

PRICE CONTROLS FOR WHOLESAL ISDN30 SERVICES

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Cable&Wireless
Worldwide

EXECUTIVE SUMMARY

We welcome this opportunity to comment on Ofcom's proposals for an ISDN30 Wholesale Charge Control. Cable&Wireless Worldwide supplies ISDN30 services to customers under the banner of our *Direct Voice* and *Indirect Lines & Calls* products.

ISDN30 is valued by customers, having a reputation for reliability and as such it remains one of the most understood products on the market today. While it continues to be well received, the product is gradually being replaced by new services which take advantage of IP-based technologies. Some customers will continue to use ISDN30 for sometime to come, but it is our belief that the majority will seek out more cost effective, flexible and feature rich alternatives within the not too distant future.

Cable&Wireless Worldwide's preference is that wherever possible, prices are constrained by competition. However given Ofcom's assessment of the strength of existing competition, some form of charge control would seem to be required. In our response to Ofcom's ISDN30 market review consultation we acknowledged BT's apparent high returns in the market, but urged Ofcom to take a cautious approach to the imposition of a wholesale charge control as there could well be unintended consequences stemming from a steep wholesale price decline, rendering alternative access providers unable to compete as a result of BT's economies of scale and scope, hindering competition and harming the very consumers Ofcom is trying to protect through the imposition of a charge control.

We have considered all the evidence presented in this consultation and are pleased that Ofcom has acknowledged these concerns. Too steep a price reduction would undermine other forms of access provision and remove choice from consumers. It would also place an unfair burden on alternative infrastructure providers who are faced with the prospect of managing a product in decline, having rising unit costs over the years ahead, with potentially a sizable minority of consumers still hoping to remain with the product until it is declared end of life and mandatory migration occurs.

Ofcom needs to create a charge control that best fits the circumstances, taking account of both short term consumer welfare as well as the impact on other suppliers and the longer term interest of consumers, who are best served by having a choice of infrastructure providers. We believe the

supply arrangements for ISDN30 are sufficiently complex to warrant a different approach from conventional charge controls, one that is sensitive to the unique and finely balanced alternative infrastructure options which underpin a significant proportion of the retail supply. If a blunt charge control was introduced, the competitive supply arrangements in the market would suffer as the control would not make any allowances for the intricacies of this long established market with multiple infrastructure based suppliers, who in part rely upon BT's Partial Private Circuits in order to compete. It may also discourage the take up of new services. To this end we would urge Ofcom to take a cautious approach, erring on the softer end of the charge control range proposed and we fully support the decision not to impose new starting charging which could immediately undermine market confidence.

It is our belief that in this instance BT's high returns do give a misleading picture of the state of competition in the market. In recent years BT's returns may have been artificially high, with an unusually low Fully Allocated Cost (FAC) floor as a result of BT's decision to throttle back investment in ISDN30 in preparation for 21CN. Ofcom is correct to make a number of adjustments to the cost base to reflect a steady state position and also contrast this against the underlying costs associated with providing services using Partial Private Circuits (PPCs), ensuring competitive provision remains viable through the continued use of PPCs.

Ofcom acknowledge that even by taking this approach around 11- 31% of ISDN30 services delivered over PPCs could eventually be more cost effectively supplied by using Openreach's Wholesale product. In our view the more services that can be preserved on competitive infrastructure utilising PPCs the better, and we urge Ofcom to try and ensure through sensible pricing outcomes that any migrations away from PPCs are kept to an absolute minimum. Ofcom should not contemplate taking any action that results in Communication Providers being penalised for past investment in PPC infrastructure. Such investment was made in good faith and Ofcom and before that Oftel has sought to promote certainty around infrastructure investment. To take action that would undermine past investment, however unintended and even while in the pursuit of another aim, would knock confidence and have implications far beyond the ISDN30 market.

We would again urge Ofcom to impose a remedy on BT that provides customers of their *Featurenet* product with a means to migrate to another supplier, as under the current arrangement many find themselves locked into the product, with no opportunity to change the underlying ISDN30 provider

due to the lack of a migration process. *Featurenet* is a complicated service offering and although other CPs offer similar managed solutions, the management of multi-site dial plans during the course of a migration to a new supplier is a complex task and requires co-operation from the incumbent supplier. As there is no formal BT *Featurenet* migration solution available from BT, this could be a significant contributing factor behind the decision of many customers not to take advantage of the more competitive pricing currently available. If the issue of *Featurenet* migration was addressed then it would stimulate competition, helping to drive prices down towards cost and reducing the need for a charge control.

It would not be in the long term interests of United Kingdom consumers if the wholesale supply arrangements were to be concentrated in the hands of just one regulated supplier. Underlying Infrastructure competition should remain the primary consideration for Ofcom in order to preserve consumer welfare in the longer term.

INTRODUCTION

Cable&Wireless Worldwide is one of the world's leading international communications companies. Demerging from C&W plc in 2010, the company has been at the forefront of service innovation in our industry, providing UK and Global organisations with the connectivity they need to do business.

With experience of delivering connectivity to 153 countries and an intention to be the first customer-defined communications service business, Cable&Wireless Worldwide prides itself on delivering a service experience that is second to none. More information on Cable&Wireless Worldwide can be found at: www.cwworldwide.com

Today Cable&Wireless Worldwide has the necessary scale to meet the needs of UK enterprise customers and we are a strategic provider of voice services to both the UK public and private sectors, offering a range of innovative and market leading voice & data products. Our customers include most of the UK's top companies and public sector organisations, each of whom has placed its trust in Cable&Wireless Worldwide to deliver an array of business critical services. Wherever possible we try and service our customers using our own infrastructure, however in many cases we remain reliant on regulated products from BT to ensure that our customers have the connectivity that they need to do business.

Cable&Wireless Worldwide is a significant provider of ISDN30 lines on a retail basis. Cable&Wireless Worldwide ISDN30 services are supplied using our own infrastructure exclusively, or by using a combination of our own infrastructure with a wholesale link product from BT such as a Partial Private Circuit, to connect the C&W Worldwide network with the end customer site. In a minority of cases, and only where it makes commercial sense we also make use of Openreach's WLR ISDN30 offering.

This consultation has very significant implications for the market and Ofcom needs to carefully consider the long term interest of consumers, with a short term price reduction potentially damaging competitive supply within the ISDN30 market and driving up BT's market share. It is important to

preserve competitive infrastructure supply, recognising its ability to deliver both price and service competition in the longer term for both ISDN30 and successor products.

In the remainder of this response we focus upon the specific questions posted by Ofcom.

Q&A

Question 1: *Do you agree that we should assess the profitability of wholesale ISDN30 services using the adjusted ROCE approach? Do you also agree that we should make an adjustment to Openreach's depreciated ISDN30 assets (line-cards and access electronics) by setting the NRC/GRC ratio of these assets to 47% (i.e. Option 4)? If not, please explain your rationale and propose alternative approaches.*

While not endorsing an adjusted ROCE approach and having previously stated a preference for an efficient operator based approach, the two approaches appear to lead directionally to the same outcome. We therefore take a pragmatic view of the approach used by Ofcom, believing that an adjusted ROCE approach with changes to the value of depreciated assets is appropriate for these specific circumstances. While we always support a consistent approach to regulatory decision making, we do not necessarily believe this approach could sensibly be applied to other product areas due to the unique nature of ISDN30 supply in the UK. Certainly, an extensive review of the specific market in question would be required, with particular attention paid to the strength and means of competitive supply available as well as future product trends and the stage reached in the product lifecycle.

Question 2: *Do you agree that an RPI-X type charge control would be the appropriate form of price control for core wholesale ISDN30 services? If not, please explain why.*

As Ofcom have indicated that there is enough evidence to intervene to reduce wholesale prices, we believe an RPI –X charge control is the best way of achieving orderly, well signalled price reductions. RPI-X charge controls are a well understood form of pricing intervention, creating predictable price movements and helping to retain efficiency incentives, therefore providing

regulatory certainty in the medium term while the control is ongoing. Alternative means of controlling prices would not be appropriate.

Question 3: *Do you agree that CCA FAC is the appropriate cost basis for setting the proposed charge controls? If not, please explain why.*

Yes. CCA FAC has been used in previous charge controls to good effect, being understood by stakeholders.

Question 4: *Do you agree that three year duration for the charge controls on wholesale ISDN30 services is appropriate? If not, please explain why.*

In this case we think that three years should be the absolute minimum duration for the control. It is far better to give the best possible advanced signals to Communication Providers, with a longer period to adjust. Anything short of a full 36 months would risk pushing pricing changes through too quickly and not giving the market sufficient time to react, with steep price reductions potentially undermining market confidence. In our view, even allowing for the 3 year market review cycle required by the Commission, there may be a case for Ofcom to introduce a 4 year control in recognition of the stage that the product has reached in its lifecycle and the uncertainty over the need for any future controls with demand expected to fall away. Ofcom have made the case for extended charge controls in previous consultation (Narrowband Voice and Mobile Call Termination) and it would seem that there is a compelling case to do the same for ISDN30.

Question 5: *Do you agree with our proposal to apply the anchor pricing approach to wholesale ISDN30 services and reflect migration to IP based alternatives? If not, please explain why.*

Under these specific circumstances this form of regulatory intervention with an anchor pricing reference point adjusted to take account of the expected decline in volumes and the resulting impact on unit costs, would seem an appropriate way to proceed in order to balance the shorter term interest of securing a price reduction for consumers, while not undermining the ability of alternative infrastructure providers to compete.

Question 6: *Do you agree that the proposed charge control on wholesale ISDN30 should be indexed to RPI?*

Ofcom and before that Oftel have used RPI as the measure of inflation since the first charge control in the communications market was established. Since the introduction of CPI in the mid-1990s many organisations have adopted it as their preferred measure of inflation and the popularity of CPI in recent years has accelerated. We now believe this is the right point in time for Ofcom to consider this issue in far greater detail than has been presented within the context of this consultation. While we don't believe further debate on the measure of inflation should delay Ofcom's work on ISDN30, we feel it is important for Ofcom to commence a comprehensive review of the two measures of inflation in the near future, so that stakeholders can help make an informed judgement over which to advocate in future Ofcom charge controls. We simply have insufficient detail on this issue on which to base a decision and we would therefore urge Ofcom to embark upon a new policy project to review this issue. With HM Government now using CPI for an increasing number of purposes, a review to determine the most appropriate measure of inflation is now overdue.

Question 7: *Do you agree with the use of prior year revenue weights when setting charge control baskets? If not, please explain why.*

Yes, given the relatively stable nature of revenues against a predictable and steady decline in the demand for the product, we believe that using prior year weights is appropriate.

Question 8: *Do you agree with our proposal to implement a combined basket for wholesale ISDN30 connection and rental services and a separate basket for transfers? Do you also agree with our proposal not to impose a cost orientation obligation on core wholesale ISDN30 services? If not, please explain why.*

The proposed structure strikes the correct balance between allowing BT the freedom to rebalance rental and connection prices (subject to any safeguard caps) yet still providing pressure to reduce prices overall. The rationale for including migration in a separate basket is clear, removing any opportunity to make these charges prohibitive in order to retain market share.

Question 9: *Do you agree with our proposal to impose a safe-guard cap of RPI+5% on the average connection charge? If not, please explain why.*

Yes. This proposal strikes the correct balance between providing commercial freedom to rebalance prices and ensuring that connection charges don't become prohibitive.

Question 10: *Do you agree with our proposal to include enhanced care services in the combined wholesale ISDN30 rental and connection basket? Do you agree that each of the enhanced care services should also be subject to a safe-guard cap of RPI-0%? If not, please explain why.*

While enhanced care is only purchased by 25% of BT's customers, it is often viewed as an essential element of the service by those who purchase it. We therefore support the additional protection that a safeguard cap will bring, while not acting as too severe a constraint on BT's commercial freedom.

Question 11: *Do you agree that the DDI rental and connection services should be subject to a safe-guard cap of RPI-0%, whilst other ancillary services should not be subject to a specific form of price control? If not, please explain why.*

Yes. DDI is more often than not purchased alongside the main product, so for intents and purposes it can be considered as an essential feature and therefore should be subject to some form of price protection to prevent pricing being increase in order to off set regulated reductions elsewhere in the product set. To our knowledge no other chargeable ancillary service has the same popularity or is viewed as an essential part of the service offering, therefore specific safeguards are not required.

Question 12: *Do you agree with our proposal that the costs of wholesale ISDN30 services should be based on BT's costs? If not, please explain why.*

Any remedy needs to be sensitive to other infrastructure suppliers in the market, recognising their efficient cost base. There is a real danger that setting too low a price will damage other suppliers

and undermine any existing competitive pressures in the market, by harming alternative suppliers culminating in greater market share for BT.

As we have previously highlighted, the cost base of alternative infrastructure providers is greater than BT's for a variety of technical, scale and synergy reasons which can't be replicated by an efficient alternative supplier. Add to this the complication that alternative infrastructure providers' assets might not be fully depreciated and that future migrations to NGA services might cause a jump in costs as fixed costs are spread over few circuits. A classic charge control remedy would be too blunt an instrument for this market, as setting it at BT's unadjusted FAC would distort the market resulting in adverse long term consequence for consumers in both the ISDN30 market and successor NGA markets. For this reason we remain in favour of efficient operator costs being used rather than adjusted BT costs, however as we have previously stated, we have taken a pragmatic view, recognising that Ofcom's adjusted anchor pricing approach achieves broadly the same outcome.

Question 13: *Do you agree with our proposed adjustments to Openreach's cost base in 2009/10 for core wholesale ISDN30 services? If not, please explain why.*

Yes. Ofcom's adjustments appear sensible. In particular we support the decision to exclude BT's duct revaluation figures.

Question 14: *Do you agree with our volume forecasts for wholesale ISDN30 rental, connection and transfer services? If not, please explain why.*

Based on the information presented, including the data collected from stakeholders, coupled with the consumer research, we have no reason to doubt that Ofcom's figures provide a reasonable estimate of possible future volumes. Much will depend on the take up of new technology. As the pace of new product adoption is always difficult to predict and in the absence of anything more concrete we are content to accept Ofcom's view of market volumes. In the event that Ofcom decides that 4 year control is appropriate we believe the forecasts should be updated to take this

into account (as the data collected extends beyond a four year time horizon this shouldn't be an onerous task).

Question 15: *Do you agree with our proposed AVEs for line-cards and access electronics? If not, please explain why.*

Ofcom's assumptions on this issue appear reasonable.

Question 16: *Do you agree with our proposed approach to forecasting capital expenditure for core wholesale ISDN30 services? If not, please explain why.*

We do have concerns that lower pricing could artificially boost demand for this declining near end of life product, potentially leading to stranded capital investments. We believe Ofcom's forecast expenditure is reasonable only if demand is not over stimulated. To that end we think that Ofcom can only be confident of their capital expenditure figures if the value of X is at the softer end of the range proposed. A higher value of X is likely to increase capital expenditure beyond what has been forecast.

Question 17: *Do you agree with our proposed efficiency assumption range of 3.5% to 5.5% for core wholesale ISDN30 services? If not, please explain why.*

As ISDN30 is a mature product near end of life, scope for efficiency savings is expected to be limited. That said, we have well documented views on BT's ability to act in a more efficient way when delivering all products. In the 2009 leased lines charge control Ofcom used an efficiency assumption of 2.5% for TI and 2.8% for AI services. In our view there should be some degree of consistency between the efficiency assumption adopted for ISDN30 and PPCs/AI services due to the number of common costs. We would therefore expect the higher efficiency figures proposed in this consultation to also be reflected in any future leased lines charge control.

Question 18: *Do you agree with the range of WACC proposed for wholesale ISDN30 services? If not, please explain why.*

Yes. Again we would expect consistency between Ofcom's approach to this issue and its treatment of PPCs, as PPC remain the best benchmark. The ISDN 30 product shares a considerable amount of common equipment and assets with PPCs and the products are in a similar phase in their lifecycle. As the leased lines charges control uses the rest of BT rate for PPCs then it would follow that the ISDN30 control should also do the same.

Question 19: *Do you agree with our proposed approach to inflate operating costs at 2.5% p.a., pay costs at 3.0% p.a. and holding gain/losses at an average RPI of 3.0% p.a.? If not, please explain why.*

In the absence of any contradictory information we consider Ofcom's assumptions on this issue reasonable.

Question 20: *Do you agree that one-off adjustments to the starting charges of wholesale ISDN30 rental services are not required? If not, please explain why.*

We are strongly opposed to one off adjustments to starting charges on both rental and connection, given the potential impact on alternative suppliers. In some circumstances one-off adjustments are desirable, however in this case due to the existence of well established alternative suppliers who rely on their own infrastructure and PPC inputs, a sudden price reduction wouldn't leave any time to make any investment changes and be potentially destabilising. In the case of ISDN30 future price reductions should be well understood and predictable having been well signalled to the market in advance.

Question 21: *Do you agree that one-off adjustments to the starting charges of wholesale ISDN30 connection services are not required? If not, please explain why.*

We believe the same arguments as above are also relevant to connection charges.

Question 22: *Do you agree with Ofcom's approach to the pricing of wholesale ISDN30 transfer charges during the next charge control? If not, please explain why.*

In order to keep the approach consistent, we would support Ofcom's proposal not to implement any one-off adjustments to the starting charges of transfer services. The benefits of the charge control on this service will be felt in the fullness of time.

A significant issue that needs to be addressed by Ofcom is the ability of BT Featurenet customers to migrate to another supplier. Under current arrangement many are effectively be locked into the product, with no opportunity to change the underlying ISDN30 provider due to the lack of a migration process. *Featurenet* is a complicated service offering and although other CPs offer similar managed solutions, the management of multi-site dial plans during the course of a migrations to a new supplier is a complex task and requires co-operation from the incumbent supplier. As there is no formal BT *Featurenet* migration solution available from BT, this could be a significant contributing factor behind the decision of many customers' not to take advantage of the more competitive pricing currently available. We would urge Ofcom to impose a specific remedy to enable BT *Featurenet* customers to move without hindrance.

Question 23: *Do you agree with our analysis of the LRIC differentials? If not, please explain why.*

This issue comes down to a matter of regulatory judgement. Ofcom have stated that they do not wish to take a position that promotes PPC based services over BT's WLR ISDN30 offering; equally Ofcom don't wish to undermine existing investment in down stream infrastructure. We believe Ofcom have to be very careful not to damage existing investments made by CPs to support retail ISDN30 offerings and to that end we would urge Ofcom to set the value of X at the lower end of the range proposed. Ofcom should take reasonable steps to ensure that the economics of alternative infrastructure is not undermined as a result of this charge control.

Question 24: *Do you agree with our analysis assessing the extent of switching from 2Mbit/s PPCs to wholesale ISDN30 services? If not, please explain why.*

This phenomenon is very difficult to predict, and we would like to avoid a situation where there is any switching away from alternative infrastructure to BT's wholesale product as a result of this charge control. It is not beneficial to consumers to have a growing proportion of wholesale supply in the hands of one very large supplier.

While Ofcom state they have used conservative assumptions in their model on the extent of switching, at the upper end of the range almost one third of all circuits would migrate to BT, concentrating their market power and potentially leaving some alternative supplier without the critical mass needed to offer a product. We would reiterate that we believe that Ofcom should do everything possible to support alternative infrastructure and while we understand that nothing will be done to actively promote it, equally nothing should be done to undermine it. A low value of X will strike the correct balance between delivering consumer price cuts, while still allowing choice at the infrastructure level to ensure that a range of suppliers can remain in the market at a wholesale level. We have no reason to doubt the work carried out to estimate the extent of potential switching, but as is always the case with this kind of analysis, it is nearly impossible to predict just how much of an influence the charge control will have on consumer behaviour. On balance we believe it is more harmful to undermine alternative infrastructure, reducing supply options than it is to allow pricing to be set at a slightly higher level in order for alternative supplier infrastructure to remain viable.

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