



Ofcom

Response to the Fixed Access Market Review: WLA related issues

Part 2 of TalkTalk Group submission: Service performance aspects

Non-confidential version

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1 Introduction and summary

- 1.1 This is TalkTalk Group's (TTG) response to Ofcom's consultation regarding proposals to improve Openreach's service performance in sections 9 and 10¹ of FAMR. TalkTalk Group provides broadband to over 4 million residential and business customers principally under the TalkTalk and TalkTalk Business brands. We are the UK's biggest local loop unbundler, operate the UK's largest next generation network (NGN) and are BT Openreach's largest external wholesale customer.
- 1.2 Service quality is self-evidently important to consumers. Excessive faults or prolonged delays for faults to be repaired hampers consumers and businesses ability to conduct their lives or business activities particularly as broadband and Internet access become more critical. Poor quality adds costs to CPs which are passed onto customers in inflated retail prices. It also impedes competition: slow provision of exchange space protects BT Retail from LLU competition; and, slow provision of new lines and migrations discourages customers from switching providers to get better services.
- 1.3 Over the last 3 years UK telecoms and consumers have suffered from an unacceptably poor level of quality. Ofcom's consultation clearly shows the cause and effect – in the last 2-3 years:
- there has been a significant fall in quality – more faults, slower fault repair and late provision. As Ofcom summarises (§9.12)
“... since the end of 2009, and particularly from the summer of 2010, Openreach's service performance deteriorated significantly, particularly with respect to the provision (i.e. installation) of new copper lines and fault repair. While service levels have fluctuated over time, the evidence shows that service levels have been consistently lower since 2009 for both MPF and WLR”
 - and at the same time BT has reduced its staff and investment² and substantially increased its already excessive profits – for instance NewStreet analysis³ shows that excess regulatory profits on wholesale products have increased to about £570m in 2011/12 (profits were 50% higher than they should have been⁴)
- 1.4 Furthermore, contrary to Openreach's oft-repeated claims, Ofcom evidence shows that Openreach's poor performance is not a result of poor weather or higher broadband uptake – these factors could at most account for about 10% of the substantial increase in fault levels⁵. It is simply not true that good service quality is beyond Openreach's control.

¹ The following parts of section 10: §§10.44-10.59; §§10.157-10.185; §§10.246-10.284; and, §§10.281-10.332.

² see Frontier report

³ NewStreet research (March 2013). BT, The hare and the tortoise. Chart 5

⁴ allowed rate of return was about 9% and actual return was 13.5%

⁵ see Frontier report

- 1.5 The experience over the last few years exemplifies Openreach's current incentives – to increase profit by letting quality fall. We consider that there are not currently adequate or effective regulatory mechanisms in place to prevent or deter this harmful behaviour. It is notable in this respect that telecoms is the only regulated network industry where quality is not directly regulated. As Ofcom has pointed out (§A9.79) addressing poor quality is central to Ofcom's duty:

We have outlined above the impact that poor QoS can have on CPs in the form of increased costs, lost margins and reputational damage. This of itself is cause for concern. However, we are also concerned about how this then, in turn, has the potential to lead to particular negative impacts on end-users of the services. Ofcom's principal duty is to further the interests of consumers and citizens in relation to communications matters and these impacts are therefore of central importance in this review. Moreover, any negative impact that poor quality of service has on the consumer/business experience could then in turn be impacting competition within the sector by acting as a barrier to switching.

- 1.6 Ofcom's proposals focus on setting minimum service standards as the principal means to improve service quality. In addition Ofcom is proposing improvements to the way SLASLGs are negotiated. We summarise below our views on Ofcom's proposals.
- 1.7 We agree with Ofcom's proposals to introduce minimum service standards with fines for breach as the principal means to incentivise BT to deliver improved service (since Ofcom considers that SLASLGs cannot be set high enough). However, minimum service standards and fines will only be effective in driving improved performance if Ofcom provides clarity in advance as to how it will set fines for breach and also Ofcom sets fines at a high enough level to create a meaningful incentive.
- 1.8 A critical assumption in setting minimum service standards will be the level of the standard e.g. the MPF/WLR New Provide appointment lead time. There may be some desire to base the minimum service standard on a much shorter target lead time for appointments (of around 5 days) than is currently experienced (currently targeted at about 12 days). We are concerned that this might be against consumers' interests – although Ofcom's research showed that on average consumers' 'expected' appointments in about 5 days consumers' responses did not take account of the cost that they would bear (not least since the additional cost is not yet fully clear). Setting a higher quality level than is experienced today risks imposing costs on consumers that they are not willing to pay particularly if Openreach is able to charge additional margin for the better service. This will also distort competition if the prices that BT Retail's competitors pay are above the cost to BT.
- 1.9 We think that consumers' interests would be best met if Openreach offered a choice of several service levels and priced these at their cost differences. In the case of new provides this could involve Openreach offering a (say) 5 day option as well as the current 12 day service. For fault repair there are already 4 different care levels and expedite options. The prices of these services must reflect the incremental cost difference. This is different from the situation today where Openreach charge massive margins for higher service quality – for instance £500 for a single fault to be

fixed 24 hours more quickly⁶; while the proposed additional charge (£50) for a quicker new provide in 3-6 days was more than 10 times the additional cost⁷.

- 1.10 Setting the price of other service levels at their incremental cost will allow the consumers greater choice of different services and allow different consumers to chose services that fit their needs. It will also allow the market to 'discover' the appropriate levels of service (rather than Ofcom 'ordaining' it by selecting a single standard service level) and so the market will act efficiently. Setting price difference to reflect incremental costs will also prevent BT over-recovering its costs for premium services as it does today.
- 1.11 Even if effective minimum service standards are introduced SLASLGs will still have a key and complementary role to play in ensuring Openreach acts in consumers' interests. They will be most effective if they genuinely reflect CP losses and are able to be put in place quickly. We welcome the proposed involvement of the OTA (with a backstop of Ofcom investigation) but have a number of suggestions to ensure that this will be effective: Ofcom should provide guidance on how SLGs and SLAs should be set; the negotiations should include an Ofcom observer; and, in the case that Ofcom investigates it (a) must determine a single SLG (rather than a range that Openreach's offer must fall within) and (b) must backdate the determined SLG to the start of negotiations.
- 1.12 We also consider that Openreach's fault repair costs (in particular) are excessive and prices should assume that Openreach's efficient costs are much lower. Ofcom must also closely scrutinise Openreach claims regarding the additional costs of better service.

2 Minimum service standards/fines

- 2.1 Ofcom have proposed minimum service standards with fines for non-compliance as the principle means to create sufficient incentives for Openreach to provide acceptable levels of service. The minimum standards will be set in an SMP Condition and, if Openreach breaches such a condition it could be fined (up to 10% of its relevant turnover). We strongly support this approach. However, for this to be effective in meeting Ofcom's objectives we think Ofcom must introduce fining guidelines to create strong and appropriate incentives for compliance. We comment on this below as well as what the targets should be.

2.1 Need for fining guidelines

- 2.2 The prospect of fines is obviously critical to creating the incentives for Openreach to comply with minimum service standards. Ofcom says in regards of fines: "*The*

⁶ Expedite charge to move from Care Level 2 to Care Level 3 is £500. The cost is about £50 – see §3.2 below

⁷ Openreach proposed about £50 price premium though the additional cost to Openreach is about £5 – see §3.2 below

standard ultimately selected will be imposed by way of a SMP [C]ondition, which, if breached, will render BT subject to potential sanctions". Ofcom has not been specific that a breach will result in a fine or explored the appropriate level of fine.

- 2.3 The lack of clarity and detail regarding the level of fine and the circumstances in which these will be imposed is concerning since fines will only create appropriate incentives if Openreach expects that there will be significant fines as a consequence of non-compliance (that are larger than the cost of non-compliance). This means that:
- the likely fines need to be sufficiently large to provide an effective deterrent by outweighing the benefit of non-compliance; and,
 - Openreach needs to be well aware of the size of potential fines.
- 2.4 Our concerns are magnified by the fact that Ofcom has never fined BT for a breach of an SMP Condition despite multiple transgressions by BT⁸. This lack of specificity and the history of Ofcom's prior approach will create an expectation in BT's mind of no or low fines for non-compliance.
- 2.5 Further, if Ofcom does not provide any clear prior indication as to the likely level of any fine potential fines then if Ofcom sought in the case of a breach to levy a large fine Openreach would plead "regulatory uncertainty" and that any material fine is unfair since it was unaware of the likely level of fine.
- 2.6 Therefore, it is essential that Ofcom provide a reasonably clear indication of the potential fines through for instance fining guidelines⁹. This would not bind Ofcom or fetter its discretion but simply explain how Ofcom might determine the level of a fine through for instance providing criteria, ranges and the factors that Ofcom would take into account. The OFT provides guidelines on fines in the case of Competition Act infringements¹⁰.

2.2 What targets should be set

- 2.7 We think that the services that should at the outset have minimum service standards set should be for MPF and WLR and include:
- appointed new provides: appointment availability and fulfilment of appointment

⁸ For example, overcharges of £250 million on PPC and Ethernet, poor service performance for many products over much of last 10 years, multiple errors in and late delivery of regulatory accounts

⁹ For the avoidance of doubt, we consider that the fining approach should be based on a 'one strike and you're out' approach – BT should not for, instance, be able to avoid a fine by remedying a breach subsequent to it being notified of such breach. Such an approach would neuter the incentive properties of fines. Such an approach is normal in, for instance, Competition Act cases

¹⁰ OFT's guidance as to the appropriate amount of a penalty, September 2012

http://www.ofcom.gov.uk/shared_ofcom/business_leaflets/ca98_guidelines/ofcom423.pdf

- faults: faults per line per year (i.e. fault rate) and fault repair time¹¹.
- 2.8 We consider that Ofcom should reserve the power to extend the scope of minimum service standards to other products during the course of the market review period. For instance, Ofcom might consider that it wishes to include a minimum service standard for MPF Single Migrations if, say, service performance falls.
- 2.9 In terms of the actual minimum service standards for each service (i.e. 80% new provides appointments available within 12 days) we have the following comments.
- Ofcom considers that the existing contractual SLAs and/or Openreach's own internal targets are the appropriate basis for setting minimum service standards. Ofcom says: "*We have based our condition on the SLAs as these are the best available measure of what the industry considers to be an appropriate standard.*" This is not an accurate description. Many SLAs are unilaterally imposed by Openreach and even those SLAs that are set through discussion cannot be considered as an 'appropriate standard' since Openreach (as the SMP provider) has excessive bargaining strength as we explain below (§4.5).
 - We do not consider that the consumer research that Ofcom conducted provides a clear answer as to the appropriate minimum service standards either. For example, the average customer 'expected' that connections should be provided in around 4-5 days (See Table A9.25) – however, it does not follow that this should be the minimum service standard (or represent the welfare maximising quality level) since respondents would not have taken into account the higher costs of quicker or slower connections¹².
 - Ofcom might consider setting a glidepath for minimum service standards from today's level to the targeted level over a 1-3 year period. This will allow Openreach time to adapt and therefore allow Ofcom to set more stringent standards (rather than having to set standards close to what they are today). This approach is reasonable since Openreach itself has used a glidepath in setting its own internal targets (e.g. new provide appointment lead time).
 - We understand that Ofcom proposes to set the standard based on the service standard expected including MBORCs at a fixed level (based on historic experience). This means that Openreach cannot game the system and increase its measured performance by declaring excessive numbers of MBORCs. We agree with this.
- 2.10 Ofcom will also need to decide what actually constitutes a breach that triggers a fine. For instance, if quality for new provides fell below the minimum standard for one week would this constitute a breach or would there need to be a breach over a month long period. The period must not be too long since else it will reduce the

¹¹ The fault rate must be included since (a) it is important to customers (and probably equally or more important than time to repair) and (b) the recent deterioration shows that Openreach needs incentive to improve. An alternative or additional metric could be average downtime (e.g. hours per line per year)

¹² Ideally research in this area should be based on conjoint analysis to reliably identify customers preferences and willingness to pay

incentive to deliver good quality since it will allow Openreach to put off resolving problems. Obviously a breach for a month would attract a lower fine than if the breach was for a year. The period does not need to be long enough to aggregate seasonality since Openreach should resource properly to allow the higher fault rates in winter (say) to be repaired equally quickly as in summer.

3 Choice of service options priced at cost

3.1 We see considerable benefits from Openreach offering CPs/consumers a variety of different service options (that are priced at incremental cost differences) and the market choosing which it desires (the minimum service standards would then reflect the most popular of these). What we envisage is sometimes referred to as a menu approach.

3.2 Openreach do offer some service options today but these are inadequate for various reasons:

- There are some gaps in the range of options offered:
 - On MPF/WLR new provide there is only one standard service level offered (with a target around 12 days). In early 2012 Openreach proposed various expedite¹³ options (for 3-6 days and 1-2 days) though they were not introduced¹⁴
 - On MPF/SMPF connection there is one standard service and a single expedite option available
 - On fault repair there are various care levels (Care Level 1, 2, 3, 4¹⁵) that can either be 'rented' (i.e. pay an annual charge called enhanced care) or purchased one-off when required (referred to as expedite)
- Where higher quality options are offered their price is well in excess of cost and the competitive price level – for example:
 - The proposed prices for faster MPF/WLR new provide were about £50 extra for a 3-6 day provide whereas the additional cost is likely to be around £5¹⁶ (and around £100 extra for a new provide in 1-2 days)

¹³ Enhanced and expedite both refer to higher quality. Enhanced refers to a situation where the annual charge is elevated which entitles the customer to a higher quality (in other words higher quality is rented). Expedite refers to the situation where a one-off charge is paid in return, for instance, for a faster repair on one fault. For repair services either option is possible. For new provide/connection services enhanced service is not payable since there is no ongoing annual charge

¹⁴ These were unanimously rejected by operators since they involved the average delivery on the 'standard' service deteriorating but with no reduction in charge and the expedite prices were excessive

¹⁵ Level 1 Clear by 23.59 day after next, Monday to Friday. For example, report Tuesday, clear Thursday.

Level 2 Clear by 23.59 next day, Monday to Saturday. For example, report Tuesday, clear Wednesday.

Level 3 Report 13.00, clear by 23.59 same day. Report after 13.00 clear by 12.59 next day, seven days a week, including Public and Bank Holiday.

Level 4 Clear within 6 hours, any time of day, any day of the year

- Fault repair for care level 3 (“CL3”) is charged at £37.20 per year (above care level 2 (“CL2”)) whereas the genuine additional cost might be around £5 to £10¹⁷
- Expedite for fault repair is even more excessive. The extra paid to accelerate the repair of a single fault by less than 24 hours i.e. from CL2 to CL3 is £500¹⁸ [sic]. This *prima facie* looks excessive. The level of excess is obvious when one considers that to repair a single fault in 48 hours only costs £100¹⁹ – it cannot be true that it costs £600 to repair that fault in 24 hours. In fact, Openreach itself claims that moving from CL1 to CL2 costs 20% more i.e. £20 so it is nonsense to think that moving from CL2 to CL3 costs £500. Further, because there is no SLG, Openreach can choose to only provide this expedite service when there is free resource and so no incremental cost to it²⁰
- The existing expedite connection and expedite fault repair services are not guaranteed in the sense that if Openreach do not deliver them there is no penalty (though they don’t retain the expedite charge)

3.3 For the market to be able to be effective and meet consumers’ interests two regulatory changes are required:

- An obligation on Openreach to respond to requests for different/higher service levels (these would be implemented by means of operator requesting them through the standard SOR approach); and, such services should have associated SLASLGs
- An obligation that different service levels are priced at or near their incremental cost difference²¹. This can be implemented through the LLU / WLR charge control

3.4 This will have a number of benefits

¹⁶ Figure 5.1 in the FAMR indicates moving from 13 to 12 days increase resources require by around 1% (at 85% within target). If we assume labour costs of £25 for MPF New Provide then the added cost for a one day reduction is around 25p. For a reduction from 13 days (today) to 3-5 days (8-10 days) would cost £3. The cost per day of improvement might increase slightly as the number of days reduces.

¹⁷ Since costs £12 to repair at CL2, CL3 unlikely to cost more than 50% more

¹⁸ see Openreach price list

<http://www.openreach.co.uk/org/home/products/pricing/loadProductPriceDetails.do?data=o1GUUZ4oSGmoXU5lc%2BgZQD265It6W32TNnfEUU7w1FZ6rNZujnCs99NbiKJZPD9hXYmijxH6wr%0ACQm97GZMyQ%3D%3D>

¹⁹ We estimate that the cost of fault repair per line is about £12 per year for care level 2 derived from Component cost stack per product 2011/12 in model – faults are included in e-side current, d-side current, drop current and frame current (total £15.23 less £3.16 cumulo). Given fault rates are 3m a year for 24m lines this implies 0.12 faults per line per year which implies a cost of £100 to fix a single fault

²⁰ Openreach can effectively choose to only repair in the shorter time when it has spare (and therefore close to free) capacity available

²¹ Since the standard service is charge controlled then if the additional charge for different service quality is priced at LRIC it may be that it is appropriate to include enhanced/expedite services within a charge control basket

- It allows the market to operate efficiently since different customers have choice and can select the option that suits their demands rather than putting up with a one size fits all approach – in effect it allows the market to ‘discover’ the quality level it wants (as would happen in a competitive market). This is preferable to Ofcom or Openreach deciding the ‘right’ target
- It allows innovation by downstream ISPs to create new services for different customers
- It makes setting the minimum service standards far more effective. It avoids the risk of Ofcom mis-estimating the appropriate minimum service standard and the inefficiency of Openreach delivering a quality more or less than the market average demands (this has some parallels to the effect of setting a regulated price too high or too low). It also allows minimum service standards to be adaptive to market demands since the minimum service standards can ‘follow’ what consumers chose rather than Ofcom having to ‘ordain’ a single level

3.5 We do not consider providing additional service levels (at incremental cost differences) as difficult. Openreach already offer some options and was considering offering more in early 2012 (though their proposals were rejected since they involved existing services being degraded). In fact the only key gap is a shorter (say 5 days) MPF/WLR New Provide appointment lead time. We believe that the development required is minimal – Amazon, Waitrose and many other companies have been offering far better service levels on home visits with far more flexibility and optionality for many years. Resetting prices to reflect cost is a fairly straightforward matter particularly since the charges will reduce and so will not be disruptive to CPs²². Probably the main barrier to new service is likely to be Openreach wanting to retain its excessive profits on these services (see below).

3.6 If this menu approach (priced at incremental cost differences) was adopted then it would result in price regulation of enhanced/expedite services, which are currently unregulated. This is different to the current situation and Ofcom proposals for the next review period where no charge control nor cost orientation obligation applies²³. We do not consider Ofcom’s proposals for an absence of price regulation to be warranted:

- Openreach sometimes argue that these services are optional, ‘value-added’ services that are in some sense luxuries where price regulation is not appropriate. However, this is not the case – for some customers higher service quality is essential and for them the higher quality is standard and not a ‘nice to have’. There is no coherent justification for Openreach to make hugely excessive returns on these services.

²² Any claims of the need to reset the prices slowly to minimise disruption to Openreach are unfounded – it is a large organisation that can handle this level of change in prices and there is no reason to allow BT to continue to retain excessive profits. Furthermore, volumes will increase offsetting the reduction in prices

²³ The exception is MPF and SMPF expedite connection is currently part of the MPF and SMPF ancillary baskets.

- High prices are not necessary in order to provide the incentives for Openreach to innovate²⁴ - in fact there has been almost no innovation in enhanced/expedite services in the last 3-4 years²⁵ despite the lack of price regulation. In any case, providing different service options is not a difficult innovation
- A sometimes used reason for allowing price flexibility is that it allows Openreach to recover common cost in an (allocatively) efficient manner by recovering more common cost from certain customers/products and less from others (i.e. Ramsey pricing). However, that argument is not relevant here since under Ofcom's pricing approach higher cost recovery on enhanced/expedite products is not offset by lower recovery on standard products. In any case, the level of common costs for fault repair is low meaning that there is little profit or efficiency benefit from Ramsey pricing
- Openreach is significantly over-recovering cost²⁶ for enhanced/expedite provision which demonstrates a lack of sufficient constraint on its pricing. This provides another justification for price regulating these services (which Ofcom has itself noted) *"Nevertheless we think basket control would be a credible option for enhanced care services in the event that other options are found to provide insufficient constraint on price behaviour"*²⁷

4 SLASLGs

4.1 In this section we discuss the role and benefits of SLASLGs as a complement to minimum service standards and how they should be set.

4.1 Key role for SLASLGs

4.2 Though minimum service standards are very welcome, SLASLGs will continue to play an important and necessary complementary role in delivering good quality service:

- SLASLGs can cover all/more products/services – minimum service standards will (according to Ofcom's proposals) only cover a subset of services for a subset of products
- SLASLGs are fairer for consumers since the amount (compensation) paid by Openreach is passed to Openreach's direct and indirect customers whereas under the minimum service standard approach any fine is paid to HM Treasury. As well as being fairer for consumers it is also more efficient. Paying SLGs to

²⁴ LLU Charge Control Statement Mar 2012 §4.391 *"We also considered whether LLU Enhanced Care services should be charge controlled in baskets or using a safeguard cap (Option 3 in the March 2011 Consultation). However, we felt that this approach could result in inflexibility and/or stifle innovation"*

²⁵ Around 2009 Openreach harmonized the availability and pricing of different care levels across its various products. This is not really genuine innovation but rather 'tidying up'. There has been no meaningful innovation in terms of new service options

²⁶ In the example we give above the prices are 5 or more times cost. Ofcom could request data to understand better the cost of these services

²⁷ LLU Charge Control Consultation Mar 2011 §4.158

CPs allows onward goodwill payments to consumers and can also result in lower retail charges (if expected SLGs are foreseeable). Compensating CPs for their losses is efficient since it partially removes the deadweight losses from poor provision that CPs suffer

- SLASLGs may in some circumstances have beneficial impacts on Openreach's operating behaviour in ways that the prospect of fines cannot since SLASLGs are more immediate and real time i.e. the likely compensation is known before or shortly after the poor service event occurs. In contrast, the level of fines will not be known for many months after the poor service occurs and so will have a less immediate impact

4.3 Therefore, we think that SLASLGs should be developed and expanded as far as possible (as a complement to minimum service standards). For SLASLGs to be as effective as possible they must be set to fully cover the genuine pre-estimate of losses to CPs²⁸. In most cases today the SLASLGs either don't exist or are insufficient to cover CPs genuine losses.

4.2 Need for Ofcom to define SLASLGs

4.4 With regard to the approach to setting SLASLGs Ofcom has chosen not to determine SLASLGs (through for instance an SMP Condition) but rather to leave these to be set through commercial negotiation. Given the well-understood and long running history of Openreach's behaviour in not providing reasonable SLASLGs we are disappointed that Ofcom has chosen not to be more decisive. The recent process of negotiating the MPF New Provide is a good illustration of Openreach's behaviour

- TalkTalk (and other CPs) began to experience unacceptably long appointment availability on MPF New Provide from around Sept 2010 and requested that Openreach improve service and offer a proper SLG since at this point there was no SLG in place at all for MPF New Provide appointment lead times
- The negotiations on SLGs were drawn out by Openreach with no progress initially. The OTA became involved though this still did not result in any meaningful progress.
- It took more than 8 months after the initial problems (in April 2011) before Openreach made a first offer. This offer was pitiful: it would not be effective for 17 months (October 2012); and, it included absurd conditions e.g. CPs needed to accept a lower quality on fault repair (care level 1 not 2), SLGs not payable if SFI forecast were inaccurate – SFIs are not something that CPs are able to control

²⁸ For Openreach to experience the right incentives it should face the full welfare harm resulting from poor quality poor quality. This includes:

- Losses/costs to operators (lost customers/sales, higher cancellations, delayed revenues, higher operating costs)
- Costs to consumers (inability to use Internet, inconvenience, loss of downstream business revenue)
- Reduction in competition

- Eventually Ofcom had to step in to move things along and after 18 more months an offer was agreed in December 2012 27 months after the problems began and an SLASLG was requested. The agreed SLASLG was £2 per day from 14-17 days and £4 per day over 17 days with the absurd conditions being removed

4.5 We remain of the view that Ofcom can and should set SLASLGs as part of the FAMR process (through an SMP Condition or similar). Commercial negotiations are highly unlikely to be fully effective given the huge bargaining power Openreach has which enable it to unilaterally impose terms:

- Openreach has SMP which, by definition, means that it has the incentive and ability to provide products on uncompetitive terms (or not offer products at all) against consumers interests. Obviously CPs do not hold any similar market power
- The fall-back position absent agreement is what Openreach previously set which is in most cases no SLG at all
- Openreach ‘hold the pen’ in negotiations – the terms on the table are what Openreach unilaterally chooses to offer. CPs do not have such power – they can only ask Openreach to change what it offers
- It is absolutely in Openreach’s interests to protract negotiations since the starting point in negotiations is terms that Openreach had previously unilaterally set (or no SLG at all). This incentive has been amplified by Ofcom’s recent decision not to backdate offers in resolving disputes²⁹

4.3 OTA2 facilitated process

4.6 In respect of improving commercial negotiations, Ofcom has proposed a new approach to the way these negotiations are conducted and how Ofcom may get involved in order to ensure that they are more effective in setting reasonable SLASLGs in a timely manner. We welcome this intent given the poor history in this area. Based on the consultation document and the discussion held with the OTA in July 2013 we understand the process to be as follows:

- If CPs are concerned that an existing SLASLG is inadequate they can request that the OTA2 facilitate negotiations for a revised SLASLG
- If the OTA2 consider that it is appropriate it will facilitate commercial negotiations between Openreach and CPs in particular by requesting that the parties provide the relevant information to aid effective negotiations
- If an agreement is not reached within 6 months then Ofcom may decide to conduct its own investigation (it is not quite clear what the legal nature of this investigation would be)

²⁹ Dispute relating to whether Openreach offered MPF New Provide to TalkTalk Telecom Group PLC on fair and reasonable terms and conditions. CW/01098/12/12

- The pre-existing SLASLG (or nothing if no SLASLG pre-exists) continues until the new SLASLG is agreed

4.7 Though we welcome some more structure and rigour around the current negotiations we think that the proposals need to be improved in several respects if they are to have the desired impact.

4.8 First, for the OTA2 facilitated commercial negotiation process to have most chance of success then there must be very clear guidance available regarding the basis on which SLASLGs should be set. Such guidance should include:

- the methodology for estimating losses (if SLGs are based on CP losses) e.g. types of costs included, methods for deriving costs, assumptions to be used
- ‘rules’ for how SLAs should be set. Currently, there is no guidance on the question of SLA at all. Instead Openreach set them based on how it currently performs or what its internal targets are. They are not set on the basis of what is appropriate. The incentive effect on Openreach of an SLASLG and the compensation CPs receive to cover their losses depends as much on the SLA as the SLG level so the SLA cannot be left to be dictated by Openreach
- if and how forecast linkages can be included and how they should be set. We remain disappointed that though Openreach placed huge emphasis on the need for accurate forecasts of new provides (and a forecast linkage was included) we have seen no evidence (and neither has Ofcom as far as we are aware) that the forecasting information is used let alone whether a +/-10% tolerance based on a forecast 3 months in advance is necessary or appropriate. Unless the benefit of forecast linkages can be shown they should not be included in SLASLGs³⁰
- How and when force majeure can be declared. There is an absence of any guidance in this area. The criteria must be objectively justifiable and the process transparent

4.9 Absent this guidance, the negotiation process is likely to be relatively ineffective.

4.10 Second, the OTA2 facilitated process will have greatest chances of success if all parties (particularly Openreach) provide relevant evidence in a timely manner. Consequently, there must be some sanction for not providing certain information. This sanction may be reflected in Ofcom’s decision whether to open an investigation and/or the determination it reaches in that investigation. To aid disclosure it may be useful to allow confidentiality ring arrangements (or similar) which allow disclosure of confidential information to certain individuals.

³⁰ We also note that even if forecasts were useful to Openreach it is the aggregate forecast of all CPs not the individual forecasts of each CP that matter. Furthermore, we do not understand why forecasts are required to be so accurate so far in advance (3 months). Another concern is that CPs ability to forecast accurately depends on Openreach’s quality – for example, if Openreach new prove appointment availability extends it is more difficult to achieve sales and orders for new provides.

- 4.11 Third, the new SLASLG terms must apply (i.e. be backdated) from the date at which a new SLASLG was requested (i.e. so that it applies retrospectively during the negotiation period) unless agreement is reached otherwise. There are compelling reasons for this:
- if the new SLASLG is appropriate going forward from the agreement it would also be appropriate beforehand
 - the pre-existing SLASLG is one that has been dictated by Openreach so it is highly unlikely to be fair or appropriate – indeed in many cases the pre-existing SLG is zero which is plainly unreasonable
 - backdating will give Openreach incentives to improve service during the negotiation period
 - backdating will reduce Openreach’s incentive to delay negotiations
 - without backdating CPs may sidestep the OTA2 process and go straight for a dispute/complaint
- 4.12 Ofcom argue against backdating since it *“such an approach may risk distorting the negotiation process as it will lead to a disproportionate focus on the performance in that period and does not allow Openreach to respond to the SLA proposed.”* This is not a good or indeed a logically coherent reason. Knowing the SLASLG will be backdated will give Openreach better incentives for an appropriate focus on providing reasonable service during the negotiation period (than if the pre-existing SLASLG applied during that period).
- 4.13 Fourth, we consider the 6 month OTA review period too long and 4 months to be more suitable. The essence of an SLASLG is relatively straightforward (provided Ofcom has provided guidance) and should not require 6 months to resolve if all parties provide information in a timely manner and Ofcom has provided guidance. Further, in the case where deadlock is reached prior to the end of the OTA review period, the OTA should be able to pass the issue onto Ofcom without waiting for the end of the 4 (or 6) months.
- 4.14 Fifth, the discussion under OTA2 facilitation should include an Ofcom observer. This will not only speed making any future decision on whether to open an investigation (in the case of no agreement) and speed the investigation itself but will also help Ofcom understand the bargaining strength Openreach has in negotiations and the gaming tactics they adopt.
- 4.15 Sixth, in the case where agreement is not reached there should be a presumption that Ofcom conducts an investigation unless certain pre-defined criteria are met.
- 4.16 Seventh, in the case that Ofcom opens an investigation, it should determine what SLG should be provided. In the recent MPF New Provide dispute³¹ Ofcom chose not to set an SLG and require Openreach to pay compensation on that basis. Rather it

³¹ Dispute relating to whether Openreach offered MPF New Provide to TalkTalk Telecom Group PLC on fair and reasonable terms and conditions. CW/01098/12/12

estimated a very wide range for what a reasonable SLG might be and, since Openreach's offer just fell within the bottom of that range, decided Openreach was not in breach and did not require Openreach even to pay TalkTalk what Openreach had offered. Such an approach is flawed – it effectively gives Openreach the incentive to set SLGs at (or below) the bottom of the range Ofcom might calculate. This also amplifies Openreach's pre-existing power to impose unreasonable terms on CPs that do not cover their genuine losses. Therefore, the outcome of any investigation must be:

- The determination of the appropriate SLG (not a range) and SLA
- Backdating this to the first requests for a revised SLASLG (for the compelling reasons given above)

5 Other issues

- 5.1 We have two points regarding Openreach's estimated costs the first regarding their current fault repair costs and the second regarding the costs of better quality:
- We consider that Openreach's fault repair costs (in particular) are excessive and prices should assume that Openreach's efficient costs are much lower. For example, fault levels (excl GEA) are more than 50% above where they were in 2009 whereas no more than 10% of the increase is due to exogenous factors such as weather or increased broadband uptake. This point is explained in more detail in our response to the LLU Charge Control Consultation.
 - We accept that relatively higher quality results in higher costs to some degree (all else being equal) that may result in higher charges. However, Ofcom must be very wary of Openreach's claims of the costs of higher quality and should open up Openreach's claims to scrutiny by CPs (who have experience of these matters). For example the 'discrete event simulation' model that Openreach has submitted must be made transparent if it is relied upon. It is in Openreach's interests to exaggerate the cost of delivering better quality by, for example, insisting it requires huge additional headcount whereas in reality it could be done through fairly modest systems investments.
- 5.2 Ofcom is also proposing improved transparency and publication of KPIs. We agree with this. However, whilst certainly useful, it is unlikely to create sufficient incentive to drive meaningful improvement by Openreach
- 5.3 We consider that it would be appropriate for executive remuneration to be linked (to some degree) to the level of service Openreach delivers.