; and in 2006/7 LLU generated external revenues of £244 million and returns of £41 million for Openreach¹⁴. In the 12 months from September 2006 to August 2007, Ofcom estimated that the compensation that could have been claimed by external CPs for LLU was £1.2 billion, whereas the actual amount of compensation paid was £0.2 billion.
- 5.40 Ofcom also considers that Openreach already has in place the information systems to be able to identify and extract information on service failures and calculate compensation for their customers. As noted by several respondents, the claims generated by external CPs are primarily based on information that they receive from Openreach. Additionally, when handling claims for compensation, Openreach validates the claims against its own systems. If it were not for the significant under-claiming Openreach would already be incurring most of these costs in carrying out its current process.
- 5.41 Ofcom understands that Openreach will develop tactical, i.e. primarily manual, processes to operate proactive payments for MPF and SMPF in advance of the development of strategic solutions on the EMP. Openreach has shared its estimated

¹⁴ Source: BT's Current Cost Financial Statements for 2007 (<http://www.btplc.com/Thegroup/Regulatoryinformation/Financialstatements/2007/CurrentCostFinancialStatements.pdf>). The return on external WLR has been estimated by Ofcom by applying the ratio of internal to external revenues to the total return figure.

costs for the development of these tactical systems and processes with Ofcom. Ofcom also recognises that tactical processes are unlikely to be as efficient as strategic automated and systematised processes. However, Ofcom considers that these costs are reasonable.

Conclusions

- 5.42 Ofcom considers that the conclusions set out herein would provide Openreach with an appropriate financial incentive to deliver good service quality on fair and reasonable terms. Ofcom will, however, monitor Openreach's service performance to ensure that service improvements materialise.
- 5.43 The Direction set out at Annex 2 therefore requires Openreach to amend its LLU SLA contract as specified therein. There are two main differences between the Direction set out at Annex 2 and the draft set in the December consultation. First, Ofcom has decided that compensation caps should be retained. The level of the caps have, however, been amended. Second, Ofcom considers that failure to repair SMPF services should attract compensation at SMPF levels unless overall performance is below the threshold stipulated in the LLU SLA. The present arrangements therefore remain appropriate and they have not been amended.
- 5.44 In summary, Ofcom requires Openreach to amend the relevant SLGs to ensure that:
- Openreach amends its LLU SLA so as to remove: the mutual exclusivity between compensation payments for MPF/SMPF and other LLU services; and the link between LLU CPs' forecasting and compensation payments;
 - compensation caps are revised and set at 60 full days' compensation per line per annum for MPF and SMPF for any one failure.
 - for orders submitted over the EMP, if a CP informs Openreach (within eight working days of Openreach's notification of delivery) that the MPF or SMPF was provided in non-operational state, then Openreach shall pay compensation of £16 each day or part day from the date of the notification of delivery until it is made operational; and
 - Openreach should monitor its performance against the LLU SLAs for provision and fault repair and, where it fails to meet these service agreements, compensation payments should be made to CPs without any need for the customer to claim.

Section 6

Ethernet services

Introduction

- 6.1 On 24 June 2004, Ofcom identified BT as an operator with significant market power (SMP) in the following market in the UK (except the Hull area)¹⁵:
- wholesale alternative interface symmetric broadband origination at all bandwidths.
- 6.2 As a result, Ofcom imposed various regulatory obligations on BT, including SMP services condition HH1 which requires BT to supply services in the wholesale alternative interface symmetric broadband origination market at all bandwidths on fair and reasonable terms and conditions. Pursuant to the Undertakings, Openreach is the separate organisation within BT Group responsible for providing these products.

The December consultation

- 6.3 Section 6 of the December consultation explained that CPs considered that the SLGs for Ethernet services were not giving Openreach a sufficient financial incentive to provide good service quality. Ofcom agreed and provisionally concluded that it needed to amend the SLAs for:
- BES circuits, which is set out at Schedule 4 of the *Conditions for Backhaul Extension Services* ('the BES SLA')¹⁶; and
 - WES and WEES circuits, which is set out at Schedule 5 of the *Conditions for Wholesale Extension Services* ('the WES and WEES SLA')¹⁷.
- 6.4 These contracts are collectively referred to as the "Ethernet SLAs".
- 6.5 In summary, Ofcom proposed that:
- for late provisions, Openreach shall pay compensation at an increased level of one month's line rental per day or part day of delay;
 - for each late fault repair, Openreach will pay compensation at a rate of 15% of one month's line rental for each hour of additional downtime beyond the first five hours;
 - the ability for CPs to make claims for additional loss should be made explicit in the contracts;
 - the caps on compensation of a maximum of 20% of connection charge for late provisions and a maximum of 35% of annual rental for late fault repair shall be removed; and

¹⁵ http://www.ofcom.org.uk/consult/condocs/lmr/statement/state_note.pdf

¹⁶ http://www.openreach.co.uk/org/products/bes/downloads/eoibes%20-%2001-09-06/bes_eoi_schedule_4_issue4_dated_290606.pdf

¹⁷ http://www.openreach.co.uk/org/products/wes/downloads/eoiwes%20-%2001-09-06/wes_eoi_schedule_5_sla_issue4_dated290606.pdf

- for faults, proactive compensation payments shall be made within an appropriate timeframe.

6.6 Ofcom sought respondents' views on its proposals.

Respondents' views

Question 4: Do you agree that Ofcom's proposed amendment of the **structure** of the Ethernet compensation payments is consistent with the loss suffered by CPs? Do you agree that Ofcom's proposed **level** of Ethernet compensation payments is consistent with the loss suffered by CPs?

Question 5: Do you consider that the proposed changes to the SLAs and SLGs for Ethernet services are appropriate?

Question 6: Do you agree that Openreach should be required to justify changes to the Contractual Delivery Date which would delay the provision of the Ethernet services beyond the 57th day?

Compensation per event and value of compensation

- 6.7 Openreach was of the view that compensation should continue to be based on connection charges. Changing the structure of the compensation arrangements would, it considered, require the development of systems to monitor and compensate on a new basis and would therefore see resource diverted from other system developments. Openreach further explained that the Openreach proposal included more generous compensation payment arrangements and would provide a good basis to continue to improve on service delivery, which, in any case, is an extremely high priority for Openreach. Openreach added that provisioning performance for Ethernet services had improved considerably and this demonstrated its commitment to improve service.
- 6.8 Other respondents were generally of the view that linear compensation payments were more likely to reflect CPs' losses than the present arrangements and therefore welcomed the proposed changes to the compensation arrangements. They suggested, however, that compensation should be based on total first year costs (i.e. rental and connection) to ensure that price changes which alter the balance between rental and connection charges do not adversely affect compensation arrangements.
- 6.9 Another respondent suggested that the proposed changes to the Ethernet SLAs should apply equally to other Ethernet services (e.g. including Backhaul Network Services ('BNS'), Openreach Network Backhaul Services ('OBNS') and Openreach Network Ethernet Services ('ONES')).

Contractual Delivery Date ('CDD') and CP Requirement Date ('CRD')

- 6.10 Openreach was not opposed to Ofcom's proposal that any extension of a CDD beyond the 57th day would be subject to the consent of the CP affected, with a requirement that such CP consent could not be unreasonably withheld. Nonetheless, it stated that the revised SLA would need to include normal commercial exemptions and exclusions.
- 6.11 Other respondents welcomed Ofcom's proposal. They stated that service was frequently provisioned beyond the CDD without suitable explanation and considered that the CDD should not be extended unless it was clearly beyond Openreach's

control (e.g. the need for wayleaves) and, even in those circumstances, Openreach should endeavour to manage these to the best of its ability.

- 6.12 Respondents also stated that Ofcom should encourage Openreach to ensure that the expedited Ethernet provision trials (covering BES, WES and WEES) should be rolled-out nationally.

Removal of caps on compensation

- 6.13 Openreach reiterated its views expressed elsewhere in its response in stating that it was common commercial practice for suppliers to limit their exposure by capping the amount of compensation that they would contractually be obliged to pay in the event of service failure. Removal of the cap would represent an unreasonable level of risk.

Claiming for additional loss

- 6.14 Openreach considered that compensation included within SLGs should be an exclusive contractual remedy. Openreach did not agree, therefore, that it should make an explicit statement in the contracts which would allow CPs to claim for additional loss.

Proactive payment of compensation

- 6.15 Openreach explained that it already paid Ethernet compensation proactively and accepted the principle that compensation should be paid on per occasion basis in the next billing cycle. Openreach added, however, that this would require systems development.

Ofcom's response

Compensation per event and value of compensation

- 6.16 Ofcom acknowledges that the Openreach proposal included enhanced compensation arrangements for Ethernet services and that, on average and as set out in Openreach's response to the December consultation, Openreach's service in the provision of Ethernet circuits has improved. Ofcom also welcomes Openreach's desire to bring about a reduction in lead times.
- 6.17 Ofcom does not consider, however, that the Openreach proposal went far enough in terms of the compensation that Openreach would be willing to pay for delays in provisioning and repairing Ethernet circuits. The proposed enhancements maintained the structure of Ethernet payments in that compensation did not increase for every additional day that Openreach was late in delivering service and nor did it compensate for each and every fault or compensate more for longer duration faults. Ofcom considers, therefore, that it failed to address the underlying problem with the regime in that CPs would not have been compensated for each and every event that resulted in them incurring additional losses.
- 6.18 Ofcom is also of the view that the linear compensation payments for Ethernet should be based on rental costs. The rate of compensation for Ethernet has been set partly by reference to that used for other related products, which are based on rental costs. For example, for late provisions, daily compensation equal to one month's rental is the standard industry practice for most Openreach products, including WLR and LLU. Therefore, Ofcom considers that it is reasonable to assume that a similar arrangement will be appropriate for Ethernet products.

- 6.19 On reducing lead times, as stated, Ofcom welcomes Openreach's aim. Ofcom does not consider, however, that this in anyway shows that the present SLG arrangements have been effective in driving service performance given that the present arrangements for faults, for instance, are based on the number of events per year. This provides very limited incentives and certainly does not provide any incentive to repair faults once the fault lasts beyond the first five hours permitted for repair.
- 6.20 Ofcom welcomes CPs' acknowledgment that linear compensation arrangements are more likely to reflect the losses that they suffer as a result of delayed provision and repair. Ofcom notes, however, CPs' preference for compensation payments to be based on first year costs (i.e. connection and rental). Ofcom considers that this would be inappropriate for two reasons. First, as explained, compensation arrangements based on rental costs are common practice across Openreach products and this formed part of the rationale for the current arrangements proposed for Ethernet. Second, Openreach is obliged to set cost-oriented charges and, in some cases, subject to charge controls for Ethernet services and this – not the SLG arrangements – should drive price changes. Ofcom would not expect Openreach to attempt to 'game' the balance between connection and rental charges simply to avoid paying increased compensation arrangements and therefore it considers CPs' concerns are likely to be unfounded. Ofcom would, nevertheless, expect CPs to inform Ofcom should they consider that Openreach was attempting to 'game' charges in the manner described.
- 6.21 On the products covered, Ofcom concentrated on the main Ethernet services BES, WES and WEES and did not consider other Ethernet products such as BNS, OBNS and ONES. The proposals set out in the December consultation and the conclusions and legal instruments set out within this document do not therefore specifically cover these products. Nonetheless, as explained in Section 3, Ofcom considers that the General Principles set out herein could apply equally to other Openreach products and services.

Contractual delivery Date ('CDD') and CP Requirement Date ('CRD')

- 6.22 Ofcom welcomes Openreach's acknowledgement that extended CDD timescales need to be justifiable. Albeit, Ofcom notes that Openreach expects that normal commercial exemptions and exclusions would apply.
- 6.23 On the justification for delays beyond the CDD, Ofcom agrees with other respondents to the extent that they suggest that Openreach should use its best endeavours to ensure that service is provisioned by the CDD date and that, to the largest extent possible, other delays are reduced.
- 6.24 With regard to the views of respondents that Openreach trials for reduced lead times for WES and BES services should be rolled out nationally, Ofcom notes that Openreach briefing ETH016/08¹⁸ stated that the national roll-out had been completed and that all areas of the UK were subject to the same provisions. The trials are intended to determine whether Openreach can reduce Ethernet lead times.

Removal of caps on compensation

- 6.25 As explained elsewhere, there is a balance to be struck between ensuring that appropriate compensation is paid in such a way as to incentivize performance and

¹⁸ http://www.openreach.co.uk/org/news/productbriefings/ethernet/downloads/Briefing%20ETH016_08.pdf

ensuring that in amending the SLG process Ofcom is not introducing unreasonable burdens on Openreach. The removal of caps could expose Openreach to unlimited financial risk and Ofcom has, therefore, reintroduced the concept of caps.

- 6.26 The present caps for Ethernet services are based on a structure which Ofcom has replaced. For instance, the cap for faults is based on the number of instances per year whereas Ofcom is moving to a regime under which compensation is paid on a per hour basis. Ofcom has therefore needed to implement new caps for provision and repair and set them at the appropriate level.
- 6.27 Ofcom considers that a cap of 60 days for compensation for provisioning is reasonable. This is consistent with the limit Ofcom is setting for WLR and LLU. Furthermore for the period examined, Ofcom notes that around 1 per cent of late Ethernet provisions were outstanding after 60 days and that a cap of 60 days is equal to five years' worth of line rental.
- 6.28 A cap of 60 days worth of monthly rental compensation compares to the proposal in the Openreach proposal of 200% of the connection charge after 40 days. For some provisions, the value of the cap in the Openreach proposal will be higher than that in Ofcom's proposal. In general, however, the value of Ofcom's provisions cap will be slightly higher than that in the Openreach proposal.
- 6.29 For repairs, Ofcom considers that a limit of 200 hours of compensation is reasonable. The data available to Ofcom suggests that this would be broadly consistent with less than 1 per cent of late faults being outstanding¹⁹. A limit of 200 hours for faults implies a lower cap than Ofcom considers appropriate for provisions. 200 hours of compensation at 15 per cent of monthly line rental per hour would be worth 2 ½ years of line rental, compared to 5 years for late provisions. Ofcom considers that this is therefore a relatively conservative cap. Ofcom's proposed cap is, however, very significantly higher than the current arrangements (no changes were proposed as part of the Openreach proposal).

Claiming for additional loss

- 6.30 Ofcom considers that CPs should be able to claim for actual financial loss beyond that stipulated in the LLU SLA.

Proactive payment of compensation

- 6.31 Ofcom welcomes Openreach's commitment to continue to pay compensation proactively and its acceptance that compensation should be paid on a per occasion basis and paid in the next billing cycle.

Conclusions

- 6.32 Ofcom considers that the conclusions set out herein would provide Openreach with an appropriate financial incentive to deliver good service quality on fair and reasonable terms. Ofcom will, however, monitor Openreach's service performance to ensure that service improvements materialise.
- 6.33 The Direction set out at Annex 3 therefore requires Openreach to amend its Ethernet SLAs as specified therein. The only noteworthy difference between the Direction at

¹⁹ The large majority of late faults are cleared in 24 hours, and only around 5 per cent are outstanding after 48 hours. Only a handful of faults were outstanding after 72 hours. This makes the point at which less than 1 per cent of faults are outstanding very sensitive to a few particular late faults.

Annex 3 and the draft set out in the December consultation is that Ofcom has concluded that compensation caps should be retained. However, as Ofcom has changed the structure of Ethernet payments, it has had to set revised caps at levels which it considers appropriate.

6.34 In summary, Ofcom requires Openreach to amend the relevant SLGs to ensure that:

- for late provisions, Openreach shall pay compensation at an increased level of one month's line rental per day or part day of delay;
- for each late fault repair, Openreach will pay compensation at a rate of 15% of one month's line rental for each hour of additional downtime beyond the first five hours;
- the ability for CPs to make claims for additional loss should be made explicit in the contracts;
- the caps on compensation of a maximum of 20% of connection charge for late provisions and a maximum of 35% of annual rental for late fault repair shall be replaced by caps of 60 working days for late provision compensation payments and 200 hours for compensation for late repairs; and
- for faults and provisions²⁰ proactive compensation payments shall be made within an appropriate timeframe.

²⁰ The paragraph summarising the Ethernet proposals in the December consultation did not explicitly mention proactive payments for provisions, but this was implicit in the text. Late compensation payments for Ethernet provisions are currently made proactively by Openreach.

Section 7

Equivalence Management Platform

Introduction

- 7.1 The Equivalence Management Platform (EMP) is the electronic gateway via which CPs manage MPF, SMPF and WLR3 services. The EMP is used by CPs for address matching, making appointments, managing line availability at target premises, number reservation and management, obtaining installation details, diagnostic testing, placing any order type (i.e. provide, modify or cease), and reporting and managing faults.
- 7.2 If the EMP is unavailable, any CP providing LLU or WLR3 services is unable to manage its current or potential customers. For example, if the EMP is unavailable a CP will not be able to book appointments in real-time (i.e. while the customer is on the phone) or to report and manage faults. Similarly, CPs could lose potential customers by not being able to carry out line checks in real-time. Therefore any downtime of the EMP directly affects CPs' ability to gain customers and maintain their relationships with their customers.

The December consultation

- 7.3 Section 7 of the December consultation explained that the EMP provided the link between CPs and Openreach and enabled CPs to service their customers. Any downtime could cause irreparable damage between a CP and its customer or potential customer. Ofcom considered that Openreach needed to minimise downtime to the greatest extent possible and compensate CPs for any downtime to reflect their likely loss.
- 7.4 In summary, Ofcom proposed that:
- CPs should be paid compensation for any downtime of the EMP other than for scheduled outages without any need for the customer to claim;
 - compensation for downtime should be based on service credits of £20;
 - the accelerator proposed by Openreach should be applied for both LLU and WLR3 dialogue services; and
 - the compensation for EMP failure should not be capped.
- 7.5 Ofcom sought respondents' views on its proposals.

Respondents' views

Question 7: Do you consider that the proposed changes to the SLAs and SLGs for the Equivalence Management Platform are appropriate?

Value of compensation

- 7.6 Openreach did not accept that it should pay compensation should the EMP fail other than for scheduled outages without a proper analysis of the costs of such a system and whether such costs would be acceptable to industry. Openreach added that the

current system was never designed to be available 100% of the time and therefore the SLGs include a potential failure rate of 0.2% downtime. Openreach stated that, for the same reasons, it should not be required to pay compensation should the SPG experience any downtime.

- 7.7 For WLR3, Openreach stated that, on the proviso that compensation caps were reintroduced, it accepted the principle of service credits and accelerator given that it had previously acknowledged these were appropriate for LLU. It stated, however, that the service credits should only apply to firm orders and not for each and every time that CPs utilise dialogue services. Dialogue services give CPs an opportunity to check line and service compatibility and utilisation of them will not always result in a firm order. Openreach was therefore willing to accept the principle of service credits for average throughput.
- 7.8 CPs were generally supportive of the proposals. They stated, however, that service credits should also apply to the SPG and eCo repair for Ethernet services. In terms of SPG service credits, CPs stated that, given that the BT Group is the main user of the EMP platform for WLR services, it would gain a competitive advantage should Ofcom's proposals be implemented.
- 7.9 CPs also stated that Ofcom would need to monitor permitted scheduled downtime for service maintenance purposes to ensure that it does not increase.

Removal of caps

- 7.10 Openreach reiterated its views expressed elsewhere in its response in stating that it was common commercial practice for suppliers to limit their exposure by capping the amount of compensation that they would contractually be obliged to pay in the event of service failure. Removal of the cap would represent an unreasonable level of risk.
- 7.11 Other respondents generally agreed with the proposal to remove the caps.

Ofcom's response

Value of compensation

- 7.12 CPs suffer losses as a result of EMP downtime and should be compensated for such losses. Ofcom notes that the EMP was not expressly designed to prevent service failures and therefore such failures are inevitable. Ofcom does not consider, however, that the two positions are incompatible. Ofcom accepts that the EMP will from time-to-time fail in the same way that from time-to-time Openreach will not provision or repair a service on time. In both circumstances, CPs suffer loss and should be compensated. Ofcom does not therefore intend to amend this part of its proposal.
- 7.13 Ofcom has, nonetheless, calculated the potential difference in compensation payments that would result for service levels set at 100% and 99.8%. For a month in which there is a service failure and availability is below 99.8%, then the increase in compensation is not large. The extra 0.2% would result in extra compensation of the order of $\pounds 1.5$. (The precise amount depends on the volume of orders and whether the accelerator for dialogue services is applicable or not.) Ofcom considers that this represents a relatively small difference and that the change is justifiable and proportionate.

- 7.14 Ofcom welcomes Openreach's willingness to accept that compensation credits should be paid for WLR3 services and agrees that compensation should only be paid for the average level of successful orders that follow the average number of times that CPs access dialogue services.
- 7.15 On the SPG, Ofcom does not consider that service credits should be applied proactively for downtime and nor does it consider that any competitive advantage that BT might attain as a result of the proposals are likely to be material. On the first point, the EMP and the SPG are not directly comparable given that the former provides far more automation than the latter and this includes the ability to access dialogue services. The service credits concerned would predominantly be paid for dialogue services and therefore comparisons are not particularly useful. On the second point, the majority of BT's customer base is not yet served via the EMP and it is likely that other CPs will choose to gradually move to the EMP. Even then, however, BT is likely to continue to be the main user of the EMP. It should be noted that the EMP is likely to be more reliable than the SPG in any case.
- 7.16 In terms of permitted scheduled downtime for maintenance purposes, Openreach should not increase it to any appreciable extent and, in any event, Ofcom does not consider that it is that relevant. The reasons for this are that maintenance downtime is generally scheduled for out of office hours and therefore it should not have too much of a bearing on CPs. Second, Openreach will be obliged to pay compensation for the average number of firm orders which are made at other times. Ofcom does not consider that increases in scheduled downtime for maintenance purposes will change this to any appreciable extent. It is arguable that average throughput would increase in the event of longer downtime.

Removal of caps

- 7.17 Openreach's proposal in relation to EMP service credits and accelerator for LLU (and acceptance that similar credits and accelerator should apply for WLR3) was put forward on the basis that service credits could only accrue for downtime of up to 48 hours. Openreach therefore wished to limit its potential financial exposure.
- 7.18 Ofcom considers that the likelihood of the EMP platform being down for a period exceeding 48 hours, on the basis of past performance, is remote. Nonetheless, as explained elsewhere, there is a balance to be struck between ensuring that appropriate compensation is paid in such a way as to incentivize performance and ensuring that in amending the SLG process Ofcom is not introducing unreasonable burdens on Openreach. Compensation exposure beyond the present limitations could present risks of an unacceptable magnitude.
- 7.19 For these reasons, Ofcom has decided to reinstate the compensation cap for EMP service credits and accelerator. Ofcom considers that in order to provide consistency the present cap for LLU (i.e. 48 hours) should apply to WLR3 as well.

Conclusions

- 7.20 Ofcom considers that the conclusions set out herein would provide Openreach with an appropriate financial incentive to ensure that EMP downtime is kept to a minimum. Ofcom will, however, monitor Openreach's service performance to ensure that downtime is indeed kept to a minimum. The changes to the EMP arrangements are set out in the relevant Directions at Annex 1 and Annex 2.

7.21 In summary, for EMP, with regard to MPF, SMPF and WLR3, Ofcom is proposing that:

- CPs should be paid compensation for any downtime of the EMP other than for scheduled outages without any need for the customer to claim;
- compensation for downtime should be based on service credits of £20;
- the accelerator proposed by Openreach should be applied for both LLU and WLR3 dialogue services; and
- compensation should be capped at 48 hours for any single outage..

Section 8

Summary of the Impact Assessment

Introduction and summary of impact assessment

- 8.1 In the December consultation, Ofcom included an impact assessment of the implications of the changes proposed. This section summarises that impact assessment then discusses the comments in responses that relate to it.
- 8.2 Impact assessments provide a valuable way of assessing different options for regulation and showing why the preferred option was chosen. They form part of best practice policy-making. This is reflected in section 7 of the Act, which means that generally we have to carry out impact assessments where our proposals would be likely to have a significant effect on businesses or the general public, or when there is a major change in Ofcom's activities.
- 8.3 In this instance, Ofcom does not think the option of doing nothing is appropriate because Ofcom considers that Openreach's contracts for WLR, LLU and Ethernet services do not provide sufficient incentives for Openreach to maintain an appropriate level of performance. This has contributed to Openreach's customers receiving neither adequate quality of service nor appropriate compensation for service failures, in particular timely provisions and repairs.
- 8.4 Ofcom considered the impact of the proposed changes to the SLAs. To obtain an idea of the scale of the impact, Ofcom estimated what Openreach would have paid out for the 12 month period from August 2006 to September 2007 had the changes been in place at that time. This was summarised in the following table²¹.

Openreach compensation payments from Sept' 2006 to Aug' 2007

	Actual SLA payments	What payment would have been with proposed contract changes
Internal BT	✗	✗
External CPs	✗	✗
Total	✗	✗

- 8.5 Ofcom considered the level of future compensation payments. Future amounts of compensation will depend on a number of factors, including Openreach's performance. The proposed SLA changes will give Openreach stronger financial incentives to improve performance. Even before the new changes are introduced, some aspects of Openreach's performance have improved compared to the 12 month period we considered. Service performance at the level achieved currently, at the beginning of 2008, would imply significantly lower compensation payments than for the period considered.
- 8.6 Openreach has plans to improve substantially some aspects of performance compared to current levels. For example, Openreach's LLU Integrated Improvement Plan envisages the 'First Touch-Last Touch' KPI for provisioning MPF rising from 91

²¹ Ofcom has subsequently made minor changes to the proposals (such as the reintroduction of caps), but does not consider these changes would significantly affect any of the numbers in this table.

per cent in January to March 2008 to 98 per cent by the end of 2008. This implies the number of late provisions falling from 9 per cent of all provisions to 2 per cent. If achieved, such dramatic improvements in performance would greatly reduce potential compensation payments.

- 8.7 Ofcom also recognised that there would be costs for Openreach in terms of changing its processes to enable the proactive compensation of payments. Ofcom considered, however, that these were likely to be comparatively small.
- 8.8 In conclusion, Ofcom considered that the limited set of changes to the SLAs would lead to increased payments by Openreach and would increase the financial incentive on Openreach to deliver good service performance on fair and reasonable terms. The benefits to CPs, and ultimately consumers, of appropriate compensation and incentives are significant enough to justify the additional costs to Openreach, even given the potential improvement in Openreach's performance as described above.
- 8.9 In its response, Openreach commented on the costs of implementing the proposals and the need for a cost benefit analysis that included the impact of the proposals on prices. These are considered below.

Costs of implementing proposals

- 8.10 In the December consultation, Ofcom said that Openreach is likely to already have processes in place to *record* most of the information it needs to enable the calculation of proactive payments. However, Openreach will need to make changes to its processes to enable the calculation and payment of compensation payments.
- 8.11 In its response, Openreach said that Ofcom's proposal contained limited discussion on the likely costs of supporting the proposals. In particular, Openreach said that significant cost will be incurred in developing and implementing either tactical (manual) or strategic (systems-based) proactive payment processes across the entire WLR product set. Openreach also said that linking Ethernet payments to rental payments rather than connection payments would result in further incremental costs.
- 8.12 In terms of the overall costs incurred by both CPs and Openreach, Ofcom considers that it is likely to be much more efficient if Openreach performs the calculations and makes the payments proactively. This is partly to do with the fact that some of the current processes are difficult for CPs to complete, because they involve considerable manipulation and manual re-entry of data originally supplied by Openreach. But it is also because there are large economies of scale in making these calculations, meaning it is more efficient for one company to do it. Ofcom considers that these economies of scale are the main explanation for the fact that BT Retail claims a much higher amount of compensation per line than other CPs.
- 8.13 Ofcom recognises that if Openreach makes the calculations and payments, then CPs are likely to want to check their compensation payments periodically. But this is only likely to be done occasionally on a sampling basis rather than systematically. For those CPs that currently claim compensation, there will therefore be some reductions in the costs.
- 8.14 There will clearly be an increase in cost for Openreach. After receiving Openreach's response, Ofcom asked Openreach for information they had on the likely costs of implementation. Openreach presented a preliminary estimate of the likely costs of a tactical (manual) solution for pro-actively calculating and paying compensation payments which was £3 million in the first year. Around £3 million of this would be

on-going costs that would recur in future years, though this might fall if the business case for a strategic (automated) approach was lower cost. The first year costs represent around \times per cent of what we estimated the payments would have been for the 12 month period we considered. The costs of making proactive payments are therefore fairly small relative to the size of the compensation payments themselves for the 12 month period considered. If in the future the amount of compensation falls, Ofcom considers that the cost of calculation and payment would also fall, though not proportionally.

- 8.15 If Ofcom considers BT Group rather than Openreach, then there will also be some off-setting cost savings from a reduction in costs for BT Retail and other parts of the BT Group. This is because these other parts of BT Group currently have to calculate and claim compensation from Openreach. As the rest of BT Group currently receives a large amount of compensation payments, and there are large economies in scale in such calculations, then this off-setting reduction in costs is likely to represent a sizeable proportion (possibly more than half) of the increase in process costs for Openreach.
- 8.16 Ofcom concludes that the costs of implementing the proposals are proportionate in the context of the benefits that it anticipates from the changes to the SLAs. For industry as a whole, it is likely to be more efficient for Openreach to calculate centrally and make the payments, and even for BT Group as a whole the cost increases will not be large.

Cost benefit analysis and impact on price

- 8.17 Openreach said that Ofcom needed to perform a proper analysis of the relationship between the costs of the cumulative effect of the proposals and the benefits to CPs, and ultimately consumers in order to determine why these identifiable benefits outweighed the costs. Openreach said that instead of doing this, Ofcom simply stated that it considered that the benefits to CPs were significant enough to justify the costs.
- 8.18 Ofcom considers that this can be considered in terms of incentives. The current financial incentives on Openreach to provide a sufficient level of service quality are inadequate because much of the compensation due is not claimed. Ofcom considers that this lack of incentive is contributing to poor service performance. By ensuring compensation payments are paid, Ofcom's proposals should give Openreach an incentive to improve performance up to the point where it is more cost effective to pay compensation than make further service improvements. Provided the compensation payments are not set above the costs that CPs incur as a result of service failures, then this should result in a more efficient outcome for the industry as a whole. CPs have argued strongly that the costs to them of Openreach's poor performance are significant and if the compensation payments were made they would, if anything, be inadequate to compensate fully for their losses. Ofcom therefore considers that the proposals must result in a better price/quality trade-off for CPs, and ultimately consumers.
- 8.19 As a general principle, Ofcom accepts that Openreach should be able to recover in its prices an amount to cover the level of compensation payments that an efficient CP would pay out. The higher the levels at which compensation payments are set, the higher prices will tend to be. Given that Openreach's own integrated plan for LLU envisages very significant improvements in performance by the end of 2008, the levels of compensation that an efficient operator would pay out (at least for LLU) are likely to be significant less than that which Openreach would have paid out in the 12

months considered. Ofcom will consider what an efficient level of service means in practice in the Openreach Financial Framework Review.

- 8.20 If Openreach's performance does improve, then CPs will be better off because any tendency for prices to increase will be less than the costs they would otherwise have incurred from poor service performance. If, despite the incentives, Openreach's service performance remains below that which an efficient operator could achieve, then CPs will be compensated for this through SLA payments, and these will more than off-set any tendency for prices to increase. If downstream markets are sufficiently competitive, this is likely to be passed on to consumers in the form of lower prices. For CPs, and ultimately consumers, Ofcom considers therefore that the benefits are likely to be better value for money.
- 8.21 In terms of the costs of calculating and processing compensation claims, Ofcom considers that a system where Openreach proactively makes payments is likely to be more cost efficient than individual CPs making claims because of the significant economies of scale in making the calculations.

Future impact

- 8.22 Ofcom is making a limited set of changes to the SLAs focussing on their main deficiencies. The changes will be successful if they result in CPs receiving the compensation they are entitled to and if Openreach responds to the incentives by delivering improved service performance.
- 8.23 Ofcom intends to carry out a review to assess whether or not the SLGs have been effective in driving improved service performance and have not given Openreach perverse incentives which would allow it to avoid compensation payments by extending lead times. Ofcom will do this six months after the changes are implemented, i.e. nine months after the date of the publication of this document. Ofcom also intends to review the success or otherwise of these changes as part of the broader Review of Openreach's Financial Framework.

Section 9

Statutory duties under the Communications Act 2003

Ofcom's duties and functions

Sections 3 and 4 of the Act

- 9.1 Ofcom has considered all its duties under section 3 of the Act and, in particular, its principal duties under section 3 which are:
- a) to further the interests of citizens in relation to communications matters; and
 - b) to further the interests of consumers in relevant markets, where appropriate by promoting competition.
- 9.2 Ofcom has also considered its duties under section 4 of the Act and, in particular, the six community requirements which are to:
- a) promote competition;
 - b) contribute to the development of the European internal market;
 - c) promote the interests of all persons who are citizens of the European Union;
 - d) carry out its functions in a manner which does not favour one technology or service over another;
 - e) encourage the provision of network access and service interoperability; and
 - f) encourage compliance with the standards necessary to facilitate service interoperability and to secure freedom of choice for consumers.
- 9.3 Ofcom considers that its proposals are consistent with its principal duties under section 3 of the Act. It considers that its proposals would be likely to further the interests of citizens and consumers because they are intended to ensure that Openreach has an appropriate incentive to provision and repair service. Consumers should therefore benefit from increased value for money, in terms of increased service quality, higher compensation or lower prices. This, in turn, should assist competition in the provision of services.
- 9.4 Ofcom also considers that its proposals are consistent with the six Community requirements. The proposals should help to foster competition in the provision of electronic communications networks and services as CPs would know that such services were being provisioned and repaired in an efficient manner. The access network concerned would be available to all CPs on fair, reasonable and non-discriminatory terms and therefore they would be able to compete on an equivalent basis.

Section 49(2) of the Act

- 9.5 Ofcom cannot give any direction unless the direction meets the tests set out under section 49(2) of the 2003 Act.
- 9.6 Section 49(2) of the Act requires Ofcom in giving any direction to ensure that it is:
- a) **objectively justifiable** in relation to the networks, services, facilities, apparatus or directories to which it relates;
 - b) not such as 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**.

Objectively justifiable

- 9.7 Ofcom considers that its proposals are objectively justifiable in that the present SLGs do not adequately compensate CPs for losses that they incur as a result of delayed provision or repair of a service. CPs also receive significantly less than they should because of the inefficient compensation process. Proactive payments should increase compensation levels and thereby place a greater incentive on Openreach to provision and repair service in an efficient manner.
- 9.8 Ofcom considers that without this level of regulation the current situation would continue. That is, CPs would continue to receive significantly less than they would under an efficient compensation process and Openreach would not have a financial incentive to improve quality of service for its customers. Whereas, if Ofcom's intervention has the intended consequence, Openreach will improve its performance and therefore be liable for less compensation.
- 9.9 As set out in the impact assessment Ofcom has reviewed the potential options, costs and benefits and consider that the resultant measures to be objectively justified.

No undue discrimination

- 9.10 Ofcom considers that its proposals do not discriminate unduly against Openreach as it is the only company that provides the required wholesale communications services on a national basis and therefore equivalent measures could not be applied to anyone else. Ofcom has also considered the consistency of the proposals across different types of Openreach customers.
- 9.11 It is also not necessary to compare the provision of SMP products by Openreach with the provision of non-SMP products by other CPs in competitive markets. The unique position of Openreach as the only provider of the products places it in a position to act without competitive constraint. Therefore, it would not be appropriate to compare the proposed regulatory remedy with conditions that may arise in a competitive market.

Proportionate

- 9.12 Ofcom considers that its proposals are proportionate in that Ofcom only proposes to change the regime in areas in which it considers that the present regime is not working effectively. Ofcom has carried out an impact assessment and considers that the costs involved in its proposals are outweighed by the benefits of improved compensation arrangements and incentives for Openreach to improve quality of service.
- 9.13 Additionally, Ofcom's measures will not increase the actual agreed level of compensation in most cases. Instead, Ofcom is implementing a mechanism which will result in Openreach actually paying out what it owes CPs for service failure. The value of compensation remains in most cases that entered into by Openreach following negotiations with its customers.
- 9.14 Similarly, in relation to the ability of the CP to claim for additional loss over and above the compensation payment, Ofcom notes that this practice reflects existing BT contracts, for example, LLU.
- 9.15 In relation to the pricing issues raised by Openreach in its response, Ofcom has stated that the SLA arrangements will be taken into consideration in the Openreach Financial Framework Review.
- 9.16 On this basis, it is clear that the proposals are proportionate to the objective of improving Openreach performance.

Transparent

- 9.17 Ofcom is satisfied that the measures set out in the directions are transparent insofar as their nature, purpose and impact are set out in this document. The directions are set out at Annexes 1, 2, and 3.
- 9.18 Ofcom has also set out fully our consideration of the issues involved and the alternatives considered. In consulting on its proposals in the December consultation, Ofcom invited comment on its analysis and its recommendations and summarised the potential implications in our impact assessment. In this document, Ofcom has summarised all material responses to the consultation and described its consideration of the issues raised by respondents.

Conclusion

- 9.19 In coming to the conclusions set out in this document, Ofcom is satisfied that it has met all relevant tests.

Section 10

Conclusions and next steps

Conclusions

10.1 Ofcom requires Openreach to amend the WLR SLA Contracts to ensure that:

- for analogue WLR, ISDN2 WLR and ISDN30 WLR, all transfer orders are to be completed by the 10th SMC Working day and all new provision and conversion orders are to be completed by the stated date or compensation shall be payable;
- for WLR3, all provision transfer and all new provision orders will be available to use by midnight on the date provided in the KCI 2 or on a later date agreed by both parties or compensation becomes payable thereafter;
- there are no caps on total value of compensation paid to any one company;
- CPs should be able to make claims for any downtime of the SPG other than for scheduled outages;
- compensation is capped at 60 full days per line for any one failure for analogue WLR2, ISDN2 WLR2 and WLR3 and 60 full days compensation per 2Mb bearer for any one failure for ISDN30 WLR;
- the ability for CPs to make claims for additional loss should be made explicit in the WLR SLAs; and
- Openreach should monitor its performance against the WLR SLAs and, where it fails to meet these service agreements, compensation payments should be made to CPs without any need for the customer to claim.

10.2 Ofcom requires Openreach to amend the LLU SLA to ensure that:

- it removes the mutual exclusivity between compensation payments for MPF/SMPF and other products and the link between LLU CPs' forecasting and compensation payments;
- compensation caps are revised and set at 60 full days per line per annum for MPF and SMPF for any one failure.
- for orders submitted over the EMP, if a CP informs Openreach (within eight working days of Openreach's notification of delivery) that the MPF or SMPF was provided in non-operational state, then Openreach shall pay compensation of £16 each day or part day from the date of the notification of delivery until it is made operational; and
- Openreach should monitor its performance for late faults and provision and, where it fails to meet these service agreements, compensation payments should be made to CPs without any need for the customer to claim.

10.3 Ofcom requires Openreach to amend the Ethernet SLAs to ensure that:

- for late provisions, Openreach shall pay compensation at an increased level of one month's line rental per day or part day of delay;
- for each late fault repair, Openreach shall pay compensation at a rate of 15% of one month's line rental for each hour of additional downtime beyond the first five hours;
- the ability for CPs to make claims for additional loss should be made explicit in the contracts;
- the caps on compensation of a maximum of 20% of connection charge for late provisions and a maximum of 35% of annual rental for late fault repair shall be replaced by caps of 60 working days for late provision compensation payments and 200 hours for compensation for late repairs ; and
- for faults and provisions proactive compensation payments shall be made within an appropriate timeframe.

10.4 In summary, Ofcom requires Openreach to amend the WLR SLA Contracts and the LLU SLA to ensure that for EMP, with regard to MPF, SMPF and WLR3, that:

- CPs should be paid compensation for any downtime of the EMP other than for scheduled outages without any need for the customer to claim;
- compensation for downtime should be based on service credits of £20;
- the accelerator proposed by Openreach should be applied for both LLU and WLR3 dialogue services; and
- compensation should be capped at 48 hours for any single outage.

ERG approach to appropriate remedies

10.5 Ofcom has considered the *Revised ERG Common Position on the approach to Appropriate remedies in the ECNS regulatory framework*²² and, in particular, the statement that NRAs may find it appropriate to oblige the SMP player to make compensation payments to reflect any failure to provide the agreed level of service. The ERG further states that SLGs represent a standard practice in competitive markets. Ofcom considers that robust commercial SLGs are not only important in competitive markets, but also in regulated markets where the bargaining position of the parties may not be equal.

10.6 The proposals set out within this document are consistent with the ERG position and are intended to encourage Openreach to provide an appropriate level of service performance on fair and reasonable terms. If it does not, however, it should compensate CPs accordingly.

Practical issues

10.7 Openreach explained in its response that implementation of the changes proposed to the SLGs in the timescale envisaged by Ofcom would not be possible. It explained that, first of all, it would need to amend the relevant contracts to reflect Ofcom's proposals and this would require bilateral negotiations on the detail of them. Second,

²² http://erg.eu.int/doc/meeting/erg_06_33_remedies_common_position_june_06.pdf

it stated that it would need to implement the proposals through tactical (manual) and strategic (automated) solutions. In terms of the latter, CPs' requirements for the EMP products are being delivered in a phased approach and the requirement to deliver proactive payments would involve queue jumping which would inevitably delay other functionality. It added that it was unlikely that it would be able to introduce strategic solutions until later in the year given that CPs have already prioritised the functionality that it needs to deliver in earlier releases.

- 10.8 Ofcom acknowledges that the timetable for implementation was challenging and therefore it has revised it as set out below. The new timetable will still require Openreach and CPs to conclude the contractual negotiations rapidly. Ofcom intends to attend the negotiations and intervene where appropriate.
- 10.9 The changes to the SLG regime set out herein apply to the parts of the BT Group which supply Ethernet services, LLU and WLR. For Great Britain, the changes therefore apply to Openreach. For Northern Ireland, they apply to BT Wholesale. They should not, however, be applied in an appreciably different manner.

Next steps

- 10.10 Openreach is required to implement the new arrangements by 25 June 2008. The new arrangements can be implemented via tactical and/or strategic solutions. This is a matter for Openreach based on ease of implementation and relevant costs.
- 10.11 Ofcom will carry out a review to assess whether or not the SLGs have been effective in driving improved service performance and have not given Openreach perverse incentives which would allow it to avoid compensation payments by extending lead times. Ofcom will carry out this review once the measures have been in place for six months.
- 10.12 The decisions set out herein will also be taken into account in the broader Openreach Financial Framework Review. In particular, Ofcom accepts as a general principle that Openreach should be able to recover in its prices an amount to cover the level of compensation payments that an efficient operator would pay out.

Annex 1

Direction: WLR

Direction under section 49 of the Communications Act 2003 and SMP services condition AA1(a) imposed on British Telecommunications plc ('BT') as a result of the market power determinations made by OFCOM that BT has significant market power in the markets for: wholesale residential exchange line services; wholesale residential ISDN2 exchange line services; wholesale business exchange line services; wholesale business ISDN2 exchange line services; and wholesale ISDN30 exchange line services on fixed public narrowband networks for 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, the Dominant Provider has significant market power in the markets for among others: wholesale residential exchange line services; wholesale residential ISDN2 exchange line services; wholesale business exchange line services; wholesale business ISDN2 exchange line services; and wholesale ISDN30 exchange line services in the UK, excluding the Hull Area and the setting of certain SMP services conditions;
- (B) the Director 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 (the '**Notification**') identified the relevant services markets, made market power determinations to the effect referred to in recital (A) above and set certain significant market power ('**SMP**') services conditions on the Dominant Provider to take effect on 28 November 2003, unless otherwise stated in Schedule 1 thereto;
- (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) this Direction concerns matters to which Condition AA1(a).2 relates;
- (E) for the reasons set out in the explanatory statement accompanying this Direction, OFCOM is 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.
- (F) for the reasons set out in the explanatory statement accompanying this Direction, OFCOM is satisfied that it has acted in accordance with the relevant duties set out in sections 3 and 4 of the Act;

- (G) on 10 December 2007, OFCOM published a Notification of the proposed Direction and accompanying explanatory statement in accordance with section 49 of the Act and invited representations about any of the proposals therein by 25 January 2008;
- (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) 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 Condition AA1(a).2 in Schedule 1 to the Notification, OFCOM gives the following Direction:

1. The Dominant Provider shall modify the service level agreements which govern the supply of wholesale analogue access, wholesale digital access, wholesale ISDN30 and WLR3. In particular, the following contracts will require modification to reflect the proposals set out in the accompanying Annex to this Direction: (i) The Contract for Wholesale Line rental; and (ii) The Contract for WLR3.

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

- (a) '**Act**' means the Communications Act 2003;
- (b) '**Dominant Provider**' means British Telecommunications plc, whose registered company number is 1800000, and any British Telecommunications plc subsidiary or holding company, or any subsidiary of that holding company, all as defined by Section 736 of the Companies Act 1985 as amended by the Companies Act 1989;
- (c) '**The Notification**' means the Notification referred to in recital (B) of this Direction;
- (d) '**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 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 Direction:

- (a) headings and titles shall be disregarded; and

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

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

6. The Schedule to this Direction shall form part of this Direction.

CRAIG LONIE
DIRECTOR OF REGULATORY FINANCE

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

20 MARCH 2008

Annex

Modifications to the *Contract for Wholesale Line Rental* and the *Contract for WLR3*

1) BT shall amend the terms and conditions which govern the supply of wholesale analogue access, wholesale digital access, wholesale ISDN 30 set out in the Contract for Wholesale Line Rental to provide the following:

Compensation per event

- a) All transfer orders shall be completed and available to use by midnight on the 10th SMC working day (as defined in the Contract for Wholesale Line Rental) or on such later date as may be specified or compensation will become payable thereafter.
- b) All new provision orders shall be completed and available to use by midnight on the date stated or compensation will become payable thereafter.
- c) All orders to convert from one product to another shall be completed and available to use by midnight on the date stated or compensation will become payable thereafter.

Service Provider Gateway availability

- d) The service provider electronic gateway (SPG) will be operational at all times other than for scheduled outages.
- e) In the event of any unscheduled downtime of the SPG Communications Providers must be entitled to claim compensation for losses incurred.

Compensation caps

- f) compensation is capped at 60 full days compensation per line for any one failure for analogue WLR2, ISDN2 WLR2 and 60 full days compensation per 2Mb bearer for any one failure for ISDN30 WLR.
- g) Any limits on compensation payable as a result of a failure to satisfy the service guarantees shall be removed other than those set out in (f) above.

Claims for additional loss

- h) Any compensation payable under the contract shall be without prejudice to any right of either party to claim for additional loss.

Proactive payments

- i) BT shall monitor its performance against the service guarantees for repair, provision, transfer and conversion orders, missed appointments, and disconnections in error and compensate Communications Providers proactively should it fail to satisfy the service guarantees. For the avoidance of doubt, compensation shall be payable without the need for a Communications Provider to make a claim.

2) BT shall amend the terms and conditions which govern the supply of WLR3 set out in the Contract for WLR3 to provide the following:

Compensation per event

a) All transfer orders shall be completed and available to use by midnight on the date provided by KCI 2 (as explained in the Contract for WLR3) or on such later date as may be specified or compensation will become payable thereafter.

b) All transfer orders shall be completed and available to use by midnight on the date provided by KCI 2 (as explained in the Contract for WLR3) or on such later date as may be specified or compensation will become payable thereafter.

Equivalence Management Platform gateway availability and compensation payable

c) The Equivalence Management Platform gateway (EMP) will be operational at all times other than for scheduled outages.

d) In the event of any unscheduled downtime of the EMP Communications Providers shall be credited with £20 per relevant transaction based on the previous month's run rate.

e) In the event of any unscheduled downtime of the EMP Communications Providers shall be credited per relevant transaction based on the previous month's run rate with compensation set on the following basis:

(i) £20 per relevant transaction for an individual failure duration of up to 2 hours;

(ii) £40 per relevant transaction for an individual failure duration of 2 or more hours but less than 4 hours;

(iii) £60 per relevant transaction for an individual failure duration of 4 or more hours but less than 6 hours;

(iv) £80 per relevant transaction for an individual failure duration of 6 or more hours but less than 8 hours; and

(v) £100 per relevant transaction for an individual failure duration of more than 8 hours.

Compensation caps

f) compensation is capped at 60 full days compensation per line for any one failure for analogue WLR3, ISDN2 WLR3 and 60 full days compensation per 2Mb bearer for any one failure for ISDN30 WLR3.

g) compensation for unscheduled EMP downtime is capped at 48 hours compensation for any one period of unscheduled downtime.

h) Any limits on compensation payable as a result of a failure to satisfy the service guarantees shall be removed other than those set out in (f) and (g) above.

Additional losses

i) Any compensation payable under the contract shall be without prejudice to any right of either party to claim for additional loss.

Proactive payments

j) BT shall monitor its performance against the service guarantees for repair, provision and transfer orders, and missed appointments, and compensate Communications Providers proactively should it fail to satisfy the service guarantees. For the avoidance of doubt, compensation shall be payable without the need for a Communications Provider to make a claim.

3) The terms and conditions amended as set out in paragraphs (1) and (2) above shall take effect from 25 June 2008.

Annex 2

Direction: LLU

Direction under section 49 of the Communications Act 2003 and SMP services condition FA1 imposed on British Telecommunications plc as a result of the market power determination made by OFCOM that BT has significant market power in the market for wholesale local access in the UK (excluding the Hull Area)

WHEREAS:

- (A) as a result of a market analysis carried out by OFCOM, it was proposed on 13 May 2004 and on 26 August 2004, in accordance with sections 48(2) and 80 of the Act that the Dominant Provider has significant market power in the market for wholesale local access in the UK (excluding the Hull Area) (**'the Relevant Market'**) and the setting of certain SMP services conditions;
- (B) OFCOM having considered every representation duly made, and thereafter on 16 December 2004 pursuant to sections 48(1) and 79 of the Act by way of publication of a Notification (the **'Notification'**) and identified the relevant services markets, made market power determinations to the effect referred to in recital (A) above and set certain significant market power (**'SMP'**) conditions on the Dominant Provider to take effect on 16 December 2004, unless otherwise is stated in Schedule 1 thereto;
- (C) this Direction concerns matters to which SMP services condition FA1.2 relates;
- (D) for the reasons set out in the explanatory statement accompanying this Direction, OFCOM is 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.
- (E) for the reasons set out in the explanatory statement accompanying this Direction, OFCOM is satisfied that they have acted in accordance with the relevant duties set out in sections 3 and 4 of the Act;
- (F) on 10 December 2007, OFCOM published a Notification of the proposed Direction and accompanying explanatory statement in accordance with section 49 of the Act and invited representations about any of the proposals therein by 25 January 2008;
- (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) 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 Condition FA1.2 in Schedule 1 to the Notification, OFCOM gives the following Direction:

1. The Dominant Provider shall modify the service level agreement which governs the supply of metallic path facilities ('MPF') and shared metallic path facilities ('SMPF'). In particular, the Access Network Facilities Agreement will require modification to reflect the proposals set out in the accompanying Annex to this Direction.

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

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

(b) '**Dominant Provider**' means British Telecommunications plc, whose registered company number is 1800000, and any British Telecommunications plc subsidiary or holding company, or any subsidiary of that holding company, all as defined by Section 736 of the Companies Act 1985 as amended by the Companies Act 1989;

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

(d) '**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 work 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 Direction:

(c) headings and titles shall be disregarded; and

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

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

6. The Schedule to this Direction shall form part of this Direction.

CRAIG LONIE
DIRECTOR OF REGULATORY FINANCE

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

20 MARCH 2008

Annex

Modifications to the *Access Network Facilities Agreement*

1) BT shall amend the terms and conditions which govern the supply of metallic path facilities ('MPF') and shared metallic path facilities ('SMPF') set out *Access Network Facilities Agreement* to provide the following:

Compensation per event

- a) BT will repair all MPF or SMPF faults within the requisite period²³, failing which compensation will be payable as outlined in the LLU SLA.
- b) Compensation for the delayed provision of MPF and SMPF shall not be linked to the provision of co-location, internal tie cables, distant location, or BT egress links. In other words, compensation for MPF and SMPF shall not be off-set against any compensation that may be payable for any failure to provision co-location, internal tie cables, distant location or BT egress links.
- c) Forecasting shall not affect the compensation paid for delayed provision of MPF and SMPF. Therefore, compensation for the delayed provision of MPF and SMPF shall not be linked to the forecasting arrangements for MPF and SMPF.

Equivalence Management Platform gateway availability and compensation payable

- d) The *Equivalence Management Platform gateway (EMP)* will be operational at all times other than for scheduled outages.
- e) In the event of any unscheduled downtime of the EMP Communications Providers shall be credited with £20 per relevant transaction based on the previous month's run rate.
- f) In the event of any unscheduled downtime of the EMP Communications Providers shall be credited per relevant transaction based on the previous month's run rate with compensation on the following basis:
 - (i) £20 per relevant transaction for an individual failure duration of up to 2 hours;
 - (ii) £40 per relevant transaction for an individual failure duration of 2 or more hours but less than 4 hours;
 - (iii) £60 per relevant transaction for an individual failure duration of 4 or more hours but less than 6 hours;
 - (iv) £80 per relevant transaction for an individual failure duration of 6 or more hours but less than 8 hours; and
 - (v) £100 per relevant transaction for an individual failure duration of more than 8 hours.

Non-operational delivery

²³ The requisite period for standard care is 40 hours. The requisite period for enhanced care is 20 hours.

- g) BT shall pay compensation, for orders submitted over the EMP, if a Communications Provider informs it within eight working days of notification of delivery by BT that the MPF or SMPF was provided in a non-operational state.
- h) BT shall pay compensation of £16 each day or part day from the date of the notification of delivery by BT until it is made operational.

Compensation caps

- i) compensation is capped at 60 full days per line per annum for MPF and SMPF for any one failure and the Communications Provider shall not be able to take over responsibility for the line in accordance with the Access Network Facilities Agreement before that time period (the Fixed Compensation Period) has elapsed.
- j) compensation for unscheduled EMP downtime is capped at 48 hours compensation for any one period of unscheduled downtime.
- k) Any limits on compensation payable as a result of a failure to satisfy the service guarantees shall be removed other than those set out in (i) and (j) above.

Proactive payments

- l) BT shall monitor its performance against the service guarantees for repair and provision orders and EMP downtime and compensate Communications Providers proactively should it fail to satisfy the service guarantees. For the avoidance of doubt, compensation shall be payable without the need for a Communications Provider to make a claim.

2) The terms and conditions amended as set out in paragraph (1) above shall take effect from 25 June 2008.

Annex 3

Direction: Ethernet

Direction under section 49 of the Communications Act 2003 and SMP services condition HH1 imposed on British Telecommunications plc as a result of the market power determinations made by OFCOM that BT has significant market power in the UK market (excluding the Hull area) for alternative interface symmetric broadband origination at all bandwidths

WHEREAS:

- (A) as a result of a market analysis carried out by OFCOM, it was proposed on 11 April 2003 and on 18 December 2003, in accordance with sections 48(2) and 80 of the Act that the Dominant Provider has significant market power in the UK market (excluding the Hull area) for alternative interface symmetric broadband origination at all bandwidths and the setting of certain SMP services conditions;
- (B) OFCOM having considered every representation duly made, and thereafter on 24 June 2004 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 significant market power ('SMP') conditions on the Dominant Provider to take effect on 24 June 2004;
- (C) this Direction concerns matters to which Condition HH1.2 relates;
- (D) for the reasons set out in the explanatory statement accompanying this Direction, OFCOM is 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.
- (E) for the reasons set out in the explanatory statement accompanying this Direction, OFCOM is satisfied that it has acted in accordance with the relevant duties set out in sections 3 and 4 of the Act;
- (F) on 10 December 2007, OFCOM published a Notification of the proposed Direction and accompanying explanatory statement in accordance with section 49 of the Act and invited representations about any of the proposals therein by 25 January 2008;
- (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) 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 Condition HH1.2 in Schedule 1 to the Notification, OFCOM gives the following Direction:

1. The Dominant Provider shall modify the service level agreements which govern the supply of backhaul extension services ('BES'), wholesale extension services ('WES') and wholesale end to end Ethernet services ('WEES'). In particular, the following contracts will require modification to reflect the proposals set out in the accompanying Annex to this Direction: (i) the Conditions for Backhaul Extensions Services; and (ii) the Conditions for Wholesale Extension Services.

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

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

(b) '**Dominant Provider**' means British Telecommunications plc, whose registered company number is 1800000, and any British Telecommunications plc subsidiary or holding company, or any subsidiary of that holding company, all as defined by Section 736 of the Companies Act 1985 as amended by the Companies Act 1989;

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

(d) '**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 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 Direction:

(e) headings and titles shall be disregarded; and

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

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

6. The Schedule to this Direction shall form part of this Direction.

Service level guarantees: incentivising performance

**CRAIG LONIE
DIRECTOR OF REGULATORY FINANCE**

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

20 MARCH 2008

Annex

Modifications to the Conditions for Backhaul Extension Services and the Conditions for Wholesale Extension Services

1) BT shall amend the terms and conditions which govern the supply of backhaul extension services ('BES'), wholesale extension services ('WES') and wholesale end to end Ethernet services ('WEES') set out in the Conditions for Backhaul Extensions Services and the Conditions for Wholesale Extension Services to provide the following:

Compensation per event and value of compensation

- a) The definition of Contractual Delivery Date ('CDD') shall be amended to require BT to provide reasons to justify a CDD which is set beyond the 57th day and that any extension of the CDD beyond the 57th shall be made subject to the consent of the Communications Provider concerned whose consent shall not be unreasonably withheld.
- b) BT shall pay the Communications Provider compensation for each day or part day of delay in delivery of service beyond the CDD or the Communications Provider's Requirement Date ('CRD') (whichever is later).
- c) BT shall pay the Communications Provider compensation for each and every fault which has not been restored in the first five hours on a per hour basis thereafter.
- d) The compensation payable in event of the each late provision of the required BES, WES or WEES service shall be set at 100% of one month's line rental for every day or part day of delay beyond the CDD or CRD (whichever is later), up to a maximum of 60 days.
- e) The compensation payable in the event of each late fault repair in relation to BES, WES and WEES shall be 15% of one month's line rental for every fault which has not been restored in the first five hours for every hour thereafter until service is restored, up to a maximum of 200 hours.
- f) Any limits on compensation payable as a result of a failure to satisfy the service guarantees shall be removed other than those set out in (d) and (e) above.

Additional losses

- g) Any compensation payable under the contract shall be without prejudice to any right of either party to claim for additional loss.

Proactive payments

- h) BT shall monitor its performance against the service guarantees for fault repair and provision and compensate Communications Providers proactively should it fail to satisfy the service guarantees. Compensation payments shall be made as soon as possible after the event and not later than the billing cycle following the billing cycle after the event unless not practicable. For the avoidance of doubt, compensation shall be payable without the need for a Communications Provider to make a claim.

2) The terms and conditions amended as set out in paragraph (1) above shall take effect from 25 June 2008.

Annex 4

List of respondents

- 1) Cable & Wireless
- 2) Carphone Warehouse
- 3) Easynet
- 4) Federation of Communications Services (FSPA)
- 5) Ofcom Advisory Committee (England)
- 6) Openreach
- 7) SSE
- 8) Thus plc
- 9) UK Competitive Telecommunications Association (UKCTA)
- 10) Five confidential responses