

Stakeholder queries on Ofcom's consultation of 31 March 2011 on charge control review for LLU and WLR services

Theme: Efficiency / Inflation

| Stakeholder | Condoc page no. | Condoc para. ref. | Stakeholder query | Ofcom response |
|--------------------|-----------------|-------------------|---|--|
| Frontier Economics | CA for Publish | Product_metrics | Can Ofcom provide an specific explanation of the reasons for this general increase in pay costs in 2013/14? | The increase is driven by a c£1 increase in unit costs due to redundancies. Excluding this pay is flat. |
| Frontier Economics | 191 | 7.53 | Can Ofcom provide an explanation of how the 0.5% adjustment for redundancy costs have been calculated and applied. In the case that the adjustment is based on the assumptions of BT's leaver costs based on the volume of Openreach staff projected, does the calculation take into account the potential for BT to re-assign staff currently employed within Openreach to other BT divisions? | 1. Net efficiency was calculated by inputting our efficiency assumption as a gross number and recording the redundancy impact. 2. We then ran the model with no redundancy payments (i.e. net efficiency = gross) using our efficiency assumption and recoded the resultant unit costs for MPF. 3. Next hardcoded our redundancy payments from 1) in the model and flexed our efficiency assumption to arrive at the 2012/13 unit cost we calculated at 2) |
| Frontier Economics | Annex 7 | A7.28-A7.38 | Methodology used for international benchmarking, historical trend analysis and BT planning documents 1) What metrics do these studies look at to compare BT's efficiency to those of other operators? 2) Do these studies account for the following sources of inefficiency: labour productivity, real unit input cost reductions, fault reductions, economies of scale or | The statistical study compared BT with US telecoms operators. The study was conducted on Ofcom's behalf by NERA in 2008 and is available on our website at: http://stakeholders.ofcom.org.uk/binaries/consultations/llcc/annexes/efficiency.pdf . The specification for this study is explained in Section 1 of the study. The benchmarking study conducted by KPMG is published on our website at |

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| | | | <p>scope, and technology changes</p> <p>3) Do these studies, implicitly or explicitly, account for the cost of implementing efficiency improvements (e.g. redundancy pay). If so, please explain how.</p> <p>4) Do these studies account for the inflation of the cost of inputs (both labour and capital) and how these may differ between Openreach and international benchmarks as well as compared to past inflation. If so, please explain how.</p> | <p>http://stakeholders.ofcom.org.uk/binaries/consultations/wlr-cc-2011/annexes/Efficiency_Review_Report.PDF . The scope of this work is described in Section 2 of this report.</p> <p>The industry averages and best in class figures are based on the confidential benchmarking study described at A7.24. The benchmarking study considers the costs incurred by participating European fixed line operators, calculated on a per revenue basis across various cost categories to derive cost "gaps" between BT and the average and best in class operators (defined as the top 25%). Data is adjusted to allow like for like comparisons of efficiency rather than local differences (for example by taking account of purchasing power parity, working hours and different capitalisation policies or levels of outsourcing). The study does not attempt to explain these cost gaps by reference to particular types of inefficiency or consider if and how the gap might be reduced or the costs of doing so.</p> <p>This data was taken into account by Openreach as part of its planning process. Specifically, we understand that the conclusions from the benchmarking study were used by BT to inform a range of efficiency targets, expressed as annual cash sums, in its Medium Term Plan (MTP). Using estimates of BT cash costs in 2009/10 we estimated that, for Openreach to move into line with the peer average it was need to achieve any cash savings of around 5% over three years and to move into line with the best in class would require annual cash savings of around 5.5%.</p> <p>The historical trend analysis is based on financial data</p> |
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| | | | | <p>provided to Ofcom to Openreach, calculated on a cash basis, as described at A7.28. Actual cash costs in 2008/09 (excluding NGA capex) were adjusted to take account of the impact of inflation and volume effects and derive a “predicted” cost level in 2009/10. The difference between the actual and predicted level was then split between underlying efficiency gains and other changes.</p> <p>On this basis, we estimated that the average efficiency saving achieved in each of the years 2008/09 and 2009/10 (before taking account of any implementation costs) was around 6%. As explained in Annex 7, Openreach has argued that these savings are not indicative of the underlying rate of efficiency improvements as some of these savings were one-off in nature and could not be repeated.</p> |
| Openreach | | | I wonder if you could confirm which Transfers costs you have not applied inflation to. | <p>We have applied our general inflation to all transfer charges except as follows;</p> <ul style="list-style-type: none"> o On LUS, Application systems maintenance and Directory costs we do not apply any inflation. o On Rent we apply labour inflation (3%) o On Group HQ costs we use the absolute number provided by Openreach, which therefore contains its implicit efficiency assumption. |
| Sky | A78 | Fig A9.1 | Table states that, for unit cost assumptions, Duct indexed at RPI but elsewhere GBCI - 0.5% is to be used - fig A5.7 - for CCA valuation. Why different? | <p>For the purposes of modelling we used a RPI indexation of the previous valuation as a working assumption for the value of duct at the beginning of the period. Coincidentally this gave a value near the middle of the range of possible values for duct set out in Annex 5. Accordingly we did not adjust this assumption for the consultation but this value will be adjusted in accordance with the final decision on the post - 97 duct value. Modelling forward through the charge control period, however, we propose to use RPI as the most reliable know index and one that</p> |

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| | | | | does more relatively closely with industry indices. |
| Sky | A49 | A7.41 | It is not clear how Ofcom has weighted and balanced the various sources of evidence in order to arrive at its proposed efficiency target. Could this be explained? | The efficiency target of 4.5% used in our base case is around the middle of the proposed range of 3.5% to 5.5%. The proposed range takes account of all the information set out in Annex 7. |
| Talk Talk | | | What is Ofcom's view on the impact of BT's 'no compulsory redundancy' scheme on productivity and unit cost levels. | We apply our own efficiency and redundancy cost assumptions. |
| Talk Talk | A54 | §A8.20 | What (implicit) inflation rate has Ofcom assumed for the Monterray contract? What evidence supports this ? | General inflation, no specific evidence. |