Regulating for Quality: Delivering service performance in UK telecoms

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EXECUTIVE SUMMARY

1. Consumers in the UK benefit from a highly competitive and extremely dynamic broadband and telephony marketplace, and enjoy significant choice, innovation and value. However, for customers properly to enjoy these benefits, they must also receive a good quality of experience; for example in having repairs carried out on time, or new lines installed. Nearly all telecoms retailers purchase an underlying service from Openreach. Retailers' ability to deliver a good customer experience requires Openreach to be efficient and effective.

2. Unfortunately, consumers across a wide range of telecoms retailers are experiencing very poor service levels. They suffer from unacceptable waits for line repairs, unnecessary delays in line activations, and service degradation and interruptions while retailers await extra capacity to be added to their networks. For example, in September 2012, some new customers had to wait for up to 41 working days – nearly two calendar months – for a new phone line to be installed.

3. Partly as a consequence, and as highlighted by Ofcom's consumer research[1], fixed line telephony and broadband receive much higher levels of complaints relative to adjacent markets such as mobile telephony and pay TV.

4. This summer, service levels dropped dramatically as exceptional rainfall caused record levels of faults across Openreach's network. But poor service quality is not a new problem. Openreach has failed to meet the targeted quality of service in provisioning and assurance ever since it was created. The poor weather layered a short term crisis over a chronic problem.

5. The UK government has identified broadband as a critical national infrastructure, delivering accelerated economic growth, government services online, and various forms of societal inclusion. Government aims to have the best broadband network in Europe by 2015 and it has set aside £530m to help achieve this. Persistently poor service quality in delivery of our broadband infrastructure threatens the delivery of this vision.

6. Openreach is regulated by Ofcom, and Sky believes that the persistent poor service is a result of the lack of underlying incentives in place on Openreach, caused by the current structure of regulation. A review of that regulatory structure reveals that:

   - many services have no service level agreements (SLAs); others have SLAs covering only a part of the process. Where services do have SLAs (and some have recently been introduced under a process brokered by Ofcom), they are unambitious and the associated compensation payments are insufficient to alter Openreach's profit maximising incentives;

[1] Ofcom Telecoms Complaints Q4 2011, page 2. http://stakeholders.ofcom.org.uk/binaries/research/telecoms-research/complaints/q4.pdf.

- rules around non-discrimination provide little incentive to deliver a good level of service quality; and
- the way Openreach's prices are regulated provides a disincentive to good service delivery. Where better quality involves higher operating costs (for example, more field engineers), this comes out of Openreach's profit margin with little or no offsetting revenue. Where better quality involves unplanned capital investment, the efficiency incentive built into the regulated price control works against innovation and the provision of quality.

7. Sky believes that regulation needs to create the right incentives for Openreach to ensure that the needs of UK consumers are put first. To achieve this, this paper proposes a new regulatory approach, deliverable under Ofcom's current powers. We propose:

- the development of SLAs for each regulated service, covering the end-to-end process and which come with adequate levels of financial compensation to incentivise Openreach to provide services of an adequate quality. These may best be negotiated with Openreach by industry, and facilitated by the Office of the Telecommunications Adjudicator (OTA). However, they will not be successful without being a part of the normal process of setting regulatory remedies following a finding of significant market power, and without formal adjudication by Ofcom in the event of an impasse; and
- that Ofcom should provide guidance signalling the circumstances in which it will use its existing power to fine where there is a significant or sustained failure to deliver quality of service on regulated products.

8. We call upon Ofcom explicitly to address the regulation for quality in its forthcoming wholesale local access (WLA) and wholesale broadband access (WBA) market reviews. Prior to those reviews (scheduled to start in early 2013), we propose that Ofcom undertakes a strategic review of the regulation of quality generally, and that it establishes a best practice framework and process along the lines proposed in this paper.

1. SERVICE DELIVERY HAS FALLEN FAR BELOW SATISFACTORY LEVELS

9. The Office of the Telecommunications Adjudicator (OTA) has recorded a number of Openreach's Key Performance Indicators (KPIs)[2] over a number of years, and Sky does the same for a wider variety of measures. The annex attached to this document contains a sample of this data. Key observations include:

- the repair target of fixing reported faults in relation to either Local Loop Unbundled (LLU) circuits or Wholesale Line Rental (WLR) has consistently failed to be met. At the low points, less than 70% of Metallic Path Facility (MPF) and less than 50% of Shared Metallic Path Facility (SMPF)[3] service faults were being repaired within the agreed period, against a target of 92%.
- the target for provision of WLR or SMPF has not ever been met and the provisioning target for MPF is regularly missed.

[2] OTA Key Performance Indicators, http://www.offta.org.uk/charts.htm. A subset of the KPI charts are presented in the Annex.

[3] SMPF (Shared Metallic Path Facility) is a variant of LLU, used to deliver broadband over a copper loops shared with the voice service.

- 2010/2011 was particularly bad with daily average waiting times for an Openreach engineer to provision a new service extending to 47 *working* days. During this period some Sky customers were waiting over 75 calendar days before they could receive service. It has been getting progressively worse over the last five months; and
- Openreach provides capacity in its exchanges for competitors' network equipment. The process for ordering capacity is not governed by a SLA but there is an expected target of delivering within 18 weeks. The target has *never* been met. At its worst the average delivery time was 40 weeks, more than double the target.

10. All of the above measures suggest a fundamental structural problem in the delivery of quality service. In several of the measures, such as WLR provisioning, this is even despite Openreach nominating its own target date as part of the process. Where there is no SLA, an incomplete SLA, or no formal acceptable service target in place, such as in the exchange unbundling process, quality of service has fluctuated dramatically.

2. CURRENT APPROACHES TO REGULATING SERVICE DELIVERY IN TELECOMMUNICATIONS ARE INSUFFICIENT

11. As a company with Significant Market Power (SMP) in many of its markets, BT and its network division, Openreach, does not face the normal market forces of competition. Consequently, supply of many of its products is subject to regulation by Ofcom. Today, quality of service delivery and assurance of regulated products in telecommunications in the UK is addressed through four discrete approaches:

    (i) as part of the efficiency assumptions within price controls;
    (ii) by non-discrimination obligations;
    (iii) through an incomplete patchwork of SLAs; and
    (iv) through the OTA.

12. In this section we suggest why these mechanisms have been insufficient to deliver an acceptable quality of service.

(i) Implicit inclusion in the calculation of regulated prices

13. Typically, where Ofcom sets a price control in relation to bottleneck assets, it applies an RPI-X charge control formula[4] aimed at reducing prices to a forecast efficient level of costs at the end of the charge control period. This mechanism explicitly incorporates an allowance for annual efficiency gains that Openreach is expected to be able to realise over the course of the charge control. Should Openreach reduce costs in excess of the extent anticipated by the charge control, it is entitled to keep the upside. Conversely, should Openreach incur actual costs in the charge control period that exceed the forecast level of costs, it will be unable to recover those costs. This acts as an incentive for Openreach to strive for efficiencies.

[4] RPI-X is short hand for the setting of a price that will change over the period of the charge control with reference to the Retail Price Index minus a factor "X" that includes an efficiency factor, assumed to be increasing or improving with time, thus supporting a reduction in price over time.

14. Where lowering costs also results in quality of service improvements (such as through lower fault rates or improved working practices), then the price control also incentivises Openreach to deliver better service. However, in the more likely case where better service quality necessitates an *increase* in operating cost (for example, to pay for more field engineers), service-improving investments and innovation merely result in costs that cannot be recouped, and so will be dis-incentivised by the price control. The same is true where improvements necessitate capital investment, and those investments do not pay back fully during the charge control period.

15. Above all, however, increased profits can be achieved under a charge control through reducing costs even if that results in significant reductions in service quality. Sky believes that this property of the price controls faced by Openreach has played a key role in the poor quality of service it delivers.

16. Additionally, where SLA targets are set along with levels of compensation for failing to meet the targets, any expected future payments under those SLAs are taken as a cost input in the setting of the future price of the product. To a degree, Openreach is allowed to treat its failure to meet SLAs merely as a cost of doing business, and be recompensed for SLA payments through future higher prices.

(ii) Non discrimination

17. There is typically a requirement for Openreach to provide regulated products on a non-discriminatory basis, or (in its stronger form) on an equivalence of inputs (EOI) basis. The key purpose of these non-discrimination rules is to prevent a vertically integrated provider with market power from unduly favouring its downstream business. However, in certain circumstances they can support the delivery of quality.

18. This is based on the principle that Openreach is guided by the customer-facing BT Retail as it balances quality of service delivery with cost efficiency. The assumption is that, having determined the appropriate level of service to satisfy efficiently the demands of its own internal retail provider, the requirement for non-discrimination will ensure that a similar level of service will be provided to Openreach's external wholesale customers.

19. However, relying on non-discrimination to deliver service quality is flawed for a number of reasons:

    (a) for Openreach to take guidance from BT Retail in preference to competitor CPs, is inconsistent in principle with BT's Undertakings[5];
    (b) neither non-discrimination nor EOI assists where Openreach provides (as is often the case) slightly different variants of inputs to BT's wholesale or retail divisions, to those it supplies its external customers[6]. Service delivery at BT's retail division may in any case not be the appropriate benchmark for quality, if it prioritises service excellence less than some other retailers; and

[5] Final statements on the Strategic Review of Telecommunications, and undertakings in lieu of a reference under the Enterprise Act 2003 http://stakeholders.ofcom.org.uk/consultations/statement_tsr/ .

[6] For example, the key input to BT's major broadband competitors is LLU MPF from Openreach. BT Wholesale takes SMPF from Openreach to build and provide IPStream as the key input to BT Retail's broadband.

(c) even if BT Retail suffers the same poor service quality as its competitors, the impact of poor service on the other operators is likely to be greater. For example, consumers may become concerned about the disruption or delay in switching between operators, resulting in a stabilisation of market shares and/or a 'flight to brand' which benefits BT.

(iii) SLAs and SLGs

20. In normal commercial contracts, service quality is assured through detailed and comprehensive SLAs, with compensation payments (service level guarantees, or SLGs) where threshold service levels are not delivered. In Openreach's case, such provisions are patchy, and where they exist are insufficient to incentivise Openreach to provide services of an adequate quality. We expand on each of these observations below.

The application of SLAs is patchy

21. The specification of a regulated service, through such mechanisms as a reference offer, usually does not include any explicit specification of service delivery. Some products have no SLAs at all. Others have SLAs covering only part of the process, not end-to-end delivery. Others have SLAs relating to targets that Openreach itself is free to set part way through the process.

The payments associated with SLAs today are insufficient to drive Openreach's incentives

22. Where targets do exist on Openreach's products, there is frequently no payment triggered if that target is missed. Even where such payments exist, the level is typically insufficient to give Openreach a financial incentive to invest or bear any extra operational costs necessary to make improvements.

23. Payments are usually set with consideration for compensation of customers rather than consideration of Openreach's incentives. But such compensation is very narrowly defined; for example it typically does not relate to detriments suffered by users of Openreach's services such as: damage to their brand and reputation or lost market share; wasted management time; lost opportunity; or diminished profitability and cash flow, as these are difficult to quantify.

24. Consequently, payments associated with SLAs are dwarfed by product revenues, even while service performance has been chronically poor. Ofcom forecasts such costs to Openreach as a whole at around £8m[7] per year, compared to nearly £3bn[8] that Openreach earns annually from LLU and WLR alone. In spite of its poor performance, the cost to Openreach of payments associated with SLAs is just 0.25% of its LLU and WLR revenues.

25. As a result, there is a risk that payments associated with SLAs may be regarded by BT simply as a cost of doing business.

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[7] Ofcom: *Charge control review for LLU and WLR services Annexes* – statement 7 March 2012, Paragraph A4.179, http://stakeholders.ofcom.org.uk/binaries/consultations/wlr-cc-2011/statement/annexesMarch12.pdf.

[8] Figures A10.1 & A10.2, *Ibid.*

26. On top of this, a large percentage of Openreach's supply is to BT Wholesale and BT Retail. Consequently much of Openreach's SLA costs are in reality internal transfer payments within BT, therefore providing little real incentive on investment decisions when considered within BT Group as a whole.

27. Finally, as we note above, payments associated with missed SLAs are considered as a cost input in the setting of future regulated prices.

(iv) The role of the OTA

28. The OTA is independent of both Ofcom and the industry and has as its members Openreach and a number of Openreach's customers who voluntarily join. Its job is to *"reach agreement and make non-binding recommendations on… process specifications… for in-scope products."* including *"facilitating the agreement of reasonable quality levels, service level agreements, and service level guarantees (and liquidated damages of these)"*[9]. Within its scope of work it has successfully addressed a range of minor service issues and it plays an important role in the on-going monitoring of Openreach's service performance.

29. Some time ago the OTA was tasked by Ofcom to broker a commercial agreement between Openreach and its larger customers for the introduction of a new SLA around the availability of appointed engineers for new-line provide orders for copper based services.

30. While this process has illustrated the useful role that the OTA can play - in facilitating dialogue between senior executives of Openreach, its customers, and Ofcom; and using industry expertise to resolve issues rather than relying on Ofcom, which is constrained in both resource and capability - it has not led to improved service. Even though this area of focus has been quite narrow, after more than eighteen months there is no contracted SLA, and during this time, availability lead times have not improved.

31. In large part, this lack of success has been due to a number of limitations that constrain the OTA's effectiveness, as currently constituted:

    (a) participation is voluntary, the OTA's recommendations are non-binding, and there is no hard deadline to the negotiations that it facilitates. Contrary to what its name suggests, it does not 'adjudicate'. This can result in prolonged discussions resulting in little or no action. The cost to Openreach of failure to propose terms acceptable to its customers is only reputational;
    (b) the OTA has no ability to fine nor to set levels of compensation;
    (c) its 'in-scope products' do not include the full range of Openreach's regulated services; and
    (d) most fundamentally, the OTA operates within the current regulatory regime and determinations handed down by Ofcom. Therefore it is constrained in its effectiveness by the incentives on all the parties (discussed above) that result from that regime.

32. Therefore while the OTA is likely to be an important component of any future service quality setting process, its current mode of operation requires amendment.

[9] OTA vision, set out at: http://www.offta.org.uk/vision.htm.

3. PROPOSED APPROACHES TO IMPROVING SERVICE DELIVERY

33. It is clear that current approaches to regulating for quality in telecommunications are not working and have not done so for some time. They fail to deliver the underlying incentives necessary for quality to be delivered.

34. We propose two initiatives, both of which can be implemented within Ofcom's existing powers, and both of which we believe will need to be applied to achieve the necessary improvement:

    (i) a new approach to the process for setting SLAs and the associated compensation payments for regulated products; and
    (ii) guidance by Ofcom, setting out its intention to use its powers to fine where a supplier with SMP persistently or significantly fails to deliver on its service quality obligations.

    We address each of these below.

(i) A new approach to setting and use of SLAs

35. SLAs are a normal part of commercial contracts. They are typically accompanied by provisions which specify the level of compensation that the customer will be entitled to, should the service not be provided to the quality specified in the SLA . Where a provider with SMP is required to provide a regulated access service, Ofcom should seek to replicate the outcome of normal commercial negotiations in the products' SLAs. We have illustrated above how far we are from such a benchmark today.

36. Sky proposes (i) a set of features of the SLAs attached to regulated products which we believe to be necessary to deliver the required incentives for quality delivery; and (ii) a process by which such SLAs may be arrived at. We set out each below.

Features of SLAs attached to regulated products

37. We believe that SLAs for regulated products need to have the following features[10]:

- **Comprehensive**. SLAs should cover every regulated product, not just a selection.
- **End-to-end**. SLAs should cover the whole process from first touch to last touch by the regulated supplier, leaving no gaps for 'service holidays'. Where the process depends on timely participation by Openreach's customers (for example, in forecasting demand), that too should be reflected in the SLA.
- **Benchmarked**. The appropriate level of service should be set through benchmarking processes and quality measures across a broad set of products, markets, companies, and experiences – not just against current performance or other incumbent telcos.

[10] Additional detail as to the development of fit-for-purpose SLAs is provided in the companion paper, *Regulating for Quality: An improved SLA regime.*

- **Define average as well as 'worst case' performance**. Openreach's service performance is sure to fluctuate regionally, for example: through unpredictable demand for particular products or localised extreme weather conditions. Hence it may be appropriate to set targets for 'worst case' performance with margins for error that anticipate this. Yet levels of consumer harm depend upon both the average performance, and the outliers. Consequently, if SLAs are to deliver the incentives on Openreach for quality at an efficient cost, they will need to define targets both for average performance and the 'worst case'.
- **Fewer 'MBORCs'**. Today, when local conditions are very poor, and that is a result of exceptional and unpredictable conditions such as prolonged heavy rainfall or floods, Openreach invokes an MBORC ('matters beyond our reasonable control'). In such circumstances, all normal SLAs and associated payments are suspended. Openreach is free to define itself when MBORCs should be invoked. In practice, 'exceptional' is often not exceptional but rather expected – such as periodic very wet weather in the UK. As with most commercial contracts, Openreach's SLAs should acknowledge 'force majeure' circumstances. However, such events need to be narrowly defined, transparent, and challengeable.
- **Incentive-driving level of compensation**. SLAs will only improve quality if they deliver an economic incentive to deliver the specified level of quality. If costs can be saved by Openreach by delivering a lesser level of quality, the ensuing SLA payments must exceed the cost saving. SLA payments for regulated products are typically set by reference to the level that adequately compensates purchasers, not by the level required to incentivise suppliers. But such alignment of incentives may easily be achieved by taking into account a broader definition of compensation in setting payments than is typical today; for example compensation should take into account the impact of poor performance on purchaser's reputation, brand, and lost sales.
- **Perhaps, a carrot as well as a stick**. Payments need not be one way. Consideration could be given to including explicit bonus payments in an SLA, available to Openreach should it 'over-achieve' in service delivery of a particular product by a predetermined margin, over an agreed period. Such bonuses could take the form of an increase in the price of the service for a defined period. These kinds of payments would be more appropriately driven off performance on 'average delivery' SLAs rather than 'worst case' SLAs.

Process for setting SLAs on regulated products

38. Sky proposes the following process for putting in place a set of SLAs that conform to the characteristics above. Every step that we propose could be taken by Ofcom within its current powers.

    1. **Ofcom requires Openreach to agree SLAs with its customers as part of its regulatory remedies**. Whenever Ofcom sets remedies following a market review where it has found SMP, those remedies should include the requirement on the supplier to agree SLAs with its customers.
    2. **Ofcom sets outline principles**. Also as part of these remedies, Ofcom should determine a set of principles which the SLAs should adhere to. Sky has proposed such a set of principles in the section above.

3. **Ofcom sets a time limit for agreement**. Finally as part of its remedies, Ofcom should determine a time limit – we suggest six months – within which the regulated supplier must agree SLAs with its customers.
4. **OTA facilitates negotiation**. Openreach and its customers negotiate a common set of SLAs, facilitated by the OTA.
5. **Within 30 days of the time limit, OTA reports to Ofcom**. Once the time limit has expired, the OTA reports to Ofcom (i) what has been agreed by both sides; (ii) where there has been no agreement, what arguments have been put forward by both sides; and (iii) the OTA's recommendation for an SLA that best adheres to the principles set by Ofcom.
6. **Ofcom adjudicates**. Ofcom uses the OTA's report to adjudicate, and to determine a set of SLAs that it believes best addresses the principles set out in its earlier regulatory remedies. Where the parties have agreed a solution under the OTA's facilitation, Ofcom would be expected to take the utmost account of what had been agreed.
7. **Ofcom incorporates the SLAs into the regulatory remedies**. The SLAs would form an addendum to the remedies put in place on completion of the market review, and would have a similar status in law. This is important, as it means that the ability to raise disputes or complaints against regulated companies would also be available with respect to SLAs.
8. **Payments under the SLAs are back-dated to the point that the market review remedies were issued**. This too is important for two reasons. First, it means that no parties have an incentive to frustrate or delay the process. Second, it means that Openreach has an incentive from the very start to offer good levels of service, even if it does not know exactly what the SLAs will ultimately be. Otherwise, the benefits felt by consumers from improvements in service delivery may be delayed by 9 months or so.

39. Ofcom will have the first opportunity to implement such a regime in its forthcoming WLA and WBA market reviews. Prior to those reviews (scheduled to start in early 2013), we propose that Ofcom undertakes a strategic review of the regulation of quality generally, and that it establishes a best practice framework and process along the lines proposed in this paper.

40. Rather than wait until the completion of the market review to start the negotiations over these SLAs, the work of the OTA today should be re-focused towards agreeing them in anticipation of the outcome of the market reviews. These could then be put in place immediately on completion of the market reviews.

(ii) Ofcom signalling its intention to use its powers to fine for failure to deliver quality of service

41. A customer taking services under a commercially agreed contract who suffers repetitive or systemic poor service normally has the option of changing their provider, and/or suing them for non-performance. Changing the provider of a bottleneck facility is not possible (by definition), and Openreach's and BT Wholesale's current contracts do not permit wholesale customers to sue for non-performance.

42. In the absence of the threat to Openreach of it losing a customer or being sued for non-performance, it is appropriate for Ofcom to replicate the latter through a

regulatory proxy – in this case, by using its existing powers to fine BT. We recommend that Ofcom lays out an escalation path of fines where a supplier with SMP persistently or significantly fails to meet its service quality obligations.

43. Other regulators, such as Ofwat, the economic regulator for the water industry, have imposed significant fines where suppliers have missed explicit quality measures, such as leakage targets. Like Ofwat, Ofcom currently has the powers to impose financial penalties up to 10% of a company's turnover.

44. The whole approach of sanctioning regimes and the application of penalty powers was reviewed in depth in 2006 by Professor Richard Macrory, who published his findings in his final report, '*Regulatory Justice: Making Sanctions Effective*'[11]. In his recommendations he proposed that sanctioning regimes for regulatory non-compliance should have regard for six principles and seven characteristics. We urge Ofcom to embrace and act on those principles.

45. We consider that Ofcom needs to publish guidance on the timing, quality measures, review processes, and consequences where suppliers with SMP fail persistently or significantly fail to meet their service quality obligations.

46. These steps are not a substitute for SLA payments; the two need to sit alongside one another. The threat of fines is necessary to drive incentives because they can never be regarded just as a cost of doing business, they come with damaging negative publicity, and consequently are likely to gain Board level attention.

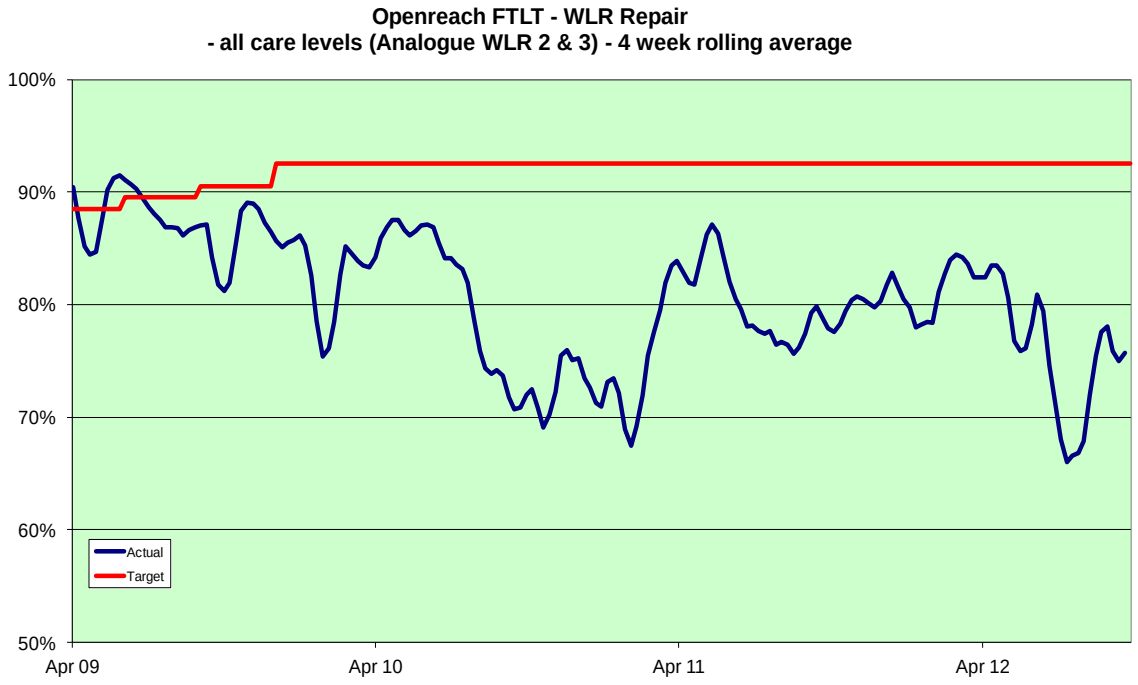
4. CALL FOR ACTION

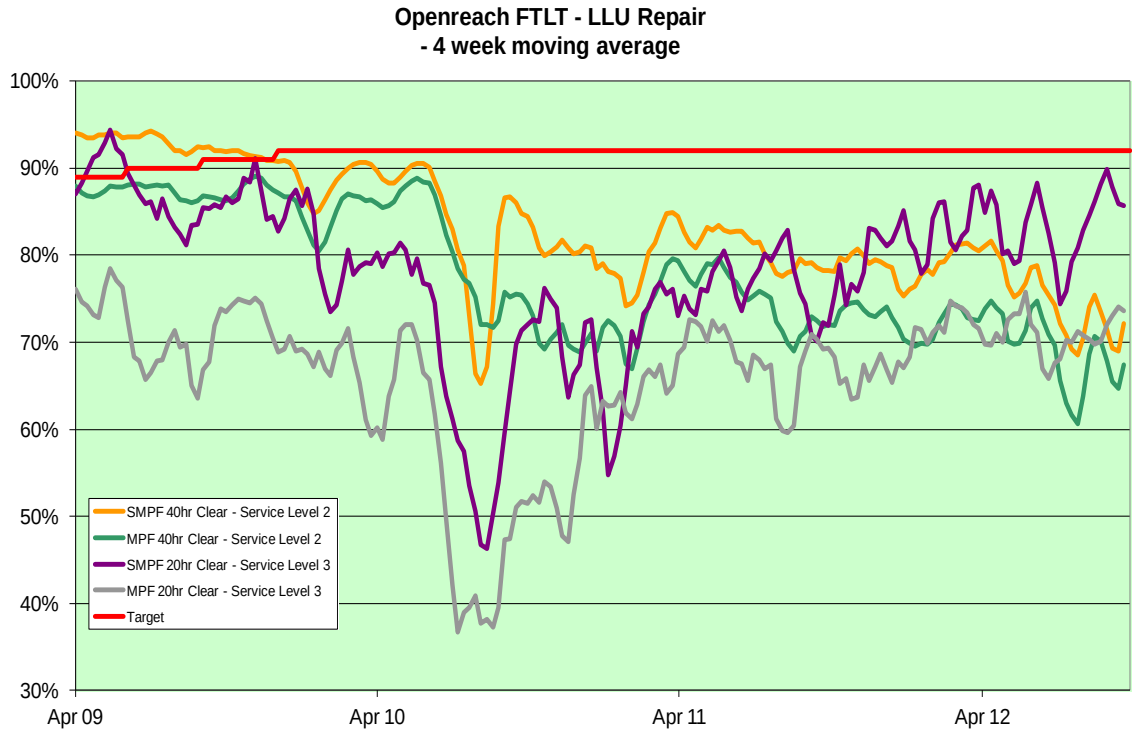
47. The evidence is clear over a long period: Openreach's quality of service has failed to meet the needs of UK consumers and the telecommunications industry. This is causing harm, disruption and expense to consumers and small businesses; is an impediment to competition in the telecommunications industry, and is harmful to the economy as a whole. The current approach to regulating for quality is unduly protracted and delivers minimal improvements. A new, comprehensive approach is required, and required now. Ofcom has the tools and opportunity to put in place the measures required to deliver the necessary immediate improvements. Ofcom's primary duty is to further the interests of citizens and consumers. To do so, it needs to act.

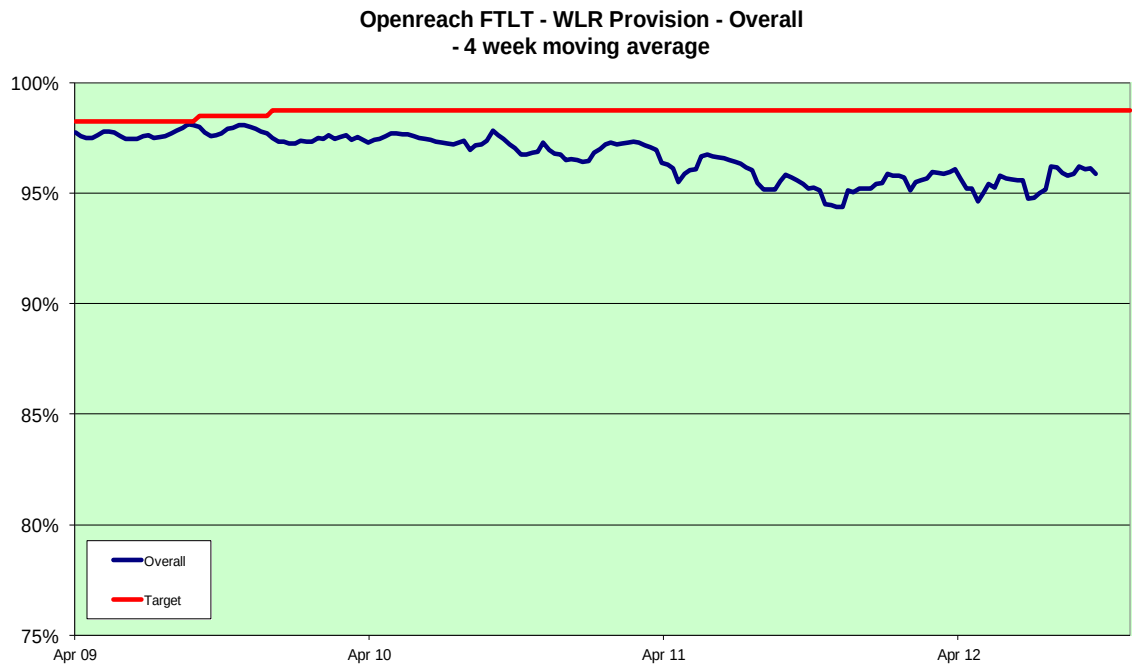
[11] Regulatory Justice: Making Sanctions Effective, a report by Professor Richard Macrory, November 2006, http://www.berr.gov.uk/files/file44593.pdf.

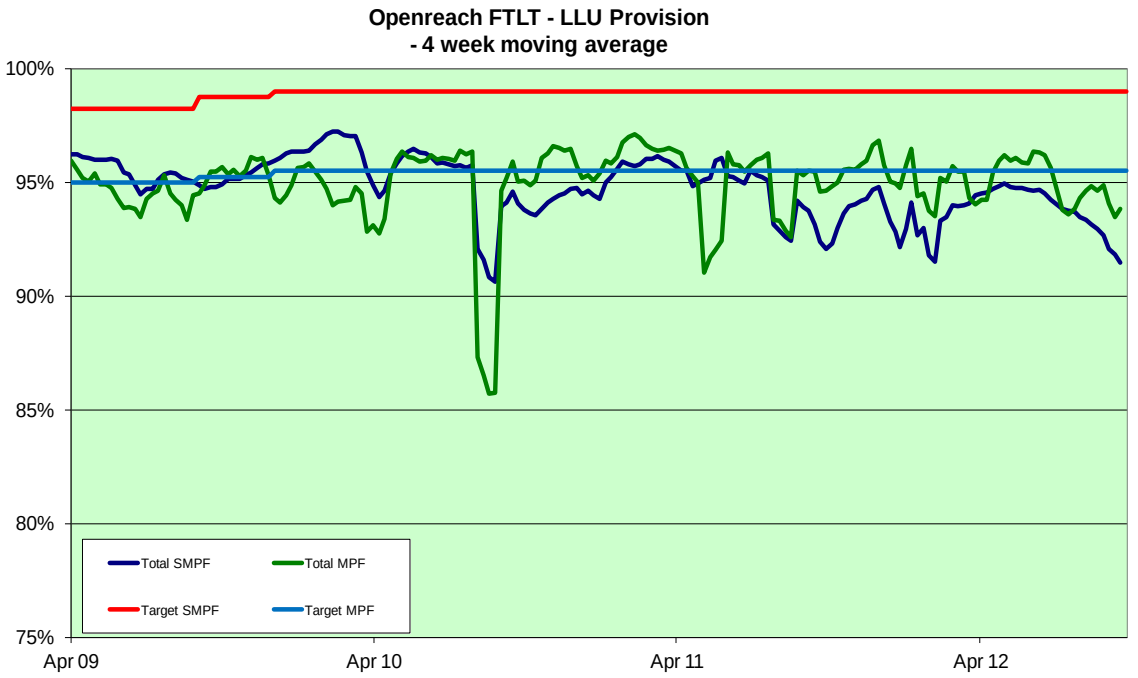
ANNEX
Recent Openreach Service Performance KPIs

First Touch - Last Touch Right First Time KPI – OTA Charts



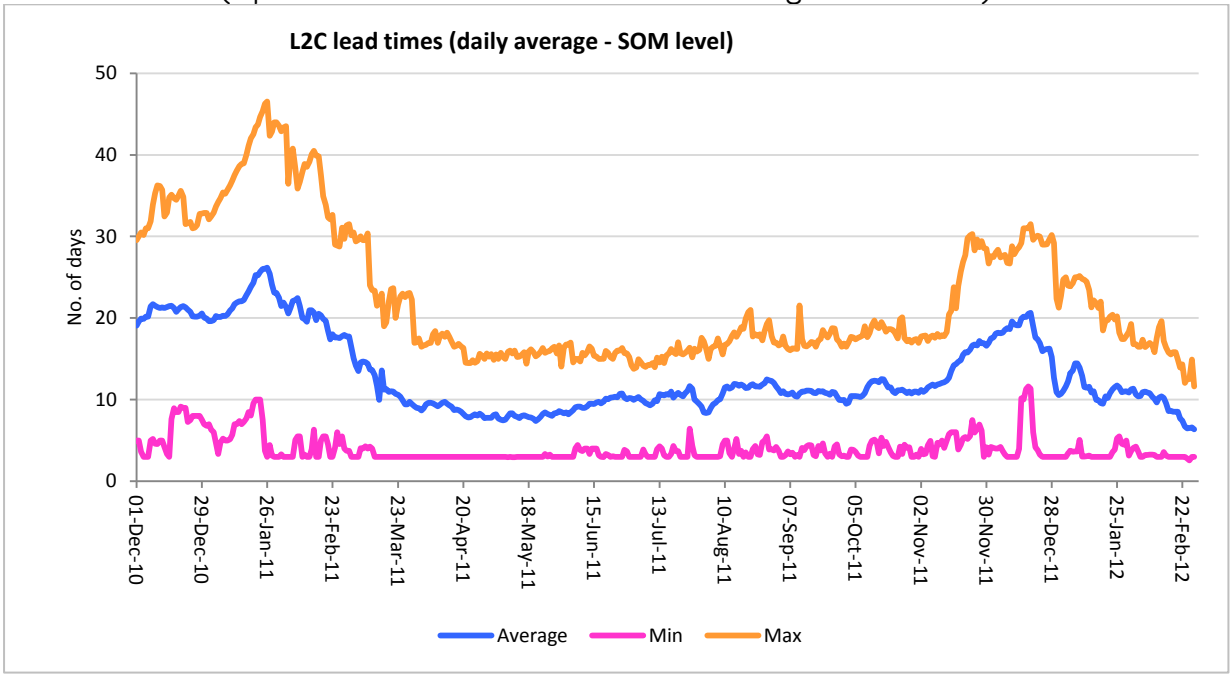



Openreach FTLT - WLR Provision - Overall
- 4 week moving average
100%
95%
90%
85%
80%
75%
Apr 09
Apr 10
Apr 11
Apr 12
Overall
Target

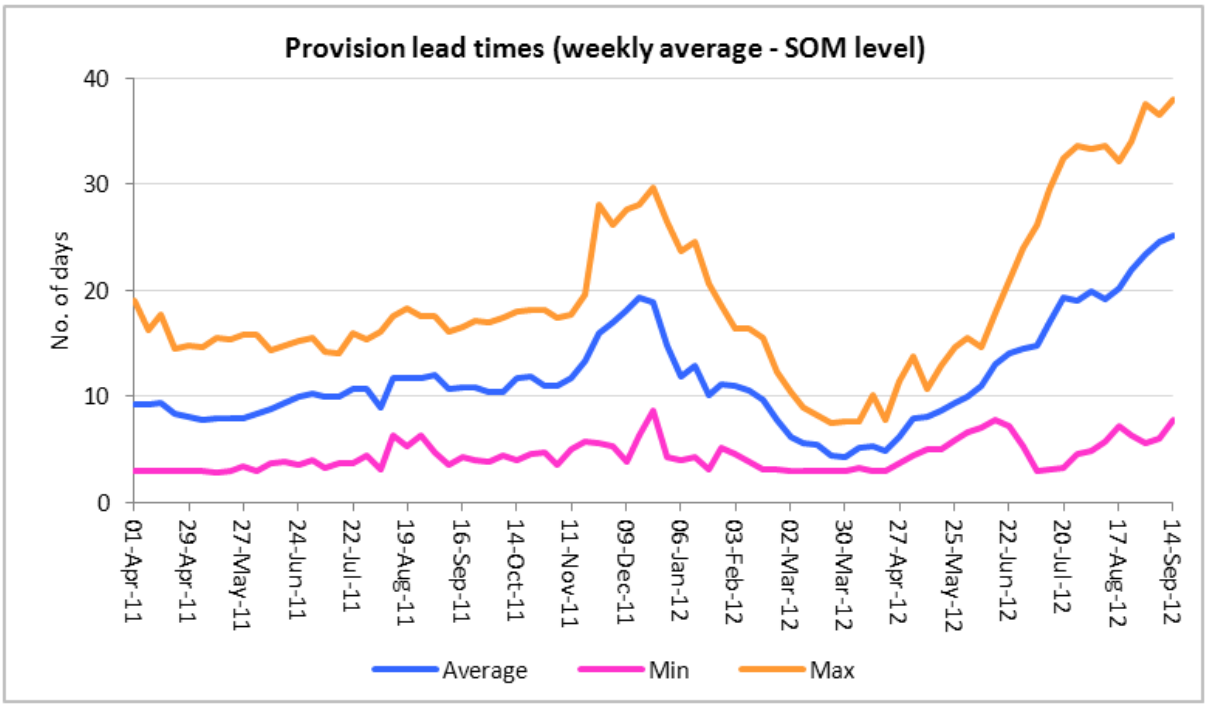

Openreach FTLT - LLU Provision
- 4 week moving average
100%
95%
90%
85%
80%
75%
Apr 09
Apr 10
Apr 11
Apr 12
Total SMPF
Total MPF
Target SMPF
Target MPF

Lead times – availability of Openreach engineers to complete work

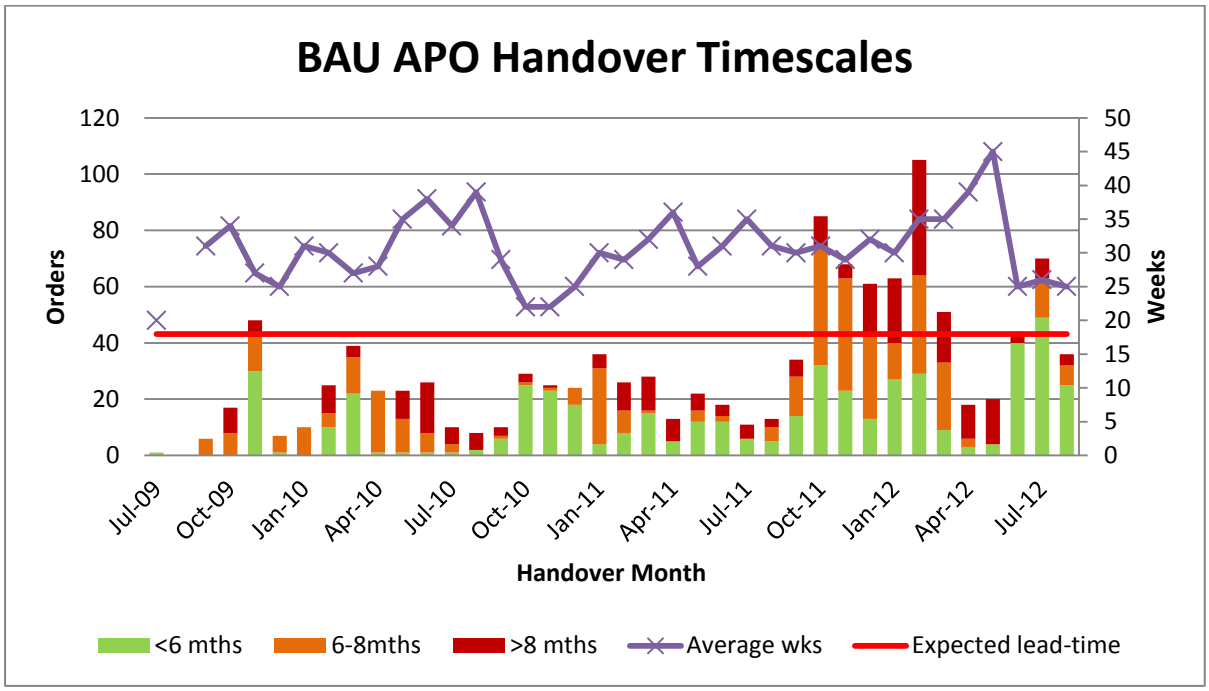
(Openreach: Presentation to Service Management Forum)



(Below) Update on above graph – showing recent worsening provisioning



Delivery of new LLU exchange capacity
(Sky data as at August 2012)



Notes:
Bars represent orders completed that month and time taken from initial request to hand over (left hand access) (eg: Jan 12 – 62 orders completed, approx. 28 within 6 months, 12 between 6 and 8 months and 22 longer than 8 months
Blue line records average time (from request to handover) for all orders completed that month (right hand access) (eg: Jan 12 – average = 30 weeks)
All orders are for additional capacity at exchanges where Sky already has its own equipment installed.
It takes no account of volume of orders received by Openreach from whole of industry in a particular month.