

Verizon Business response to Ofcom's Consultation on PPC Point of Handover Charges

Verizon Business ("Verizon") is the global IT solutions partner to business and government. As part of Verizon Communications – a company with nearly \$108 billion in annual revenue – Verizon Business serves 98 percent of the Fortune 500. Verizon Business caters to large and medium business and government agencies and is connecting systems, machines, ideas and people around the world for altogether better outcomes.

Verizon was a party to the appeal proceedings which generated this consultation and it therefore particularly welcomes the opportunity to respond.

This matter has now taken some time to conclude. The price control into which these services fall will have been in place for nearly two years by the time these proposals are implemented.

Accordingly, while we have some concerns about the analysis, Verizon supports the proposals and we urge Ofcom to move to implement them as quickly as possible, including waiving any notice periods as would otherwise be required.

Verizon does not see the need to comment on the individual consultation questions. However we would like to offer some further specific comments:

1. Ofcom is incorrect in giving primacy to the cost causation principle. There is no justification for this and, in particular, no serious attempt to reconcile this approach with Ofcom's statutory duties (see paragraphs 3.14ff of the consultation).
2. This is an error. For, when Ofcom quotes the Competition Commission in support of its approach, it highlights the Commission's words selectively. The Commission said this (with the element that Ofcom quoted un-italicised):

Ofcom was under a statutory duty to apply the test in section 88, rather than the six principles of cost recovery. We therefore regard the six principles of cost recovery as a useful tool to assist Ofcom in conducting its assessment of whether the setting of any given SMP condition is appropriate for the fulfilment of the objectives set down under section 88(1)(b). *But the six principles do not operate as a substitute for applying the statutory test set out there.*

3. In other words, while Ofcom is free to use the tool in the six principles – or, indeed, other useful tools - it must first of all follow its statutory duties.
4. When it does consider the section 88 test (in section 5 of the consultation), Ofcom does not assess its different options according to that section; it merely states that its preferred option is consistent with them¹.

¹ Further, dicta of the Competition Commission suggest that cost causation should not be given a primary or determinative effect: *whether or not the cost causation principle has been applied correctly is not determinative of the appropriateness of the setting of a condition to the promotion of efficiency or sustainable competition.*

5. The effect of this error is that Ofcom gives too much consideration to the FAC approach under Option 1 and not enough to Options 2 (which Verizon advocated before the Competition Commission) and 3.
6. That said, Verizon remains comfortable with the proposed outcome in directional terms.
7. Verizon has comments on some of the detailed analysis on the application of LRIC. These are as follows:
 - a. Verizon has concerns about the use of the Openreach price list as a proxy for the space and accommodation costs incurred in providing PPC Points of Handover. However, while BT's internal trading arrangements are opaque in this regard at best, our understanding is that BTWholesale does not procure this accommodation on an EOI basis from Openreach. Rather it has direct access to it through other arrangements (possibly from BT Operate). In short the Openreach price list figures include Openreach costs which are not relevant to the services in question². So we consider that, properly, these costs may well be substantially lower.
 - b. In any event, we are not certain that Ofcom has chosen the most efficient option from the Openreach products.
 - c. Ofcom's methodology to calculate costs using Openreach prices as an input risks 'double-counting' the allowable cost of capital. For example, as described in paragraph A.6.19, Ofcom calculates the total upfront cost for duct and fibre based on the Openreach prices adjusted using the assumed LRIC to price ratio of 70%. This upfront cost is then converted to an annual rental charge which includes an allowance for the 'rest of BT' WACC of 9.3%. The original Openreach prices will already include an allowance for cost of capital (at the higher Openreach rate), and it is not clear that the conversion to LRIC using the 70% ratio will strip out this allowance to leave an accurate estimate of upfront cost.
 - d. Network management costs account for some £1.2 million of the total Point of Handover costs. This is justified on the following basis: "Estimated from a confidential survey that showed that network management accounts for 23% of total network operating costs." However, Verizon seriously doubts whether these costs can properly be regarded as incremental to the relevant increment (i.e. all Points of Handover). The correct test here is whether the cost would continue to be incurred were Points of Handover not supplied. Verizon strongly suspects that these costs would indeed be incurred **regardless** of the Point of Handover services. Accordingly they should fall outside the current exercise altogether.

In any event, Verizon has significant doubts about whether a figure of 23% can be right in the context of Point of Handover Services. For this type of asset we would expect a much lower figure.
 - e. Ofcom allows three people for sales and marketing Point of Handover services. Verizon does not see how **any** sales and marketing resource can be incremental to Point of Handover. Point of Handover is not a product or service which can be bought on its own. This resource is properly considered incremental to the whole PPC product. In any event, Verizon strongly doubts that three people can possibly be dedicated to this given what we know of the staffing of the PPC product line.

² The LRIC factor may abate some of these costs but as far as we can see this analysis has not been done.

In short:

- Verizon would like more consideration to have been given to Options 2 and 3. Verizon considers that Option 1 has even less merit than Ofcom concludes.
- That said, Verizon is comfortable with the preference for Option 2; but
- Verizon considers that further analysis will show that prices under Option 2 should be lower than suggested by Ofcom – probably by quite significant amounts.