Virgin Media's response to Ofcom's Consultation on Excess Construction Charges for Openreach Ethernet Access Direct.

14 March 2014

Introduction

Virgin Media welcomes the opportunity to comment on the proposals put forward by Openreach to restructure its pricing for EAD Services.

The proposals fundamentally affect the pricing structure for new circuits, to the extent that without regulatory intervention by Ofcom, they would breach SMP conditions set under the recent BCMR. BT holds SMP in relevant AISBO markets and therefore any regulatory intervention needs to be carefully considered. The complexity of the analysis undertaken in the BCMR was notable in order to ensure that the proposed suite of regulatory conditions was appropriate to ensure their objective fitted with Ofcom's duties under sections 3 and 4 of the Act.

The proposals made in this consultation are notable for two reasons, firstly, they represent a marked change in pricing policy, moving away from a cost-oriented approach to setting of service charges, and secondly, that the analysis and impact assessment of the proposals seems to lack the in-depth consideration afforded to the imposition of regulation within this market.

Virgin Media consider that the need to enable BT to meet self imposed commercial pricing change deadlines should not mean that an appropriate consideration of the issue of changing the regulatory scheme should suffer. In this regard we would encourage Ofcom to take note of the comments made in our response, and along with any other responses received from stakeholders consider whether additional investigation needs to be undertaken to determine the effect of this proposal on relevant markets. That this may overrun BT's price change window is irrelevant to the need to give appropriate consideration to this issue.

Ofcom's assessed benefits

Ofcom consider that there will be efficiency benefits from the proposal to create a generic ECC Connection Charge. The proposed time saving would affect 22% of EAD orders, reducing one element of the process by removing the need for ECC approval.

It is of note that the vast majority of EAD circuits 70% do not require any ECC, and 8% would continue to require ECC Approval (being outside the "inclusive work" element).

Therefore the benefit only relates to a minority of circuits, and even for those circuits the bulk of the time related to ECC work (planning, survey, engineering and fit and test cycles) will remain unaltered.

Ofcom's assessed disbenefits

Ofcom identifies that there are distributional effects that arise from Openreach's proposal. In effect an EAD circuit that incurs no (or little) ECC will cross subsidise EAD circuits that require in excess of £548 of ECC.

Whilst it is correct to say that all CPs purchasing EAD will be in the same position, in that the additional ECC Connection Charge will be levied to all purchasers, the lack of analysis of other distributional effects on the market is a concern.

Ofcom make reference to assessing the level of this distributional impact in paragraph 4.24, stating that a hypothetical loss to net losing CPs would amount to £115 per EAD order. This analysis is not further explained, either in Section 4, or in an Annex. It appears to Virgin Media to be unsupported, and we do not understand how Ofcom has arrived at its assessment.

Virgin Media consider that there are a number of scenarios that do not appear to have been fully considered by Ofcom.

Scenario 1

A CP that competes with BT using its own infrastructure to connect to customers will face a significant change in competitive dynamics. Consider two types of customer; customer A, who does not require any civils work to connect (for example being co-located in a connected building), and customer B who requires some civils work to effect connection, and the cost of that work is >£2500 (a modest assessment).

Whilst the infrastructure CP would be able to compete with BT (and other CPs purchasing BT inputs) more readily for Customer A (as it would not need to incur the subsidising ECC Connection Charge), it would be disadvantaged when competing for Customer B's business, as Openreach would be able to supply the re required civils work on a subsidised basis with the £548 ECC Connection Charge covering the first £2800 of work (a subsidy of £2252 per circuit).

This will change the "make or buy" decision for the infrastructure owning CP and potentially create a situation where inefficient "buy" decisions (from a cost perspective) are made in order to compete in the subsidised environment.

We have also sought to consider to what extent the proposal would favour BT over other CPs. BT have a market share of 74% in the AISBO market excluding the WECLA[1]. This can be assumed to vary within the market,

[1] Paragraph 7.364 / Fig 7.12 BCMR Final Statement 2013

logically being lower in areas where there is more competition and higher in areas where there is less competition from other networks.

Where existing business are in clusters (for example a business park), and there is more competition, then existing fibre is likely to be prevalent and additional/substantive construction is unlikely to achieve connection (a "Customer A" scenario); where there are fewer customers to service there is less likely to be such ease of connectivity, and additional construction work is more likely (a "Customer B" scenario). As BT is likely to have a higher market share in "Customer B" areas, it is also likely that they will be able to benefit more than other CPs from the subsidy offered by the ECC Construction charge. This means that not only are BT able to make cost savings in reaching "Customer B" (subsidised by connections to "Customer A"), but also consolidate the lack of competition in these areas.

In order to illustrate the point, we have, at Annex 1, set out some example numbers which demonstrate a considerably increased cost saving to BT Group over other CPs as a result of the proposed changes.

Scenario 2

When provisioning a new EAD circuit CPs will often not be installing new connectivity to a customer. Many CPs have legacy WES/BES estates and will from time to time seek to migrate these circuits to EAD, incurring no new civils work[2]. The levy of an ECC Connection Charge for a new EAD circuit would appear to be entirely inappropriate in these circumstances and would create an effect that would discourage CPs from modernising their Ethernet estate, reducing benefit to end consumers.

In relation to these types of circuits, it could well be that, on their initial installation, an ECC was paid to Openreach. It would run entirely against common sense and logic for a re-provision of such an existing circuit should incur any costs that cover Excess Construction when this is neither required and would have already been paid historically.

No analysis has been undertaken in relation to the size of WES/BES vs EAD estates as between BT Group companies and other CPs, which may indicate if there is a potential distortion of competition in the market.

Other factors

Additionally, no account has been taken of the effect on relevant initiatives to roll out high speed data connectivity. For example, the Government "voucher"

[2] Similarly, where an existing EAD circuit is shortened, a new circuit and connection fee is levied by Openreach, but no new civils are relevant. The same logic applies that the provision of a new circuit where there is existing Ethenet connectivity, should not attract any ECC element.

scheme already provides for a contribution to capex costs in 22 cities, and this proposal may overlay an additional benefit of further subsidising capex for a SME considering an upgrade to an Ethernet connection. This may make BT a preferred supplier in these particular sub-markets. No effect on competition in this regard has been undertaken.

Conclusion

Virgin Media consider that Ofcom's current assessment of this proposal is flawed in that:

a. it fails to take account of all relevant impacts on competition in determining whether the proposal meets relevant statutory tests; and
b. it fails to undertake a sufficient analysis of the distributional effects on CPs and underlying competition within the market; and/or
c. there is insufficient evidence presented in the consultation of the impact of the distributional effects to allow for informed comment by stakeholders.

Therefore, Virgin Media suggests that further work needs to be undertaken by Ofcom before it is in a position to consider whether the proposal, as put forward by Openreach, is appropriate. In the interim any change to the regulatory landscape should not be made and the proposed Direction should not be enacted. In the event that a Direction to create an "ECC Connection Charge" is deemed to be appropriate, Virgin Media consider that such a charge ought not to be levied on circuits where there is existing Ethernet connectivity in place already (such as migrations).

Virgin Media
14 March 2014

Annex 1

Effect of Proposed ECC Connection Charge for BT and other CP costs.

The attached Excel spreadsheet contrasts the incurred costs under the 2013-4 (Relevant Year 1) and 2014-2015 (Relevant Year 2) of the LLCC.

Three market scenarios are considered:

a. BT market share of 60%
b. BT market share of 75%
c. BT market share of 90%

These reflect plausible scenarios within the AISBO market, reflecting areas of above average business presence (a) and below average business presence (c), when BT's market share will vary from its assessed level in the BCMR (b).

The likelihood of needing ECC in areas where there is above average business presence is lower than in the "average" area. Conversely the likelihood of needing ECC in areas of below average business presence is higher. We have reflected this by flexing the 30% ECC level (quote in the consultation) by 15% in each case (to 15% and 45% respectively).

We have then compared the likely cost incurred by BT in reaching its "share" of customers both under cost conditions pertaining in the current year of the LLCC and in the next year, assuming the proposal for an ECC Connection Charge is implemented.

The result suggests that the cost reduction benefit to BT is greater than to other CPs, which in turn gives rise to a concern that the proposal may not be competitive neutral as suggested by this consultation.

The very basic modelling provided, along with its assumptions, is simply illustrative that further investigation into the competitive effects of the proposal need to be undertaken to determine the full effect of the proposal on the market beyond the simple benefit of a reduction in customer approval times within the EAD ordering process.