

# LLCC PPC POINTS OF HANDOVER

## PRICING REVIEW

**Cable&Wireless**  
Worldwide

MARCH 2011 NON CONFIDENTIAL

### EXECUTIVE SUMMARY

- We welcome Ofcom's continued work in this area and hope to see a timely introduction of the new PoH rental charges.
- We agree with Ofcom's proposal to use its own bottom up model in preference to any model proposed by BT. History has shown that BT's own systems are incapable of capturing accurate cost information at the required level of detail for this service.
- In seeking to derive relevant charges Ofcom has used existing charges for similar services and then made adjustments to derive a LRIC equivalent. We support this methodology. We do however consider that the prices selected require more refinement in order to select efficient options and options more in line with CP's purchasing of these services.

### INTRODUCTION

Despite the existence of granular price regulation for the provision of regulated PPC services BT remains able to raise dubious costs related to services only its competitors purchase. Whilst the costs of PPC PoH rental are a mere drop in the ocean in the wider portfolio of BT services they represent considerable additional costs for CPs when competing against BT. We welcome the recognition by the CAT and Ofcom that these costs and charges require independent assessment by Ofcom.

### QUESTIONS

1. Do respondents agree that options 1 and 4 are consistent with cost causation whilst options 2 and 3 are not?

C&W Worldwide supports an approach to POH rental charging which removes unnecessary cost barriers which restrict a level competitive playing field. Consequently there are three of

Ofcom's options that meet / go to meeting this objective. That is Option 2, 3 and 4. We are of the view that anyone of these three options is potentially viable.

In making a decision as to which option to proceed with we regard the following as relevant considerations:

- PoH rental is only one of a number of PoH related charges. What contribution do other charges make to the recovery of these costs?
- Whilst conceptually we believe the ideal incentive upon BT to ensure the efficient provision of PoH rental charges would be for BT to bear the charges also, it would be at odds for BT to bear only PoH rental charges and not any of the other related PoH charges.
- Ofcom has built a bottom up model which could be used to facilitate either Option 2 or Option 4. It is important that Ofcom's decision can be implemented without delay.
- Where only CPs contribute to the costs of PoH rental it is essential that the model assumes the optimal efficient inputs. Use of sub optimal inputs or providing discretion in BT's favour undermines Option 4.
- Ofcom's consideration that a move to LRIC pricing for PoH rental ought to be accompanied by a wider review of all PoH charges moving to a LRIC basis in the forthcoming BCMR.

With respect to these considerations we would support Ofcom in the adoption of Option 4.

2. Do respondents agree with our analysis of cost minimisation and with our view that we should give more weight to cost causation?

Ofcom places weight on the ability of OCPs to minimise the costs of POH rental. It is important to recall that the inefficient POH infrastructure was in fact installed by BT prior to the existence of PPCs. For OCPs to be able to act to minimise future costs necessitates the existence of low

cost and efficient migration options. We draw Ofcom's attention to the migration costs of sub 2 Mbit/s services for which BT levies a migration charge for the 2Mbit/s bearer and migration charges for each of the circuits delivered with the bearer. We believe that charges for the circuits with the bearer should only attract a nominal administration charge as the physical activity has been completed at the bearer level. For the circuits within a bearer to complete migration only a paperwork activity is required. Consequently a charge representative of this non physical activity should apply. Without cost effective migration options cost minimisation is not within the gift of OCPs.

Ofcom correctly identifies that BT has a clear incentive to raise POH charges as this not only increases its profits but it also raises rivals costs. We can be sure that BT will respond to this consultation claiming that costs are far higher than Ofcom identifies. Given that BT's systems are clearly unable to cost account to the levels required for accurate costing of this service we suggest that any new claims and evidence from BT are treated with high levels of caution.

Ofcom suggests that the RPI control (which is RPI-0% on each of the POH rental charges) will give BT an incentive to minimise costs whichever recovery mechanism is selected. We disagree that the RPI control will be effective in this manner unless Ofcom has established genuine efficient LRIC starting charges for these services at the outset. In our view the most critical part of establishing the appropriate charges and incentives on both BT and OCPs is the Ofcom bottom up modelling and the related cost of migration from inefficient handover to efficient handover. Should Ofcom consider that these migration charges are beyond the scope of this review we suggest that Ofcom seeks a voluntary change of the charges from BT or that Ofcom considers that suspension of the charges for a defined period which would enable OCPs to have a window opportunity to restructure their network to eliminate these costs and charges without being prevented from doing so by penalising and disincentivising migration charges.

3. Do respondents agree that option 4 is most consistent with the distribution of benefits of principle?

We agree with this approach.

4. Do respondents agree that option 4 is most consistent with the effective competition principle?

We agree with Ofcom's assessment. We also believe that the materiality of Ofcom's decision could be greater than currently calculated should Ofcom adopt our proposals for its bottom up model. This would strengthen the pressures for effective competition over the course of this market review and the up coming market review period.

5. Do respondents agree with our analysis of practicability?

We believe that setting charges on the basis of a bottom up LRIC model designed and calculated by Ofcom is the most practical solution to derive appropriate, fair and transparent charges. Ofcom has had to rely in part on using adjusted charges for other similar regulated services. We believe that this approach brings credibility to the charges, although some minor change is required to the selection of the appropriate comparator charge.

6. Do respondents agree with our analysis of the four options?

Yes.

7. Do respondents agree with our proposed method for converting published charges into LRIC estimates, for use in our LRIC model? If not please explain why and propose an alternative approach including relevant LRIC/price ratios we could use?

We support the approach Ofcom proposes.

It is necessary for Ofcom to identify a methodology of transparently calculated LRIC charges. Ofcom proposes to derive a LRIC price by using a LRIC/price ratio using reported LRIC charges and reported revenues for relevant services from BT's regulatory financial statements 2009/10.

The analysis of this period gives a ratio of 69.6%. In order to accommodate known volatility in the LRIC numbers Ofcom has rounded up the ratio to 70%.

In our view Ofcom has taken a cautious and conservative approach.

8. Do respondents agree with the inputs we have used to estimate the annual rental charge for the duct and fibre used in the provision of POHs? If not please explain why and provide alternative data.

In order to determine an annual rental charge for duct and fibre used in PoH Ofcom has started out by using published Openreach charges for similar services. This is the correct approach. This approach is transparent and credible. Ofcom has used Openreach's excess construction charges.

However we believe that the approach adopted by Ofcom over estimates the extent of dedicated usage of duct and fibre by CPs. We suggest that Ofcom follows its approach of using the Openreach excess construction price list but reconsiders the relevant line item to be selected.

We recommend the charge for duct to use is:

*New Ductwork - Footway (includes wayleave costs) 30/08/2007 80.00*

This line item is the correct selection for POH rental input as POH is more likely to be in an urban location. This duct work can carry 240 fibres and we agree with Ofcom's approach of apportioning part of the duct costs to each fibre (i.e. dividing the cost by 240). In Ofcom's approach Ofcom adds in addition an element to cover the cost of cabling to the ductwork costs. In our method this is not necessary as cabling is included in the fibre cost.

We recommend the charge for fibre to use is

*Cable (fibre or copper) including any jointing required 30/08/2007 7.50*

We regard this charge more appropriate as a cable is provided into a CPs Point of Presence. The cable will be a 24 fibre cable. The appropriate number of fibres (2 or 4) will be used for the PPC Handover and other fibres will be used for other handover equipment relevant to other services handed over at the same Point of Presence.

An additional line is required between rows 7 and 8 in the duct and fibre sheet to account for the 24 fibre cable.

The model then needs to reflect how the different types of handover use fibres. An ISH extension uses 4 fibres. CSH (via single fibre working and a protection fibre), 4x2 and 16 x2 all use 2 fibres. We propose that Ofcom amends the model to reflect this differentiated use of fibre.

9. Do respondents agree with the inputs we have used to estimate the operational costs associated with POHs, especially in relation to network management costs? If not please explain why and provide alternative data.

In order to determine an annual rental charge for duct and fibre used in PoH Ofcom has started out by using published Openreach charges for similar services. This is the correct approach. This approach is transparent and credible. Ofcom has used Openreach's LLU charges.

For accommodation Ofcom has used the co mingling charge of £257 per square metre which equates a LRIC price of £180. We agree with the approach.

In order to obtain a charge for rack space Ofcom has taken all of the 7 options for LLU rack space totalled the charges and divided by 7 to obtain an average of the published price. We believe that this approach needs to be built upon in order to derive a proxy for a charge that BT could reasonably expect to occur. Ofcom should look again at the charges and seek to find the most efficient option and assuming that BT would make the most efficient decision when designing and building its network it would be the most efficient rack charge that would apply. Ofcom's input model shows the most efficient option on a LRIC basis is a rack space unit that

can hold 6 units at a per unit price of £601.53 (E18 Operational costs). It is this unit price that Ofcom should use in the revised model.

In order to obtain a price for power Ofcom has taken the same approach as for rack space taking the 8 published power prices and averaging them to obtain a price. Again it is our view that BT as efficient operator would seek the optimal power arrangement and therefore the appropriate price to use will be the lowest published price of 6p (E34 Operational costs).

Ofcom identifies the category of network management costs which need to be recovered. Ofcom has used a percentage of 23% of operational costs to calculate network management costs. In the model this presently equates to £1,136,099 of cost. We disagree with this calculation. There are a number of issues with the proposal to recoup network management costs:

- Intuitively 23% of operational costs appears too high.

We have sought to provide Ofcom with an internal view of an appropriate figure. Our internal experts have identified for us that there is not a clear definition of the term network management costs. Internal calculations have included costings for spares which Ofcom in its model accounts for under a separate line item.

- Is there a standard definition of what components are included within the category of network management costs?

We believe that Ofcom needs to clarify the categories of cost that are included in its percentage assumption to ensure that double counting is not occurring.

Another view from our business is that the incremental cost to BT of providing PoH services beyond the cost of providing its network management for other BT services would be negligible. BT just like ourselves will have fixed costs for providing its network management centre and maintenance contracts. These arrangements are unlikely to vary by volume. [text removed] We believe that PPC PoH boxes represent only a very small proportion of all the boxes in BT's

network. Even if charges were on a fully allocated basis rather than a LRIC basis we find it hard to believe that the cost could be as high as is proposed. We suggest a better question to consider and answer in order to attribute an appropriate costs would be what percentage of BT's overall network does PPC PoH account for and what would this percentage increase BT's overall network management costs by.

- By how much does providing PPC PoH actually increase BT's network management costs?

In the event that BT is not able to provide robust evidence of a genuine cost we propose that Ofcom adopts a much lower uplift for network management costs if it is indeed necessary to include an uplift at all.

10. Do respondents agree with the inputs we have used to estimate the support costs associated with POHs? If not, please explain why and provide alternative data.

Our understanding is that PPCs as a whole have two full time product managers in BT Wholesale and PoH is only a relatively small part of that. Clearly there are some other admin costs such as pricing, but prices should only need to be updated once per year and do not require anything close to a dedicated person just for PoH. Therefore we would expect incremental demand for SG&A for PoH would be no more than one FTE in aggregate.

11. Do respondents agree that we should use our own bottom up model to set the level of additional POH costs to be recovered?

We believe that Ofcom has created a model for an appropriate bottom up model. The cost categories included are relevant. The costs found within them can be tracked and audited to credible cost sources. Over the extended course of consultation on this matter BT has demonstrated its own costing system to have numerous failings. We have little faith in BT's own model. Of course the incentives of greater profits and higher costs for competitors direct BT to find a higher level of costs or methodologies that result in higher costs.

12. Do respondents agree that we should not differentiate Type II POH charges between SDH and PDH technology?

We agree with the proposal not to differentiate between Type II SDH and PDH POH.

13. Do respondents agree that we should not set a single charge per SDH POH by capacity (irrespective of whether they are Type I or Type II)?

We agree that the current proposal raises cost and charges appropriately.

14. Do respondents agree that we should not disaggregate the current bearer charge for Type I POH further?

Yes there is no merit in taking further disaggregation as Ofcom identify such a small amount of difference to the costs which will be outweighed by additional cost of managing more price points.

15. Do respondents agree that we should implement the additional POH charges as set out under Option C1, where we have proposed a one off decrease in Type I POH charges to LRIC, whilst Type II POH charges are increased to LRIC in two phases?

We agree that Ofcom should bring PoH charges into line with costs. It is important that the model adopted is sustainable into the future. We believe this is best achieved by having a model which correctly reflects the costs driven by the type of handover.

We agree with the approach that Ofcom proposes of bringing the costs of POH Type II into line over a phased period. It is Ofcom's standard practice that where charges are materially out of line with costs that they are brought back into line via a one off adjustment. In the case of Type I charges, which Ofcom finds to be some 72% - 85% above cost, the case for a one off adjustment is clearly present. Where charges are not materially out of line Ofcom prefers a

glide path. In the case of Type II charges where current charges are circa 30% below cost Ofcom proposes a two step glide path which immediately raises Type II charges by 18% and implements fully cost orientated charges less than 9 months later.

It is precisely this kind of approach to price adjustment that Ofcom communicated in the LLCC statement and to the Competition Commission during the LLCC Appeal.

Notably under Ofcom's proposals BT is not prevent from recovering its costs as these can be recovered via other PPC services. Moreover proposals importantly provide CPs with a reasonable amount of time to make adjustments to their network in relation to the use of inefficient handovers.

16. Do respondents agree that BT should be allowed to increase Type 1 POH charges by RPI-0% (between October 2011 and 30<sup>th</sup> September 2012), whilst it is required not to exceed the Type II POH charge levels proposed by Ofcom?

Our views on this are dependant upon timing. Should Ofcom only implement the pricing proposed in late summer i.e. not long before October 2011 then we are of the view that Ofcom will have modelled that latest appropriate costs for this service and then therefore it is not appropriate for BT to then have the ability to immediately raise the charges.

17. Do stakeholders agree that the required notification period should be waived in respect of the proposed changes to Type I and Type II POH charges?

Yes.