FIXED ACCESS MARKET REVIEWS: APPROACH TO SETTING LLU AND WLR CHARGE CONTROLS

CONSULTATION RESPONSE BY COLT TECHNOLOGY SERVICES

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About Colt

Colt is Europe's information delivery platform, enabling its customers to embrace the changing landscape of IT and communications so they can deliver, share, process, and store all of their vital business information.

Colt aims to inspire customers to think differently about the way they tackle their core business and technology issues. Colt's information delivery platform combines high performance, end-to-end control of integrated compute and network solutions with an agile and responsive approach that delivers an integrated experience across Europe and beyond.

Today, Colt runs a 22-country, 43,000km network that includes metropolitan area networks in 39 major European cities, with direct fibre connections into 20,000 buildings and 20 Colt data centres.

Colt enables its customers to deliver, share, process and store vital business information by bringing together 3 key elements:

- Pioneering European Ethernet and IP networks that seamlessly connect over 100 cities and achieves the industry's highest standards in performance, latency and security.
- Significant IT infrastructure and services across Europe, with 20 state-of-the-art data centres with tens of thousands of devices under management.
- Extensive expertise in creating integrated IT managed services, networking and communication solutions.

Colt is continuing to invest heavily in its ability to deliver integrated network and IT managed services. Colt is also helping to lead industry standards and certification for cloud services.

Introduction

In previous market review responses, Colt has argued that Ofcom needs to take more explicit account of the linkages between the FAMR, WBA and BCMR markets. This is because of the high degree of commonality in the inputs and the scope for remedies to have (both favourable and adverse) impacts on adjacent markets. Most importantly, remedies applied in the FAMR acutely affect incentives to invest in the BCMR markets and vice versa. Ideally, the markets should be analysed together.

Our approach to the present consultation follows a similar vein. Rather than commenting on the detailed issues in designing the charge controls for WLR and LLU (ie cost allocation and model), we focus on the larger issue of Ofcom's approach to setting charge controls across linked markets.

The freedom afforded to BT in the way it recovers common costs allows it to move costs from one market to another without offering OCPs a proper justification. Moreover, the separation of the market reviews (both substantively and in timing), creates inconsistencies and scope for gaming that can only be addressed by considering the approach holistically (across both markets simultaneously).

Questions and concerns raised by BT suggested changes to the 2013 RFS

In terms of our response to question 7.5 of the condoc, we understand Ofcom's underlying reasons for choosing "*to update the cost model base year information for the most recent 2013 RFS cost information (adjusted as proposed in this Consultation) while retaining the 2012 RFS allocation methodologies"*. Since BT is actually proposing to move a large amount of cost from products reviewed in the BCMR to products reviewed in the present consultation, it would indeed be unacceptable for Ofcom to accept those methodology changes as a base to design charge controls in the FAMR and, as a result, allow BT to recover these costs twice. However, the process as it currently stands cannot properly address the (in our view) more fundamental problem, which is BT's freedom to allocate costs in whichever way it will, thus allowing it significant scope for strategic gaming of the cost allocation and market review processes.

Indeed, they have removed cost from BCMR products just at a time when the BCMR price cap is not under review, while allocating costs to FAMR products at an opportune time. While not wishing to impugn BT's motives in any way, it nonetheless highlights the nature of BT's strategic control over the entire industry and its ability to manipulate outcomes within the market review process to its advantage. This is a point that we will return to later – the key point in this context is that greater clarity is needed on the rationale behind the proposed reallocation. For example, if the proposed reallocation were to be warranted and possibly accepted in the future, then clarity is needed on why costs had been so clearly misallocated for such a long period of time.

We understand why Ofcom has decided against undertaking an item-by-item assessment of each of the methodology changes suggested by BT that might have an impact on the design of the WLR and LLU. Indeed, such an analysis would take too much time and significantly delay the implementation of the charge controls. However, there are questions that need to be answered and concerns that need to be addressed. As a result, we would seek clarity on several aspects such as the suggested and past nature of the costs themselves and also their allocation. Our primary concerns and questions are listed in a report[1] that Colt, in association with some other UK CPs, commissioned from BRG. Separate and apart from those issues, below are some additional issues on which we would welcome further clarification:

- Some of the methodology changes suggested by BT result in a reduction of PPC and Ethernet costs and in an increase of WLR and LLU costs, however, it is not clear to Colt why those costs were originally allocated to Leased Lines in the first place. An example is "SFI's (TRC's and Broadband Boost)" costs. We understand these are costs incurred for problems affecting DSL and broadband speed. Similarly, "Provisions" costs only seem to relate to copper lines.

  Colt understands the need for a change by moving the costs from Leased Lines to more appropriate products, however, we would also need to understand why it has been done differently and how that might have affected BT's regulated prices in the past.

[1] Final BRG Executive Summary Report on BT RFS13 - Berkeley Research Group, December 2013

- Two of the suggested methodology changes have a significant impact on regulated Leased Lines products: “Openreach computing and Development costs” decreasing costs of the Ethernet market by £39m and “21CN” costs decreasing costs allocated to the PPC market by £14m. This clearly illustrates the extent of BT’s freedom to play with its costs across regulated markets but, most importantly, it demonstrates how a significant impact on the market can result from a single methodological change. Even though Ofcom does not seem to be accepting BT’s 2013 RFS, the mere fact that BT holds this level of power is a concern for the industry. Indeed, since the RFS is the cost base Ofcom uses to define charge controls, giving the power to BT to determine its cost allocation across different markets, distorts the impact of Ofcom’s remedies.

Therefore in Colt’s view, Ofcom’s favoured approach of giving such a wide degree of discretion to BT is inappropriate and provides no basis for any confidence in the efficacy of Ofcom’s remedies. This is particularly true where linked markets are reviewed in separate processes and at different times.

The blatant misallocation of costs (even in regard to very simple matters) that has apparently been going on for years makes a mockery of the policy of granting BT such a high degree of freedom, and merely serves to underline the degree of strategic control that it exerts over the entire market. This is self-evidently true in regard to the allocation of costs.

Equally important, however, are the implications for the wisdom of allowing BT such a high degree of freedom to set wholesale prices under the price cap approach. The systemic nature of many of these errors must undermine policy arguments in favour of denying alternative operators access to passive infrastructure for business services (supposedly because it would disrupt BT’s incentives to apply a welfare optimising pricing gradient for all services that share common cost elements). BT’s inability even to get the simple things right would appear to cast doubt on any welfare benefits that it is able to deliver to customers by means of a perfectly constructed tariff gradient.

As suggested here and elsewhere, Colt’s suggestion is that Ofcom should at the very least, more explicitly consider the linkages between related market reviews, both in terms of the costs and in terms of the impact of remedies. This would most likely require the markets to be reviewed at the same time and perhaps under a single process.

Need for a change in Ofcom’s approach to set charge controls

As described above, greater clarity is needed regarding the content and application of BT’s RFS and, therefore, the basis on which Ofcom implements its charge controls. However, more fundamentally, BT’s suggestion to shift costs between BCMR and FAMR markets (as shown by Figure 7.1) is an illustration of the extent to which these markets are linked.

Since FAMR and BCMR involve similar inputs, reviewing the markets separately affords BT the opportunity to move costs around as it wishes between the two different time periods. The current process makes it very difficult for Ofcom to ensure that the right cost allocation is in place when designing the appropriate charge control. This kind of difficulty is then likely to arise at each period of respective market reviews. Furthermore, if the proposed reallocations are of a substantial magnitude (as is the case for the 2013 RFS), CPs and Ofcom will notice the impact and prevent BT from over recovering its common costs. However, it is not impossible for BT to make smaller changes and slip them in under the radar.

Reviewing BCMR and FAMR markets together would reduce the risk of this type of distortion occurring, as well as offering potential benefits in that it would allow Ofcom greater scope to consider the impact of proposed remedies on the adjacent market.

Moreover, as explained above, we understand Ofcom's approach "to update the cost model base year information for the most recent 2013 RFS cost information (adjusted as proposed in this Consultation) while retaining the 2012 RFS allocation methodologies" and the underlying reasons for doing so. However, this approach must surely only be a temporary solution pending greater clarity and transparency on the RFS, and finding a solution that fulfils the objectives of a) being correct in the round; and b) preventing BT from over recovering its common costs.

Indeed, when examining the changes in BT's RFS methodology and the potential implications for charge controls, as a relatively important leased line user, Colt wonders whether the Leased Line Charge Control has been appropriately designed. At the moment, BT seems to be implying the RFS cost allocations used for setting the LLCC were incorrect.

Conclusion

Colt believes an appropriate way to address the issues faced by Ofcom and the industry regarding the design of charge controls would be the following:

a. Set a temporary charge control for WLR and LLU as Ofcom is suggesting,

b. Work towards obtaining a better understanding of the RFS cost allocations changes,

c. Restrict BT's freedom to decide the implementation of those allocations,

d. Review the FAMR, WBA and BCMR markets together, including the charge controls

Such an approach would offer the following benefits:

- Avoid over recovery by BT,
- Allow a more consistent and holistic approach to market reviews that allows: a) consistency in charge controls and b) the impact of remedies on adjacent markets to be more explicitly evaluated
- Allow greater transparency for industry in terms of the underlying methodology used in setting charge controls.