

**Wholesale Local Access Market Review  
Consultation on pricing proposals for Duct and Pole Access  
Remedies**

**TalkTalk's response to Ofcom's consultation document**

**12 September 2017**

**NON-CONFIDENTIAL VERSION**

This is TalkTalk's response to Ofcom's consultation on pricing proposals for Duct and Pole Access remedies ("the consultation") published on 1 August 2017.

## 1 Overview

- 1.1 Access to BT's ducts and poles enabled by an effective Physical Infrastructure Access (PIA) remedy could play an important role in supporting investment in the deployment of ultrafast broadband networks at scale by competing players. [REDACTED]. With an appropriate regulatory environment, consumers and businesses will benefit from FTTP networks offering a step change in speeds to 1 Gbit/s alongside greater reliability than traditional copper networks.
- 1.2 Price regulation is required to ensure PIA is an effective SMP remedy. BT would otherwise have both the ability and incentive to set excessive prices for PIA to deter its use by competitors, protect its market power in broadband infrastructure, and maximise its profits. For the PIA remedy to be effective, PIA pricing must be:
- set at a low level (no higher than is necessary to allow BT to recover its costs);
  - predictable over time (so investors can develop effective and financeable business plans for network roll-out involving the use of PIA); and
  - transparent (so Ofcom and other stakeholders can assess the effectiveness of the remedy and hold BT to account).
- 1.3 We therefore welcome Ofcom's confirmation in this consultation that it plans to set regulated price caps for PIA rental charges and introduce other measures to bring greater certainty and transparency around PIA pricing. We note that the illustrative rental charges calculated using the proposed methodology are lower than current prices across almost all products. Our initial analysis suggests that in our case average PIA costs to use BT's ducts and poles will reduce by [REDACTED].
- 1.4 We are planning to complete further analysis of how we could use PIA as part of our FTTP network deployment plans and the impact on overall costs. [REDACTED]. Looking at the role that PIA could play in connecting customers we observe that:
- [REDACTED].
  - using BT's ducts to connect customers would be more expensive than poles at £18.97/year per joint box splice (plus the per metre duct cost) despite the per splice charge representing a 40% decrease compared with current charges.
- 1.5 [REDACTED]. Enabling CPs to use PIA to deploy fibre networks faster than they would be able to build their own networks is critical to its success. In particular, aerial

access will be important in enabling providers to reach wider areas more quickly so it is critical the product is fit-for-purpose and appropriately priced to avoid full fibre not-spots within roll-out areas. Furthermore, the broader benefits of ensuring providers have the incentive to use BT's poles must be considered given the disruption and visual pollution that would be caused by any attempt to build a parallel network of poles alongside existing infrastructure.

1.6 In addition to PIA price reductions and capping, the systems and operational improvements outlined in Ofcom's previous April 2017 consultation (which we provided detailed comments on in our June 2017 response) are fundamental to the effectiveness of the remedy. Ease, predictability and greater automation of processes are essential to enable CPs to industrialise the use of the PIA product at scale to enable faster network deployment. Historically, BT has made it difficult to use PIA and the whole system for consuming the product must be radically changed in order for it to be widely used. [REDACTED]:

- Reform of the processes and requirements for service accreditation, training and forecasting to ensure they are efficient and proportionate;
- Assurance of the confidentiality of information shared with Openreach about PIA plans so that it is only used for the purposes of providing PIA;
- Improved accuracy of Openreach data to avoid delays and additional resource overheads during planning and build, with standards for accuracy reflected in the SLA/Gs;
- Fully automated ordering processes;
- Digital Mapping Tools, including functionality for integration with PIA customers' systems;
- Clear, timely processes and SLA/Gs for Openreach to relieve congestion to make PIA ready-for-use and for customers to carry this work out on their behalf.

It is important that Ofcom sets out specific parameters within which the SLA/Gs should be agreed when making its statement to minimise the risk of BT watering down the proposals through the industry negotiations. The parameters should include the requirement that the full set of SLA/Gs include measures that will mean penalties apply if minor disruptions at specific points in the process add up to result in significant delays overall.

1.7 [REDACTED].

1.8 [REDACTED].

1.9 This response includes:

- Section 2: comments on the proposed approach to capping PIA rental charges;

- Section 3: comments on the proposed approach to ancillary charges and the financial limit for network adjustments; and
- Section 4: comments on the proposed approach to amending BT's regulatory financial reporting to support the revised PIA remedy.

1.10 In summary, we support Ofcom's proposals to:

- Impose maximum price caps on PIA rental charges from 1 April 2018;
- Change the treatment of network adjustment costs and productisation costs so that they are recovered across all SMP products;
- Require BT to update its regulatory financial reporting to reflect the changes to the PIA remedy and provide greater granularity of data to support the introduction of a fully cost-based charge control in the future.

We set out these areas for further consideration by Ofcom:

- Whether a financial limit for network adjustment costs is a necessary or proportionate requirement to deter inefficient requests; and
- The scope for developing the cost methodology to support simplification of the PIA product set.

## 2 PIA rental charges

***Question 3.1: Do you agree with our proposals for setting the level of the cap on PIA rental charges? Please provide reasons and evidence in support of your views.***

- 2.1 We support Ofcom's provisional conclusions in the April 2017 consultation as summarised at §3.3: a cap on PIA rental prices is required to ensure BT does not set excessively high prices to impede competition and to provide the necessary certainty to build investor confidence in deploying networks using PIA. In the long-run Ofcom's objectives will be best met by introducing a fully cost-based charge control on PIA.
- 2.2 In the absence at present of sufficiently granular information in BT's accounts to set a price cap based on BT's fully allocated costs, Ofcom reached the provisional conclusion in the April 2017 consultation that it should adapt BT's current methodology to determine the price caps for this review period. Ofcom sets out more detail on its proposed approach to adapting the methodology in this consultation and we provide our comments on the approach below. In general, we do not think that Ofcom should limit itself to only modifying BT's cost attribution methodology when Ofcom considers such methodology "clearly inappropriate" as this continues to provide too much discretion to BT (§3.14). Ofcom (rightly) did not restrict itself in the Cost Attribution Review work it completed. Ofcom must strive to improve the methodology as far as possible now by taking a more rigorous, bottom-up approach to support PIA

becoming a viable product and lay the groundwork for moving to a cost-based charge control.

- 2.3 We note that Openreach was not able to share the evidence for the assumptions that underpin the calculations for the asset cost component for the different box-related PIA rental products nor the differentiation between pole related products. This is unsatisfactory in light of BT's obligations under the basis of charges conditions to evidence and justify its charges to Ofcom.

#### Attribution of duct asset costs to PIA

- 2.4 We do not consider that the methodology for the derivation of the asset cost component results in a 'level playing field' (as is Ofcom's objective). The approach proposed is that the share of the asset cost of a duct attributed to PIA rental charge is  $1/N$ th of total cost where N is the number of sub-duct equivalents in use by BT (prior to PIA being used). To use a simplified example to illustrate the point:
- For a 2 bore spine duct the total cost is 80p per metre
  - There are 4 sub-duct equivalents used by BT
  - The cost attributed to PIA is  $80p / 4 = 20p$  per m
- 2.5 The impact of this is that after PIA is used BT pay less per sub-duct 15p (=  $[80p - 20p] / 4$ ) than other CPs (20p). This results in an uneven playing field and is discriminatory.
- 2.6 This can be simply addressed by dividing the cost by 'N + 1' i.e. the number of sub-ducts in use when PIA is used. For example in the case above setting the PIA attribution at 16p (=  $80p / 5$ ) would mean that BT and CPs pay the same per sub-duct. This would also remove the need for the 50% cap (see consultation §3.32).

#### Scope for product simplification and development

- 2.7 We note that Ofcom plans to set PIA rental price caps for the existing Openreach product set. It dismisses the arguments for product simplification, put forward by Cityfibre and Call Flow in response to the December 2016 consultation, arguing that there is no evidence that the current disaggregated approach is inappropriate. We think this may be short-sighted and consider that Ofcom should explore how it can make further improvements to the methodology to support product simplification. This is an important element of making the product suitable to consume at scale, alongside the process and systems improvements put forward in the April 2017 consultation.
- 2.8 The complexity of PIA is a significant barrier to its use and there is a risk that the current product structure leads to Openreach over recovering its costs across a combination of PIA products. A streamlined product set would remove operational complexity and improve predictability in terms of ordering

and record keeping and the associated overheads. If there is a case for keeping the current levels of product disaggregation, BT should be required to demonstrate this.

- 2.9 We would particularly welcome product simplification in relation to the following:
- A single per metre charge for spine duct rather than differentiating by the number of bores;
  - Incorporating joint box charges within the per metre duct charge rather than maintaining separate charges for joint box entry and exit, cable coils and in-line splice hosting;
  - A single price for a pole mounted distribution point (rather than separate charges for single and multi-end-user attachments and manifolds) and a single price for each dropwire or cable attached to the pole.
- 2.10 As well as looking for opportunities for product simplification, Ofcom's PIA reforms must take account of different network architectures to ensure the product can be used as broadly as possible. For example, there is potential to use PIA more extensively to connect customer premises, particularly where there are challenges relating to wayleaves or digging through different surface types. Connecting customers using lead-in ducts could entail using a 6mm cable in a lead-in every 10 metres or so and running this 6mm cable back to a 25mm sub-duct containing multiple cables in the spine duct. Under the current charging structure, to run the 6mm cable between the premises and the spine duct, the CP would face rental costs per metre for the lead-in and rental costs for a 25mm sub-duct to connect the 6mm cable back to the spine duct, despite only using a fraction of the duct space. Given this likely network configuration for providers using ducts to connect customers, we think there is merit in requiring Openreach to offer rental of smaller diameters of duct space with lower associated charges as argued by other providers in response to the December 2016 consultation.
- 2.11 We understand that Ofcom may have concerns that the prices for a revised and simplified product set may not be cost-reflective or provide appropriate incentives for CPs. However, changing the pricing methodology to support these changes warrants further investigation given the significant operational advantages of simplifying the product set. Even if Ofcom is not able to implement these changes in this review, it should require Openreach to explore the potential for product simplification and development, and require it to collect the relevant cost data, during the preparation of the Reference Offer.

#### Other comments in relation to PIA rental charges

##### *Multiple cables and sub-ducts*

- 2.12 We support Ofcom's proposal to change the rules for how charges apply to multiple cables or sub-ducts as it will support the use case we describe

above, particularly where there is a requirement to run cables without housing them in sub-ducts. Where multiple cables or sub-ducts occupy a cross-section of duct no more than a 25mm sub-duct, the total charge cannot exceed the cap for a 25mm sub-duct. If they occupy more space, the maximum charge should be for the equivalent number of 25mm sub-ducts.

#### *Lead-in ducts*

- 2.13 Ofcom describes that, under the current methodology, rental charges apply for lead-ins for the time that the CP has cable installed in the lead-in. Therefore, when a customer churns the CP has the choice of leaving the cable installed and paying rental charges, or removing the cable to avoid continuing rental charges (§3.39-§3.42). We assume that this means that PIA rental charges for lead-ins are not subject to the five-year minimum term referred to at §3.71. We agree that lead-in charges should not be subject to a minimum term but consider that scenarios for customers churning and switching providers when PIA is used to connect to the premises require further consideration. Incentives must be aligned and service standards agreed to minimise delay and optimise a smooth customer switching experience. We think it would be appropriate for Ofcom to set out these principles in its statement and require Openreach and industry to agree the customer journey with associated SLA/Gs as part of the Reference Offer.

#### *New PIA rental products*

- 2.14 We understand that any new PIA rental products introduced by Openreach would be subject to the existing basis of charges condition. Importantly Ofcom has made it clear that Openreach cannot introduce new products which are essentially equivalent to existing products in order to avoid the price cap regulation. Risks of over recovery of costs across the whole PIA product set in the event new products are introduced will be taken into account when assessing compliance with the basis of charges condition (§3.13). Ofcom must take a robust approach to monitoring compliance with the basis of charges condition.

#### *Immediate price cap with yearly adjustment for inflation*

- 2.15 We agree with Ofcom's proposal that the maximum charges will apply from the start of the review period, rather than being introduced on a glidepath. Immediate introduction of the price caps is required to make the PIA remedy effective and ensure the benefits of the changes Ofcom is introducing to better align the costs faced by Openreach and CPs when using the infrastructure are delivered as soon as possible. There is no productive



efficiency benefit of gliding prices to final price (which is the normal reason Ofcom adopts for using glidepaths).

- 2.16 We also support Ofcom's proposal that the maximum charges will be updated for inflation each year, with reference to the Consumer Prices Index (CPI).

*Network adjustment and productisation costs*

- 2.17 We support Ofcom's proposal to change the treatment of productisation and network adjustment costs in order to set the price caps in a way that improves the viability of the PIA product and reduces the barriers to scale investment in PIA:

- Only allocating a proportion of the "productisation costs" – the costs of setting up and managing the remedy - to the PIA rental charges (recovering the remainder across other SMP products).
- Including a proportion of "network adjustment costs" – the costs of making the infrastructure 'ready for use' e.g. repairing blocked ducts - in the rental charges (recovering the remainder across other SMP products).

- 2.18 We agree that there is significant uncertainty around the overall network adjustment costs that Openreach will need to recover across all SMP products in this market review period. Ofcom sets out its approach to modelling and allocating these costs at §3.52-§3.55. Given the high degree of uncertainty associated with the assumptions made (including the typical network adjustment costs per premises passed and overall scale of new network roll-out using Openreach infrastructure over the review period), we suggest that it might be prudent to either:

- wait until the following charge control period to recover the actual network adjustment costs (in that period); or
- recover the forecast network adjustment costs in this review period but reconcile with the actual costs in the next charge control.

*WACC*

- 2.19 Although TalkTalk considers that Ofcom should use a consistent WACC estimate between DPA rental charges and MPF rental charges, we also consider that the estimate of the WACC for Openreach copper is excessive, and should be reduced to better reflect market conditions. Please see section 6.4 of TalkTalk's WLA response, and the supporting submission by Frontier Economics, for more details.

*Commencement of charges and duration of minimum term*

- 2.20 We note that Ofcom plans to defer agreement of the requirements for when PIA rental charges start and the duration of the minimum term to the Reference Offer. We supported the April 2017 proposal that rental charges should only start after BT has completed any necessary enabling works to



relieve congestion in the specified exchange area and think Ofcom should confirm this in its statement. However, we accept that the arrangements for when rental charges should start when the CP completes the enabling works on behalf of BT will require further consideration as part of the Reference Offer discussions. On minimum terms, Ofcom should set out parameters for BT and industry in its statement to frame the Reference Offer discussions.

### 3 Ancillary charges and the financial limit for network adjustments

***Question 4.1: Do you agree with our proposals for setting a financial limit for network adjustments? Please provide reasons and evidence in support of your views.***

- 3.1 We understand that the purpose of proposing to set a financial limit for network adjustments that can be recovered across SMP products is to encourage efficiency and low costs by deterring CPs from requesting enabling works when it would have cost less to build their own network. Considering that the average cost of own build is roughly [£<] per km (if we assume [£<] per premises costs \* 64 homes per km), we consider that the cost threshold of £4,000 to £6,000 per km is lower than it needs to be to achieve this objective. In fact, the threshold could be double this level and CPs would still be incentivised to choose the most efficient roll-out method. We acknowledge that there is considerable uncertainty around the total network adjustment costs that may need to be recovered through SMP products, but consider that this can be managed by the approach set out above.
- 3.2 In light of the significant uncertainty around average network adjustment costs and numerous assumptions required to project the scale of network adjustments that Openreach will be required to perform under the regulation, we think it may be more prudent not to set a cost threshold in this market review period while use of PIA develops. Instead, Ofcom could establish the principle that CPs should only require network adjustment under the regulation when it represents the most efficient roll-out approach. Openreach would then have the ability to dispute specific cases if issues arose. In addition, data could be collected in this period based on use of PIA and associated network adjustment costs to assess the reasonableness of CPs' requests. We think this would be a more proportionate measure at this stage of PIA's development and significantly reduce the complexity associated with implementing and administering the revised remedy.
- 3.3 If Ofcom is minded to set a cost threshold, we consider it should be set at a higher level of at least £15,000. This will ensure that CPs are on a more level playing field with BT yet will not create incentives to select inefficient roll-out.
- 3.4 We support Ofcom's proposal to exclude the cost of network adjustment for poles from any cost threshold.

***Question 4.2: Do you agree with our proposals for ancillary charges? Please provide reasons and evidence in support of your views.***

- 3.5 We agree with Ofcom's proposal to recategorise the activities in Table 4.4 as productisation activities and cap the charge to CPs for these activities at zero. We are comfortable that the remaining ancillary charges will continue to be subject to a basis of charges condition. However, we expect Ofcom to monitor the charges for these activities and if they become material, impose a price cap.

#### 4 Regulatory Financial Reporting

***Question 5.1: Do you agree with our proposals for BT's regulatory financial reporting in relation to PIA services? Please provide reasons and evidence in support of your views.***

- 4.1 We agree that Ofcom must impose additional regulatory financial reporting requirements on BT through the SMP conditions in order to monitor compliance with its regulatory policy for PIA. The additional requirements are also necessary to ensure sufficient transparency for industry to review the effectiveness of the regulation. We note that the transparency direction Ofcom proposed for the WLA market as a whole will apply to PIA.
- 4.2 Ofcom proposes to require BT to update its Regulatory Financial Statements (RFS) to reflect the different treatment of network adjustment costs and cost recovery under the revised regulatory policy (§5.5). We agree that these changes are required.
- 4.3 Specifically, we note that Ofcom proposes that BT includes the following financial information in the RFS:
- the revenue, volume and average price information for PIA services, split by PIA rental charges and PIA ancillary charges and reported separately for internal and external customers. Ofcom does not propose that this information is provided at individual product level due to low service volumes at present. Further, it does not propose a requirement for BT to publish the fully allocated costs (FAC) for individual services as this information is not currently recorded at this level of granularity.
  - internal and external revenues relating to network adjustment and related FAC in gross, relating to work above the cost threshold and the resulting net costs (for recovery across all SMP products).
  - the allocation of network adjustment costs below the financial limit recovered from PIA products and other WLA products.
- 4.4 We note that Ofcom also proposes for BT to provide it with the following additional financial information in confidence:
- further breakdown of PIA service revenues and volumes by the categories of service set out at footnote 144.

- where the revenue for a category of service is over £1m, the internal and external revenue and volume information should be broken down by service.
  - updated inputs for the PIA pricing model to track estimated costs against actual costs.
- 4.5 As explained above, we consider that Ofcom should not impose a cost threshold for the network adjustment costs that can be recovered across all SMP products. If Ofcom amended the remedy in this way the requirements for reporting the network adjustment costs in the RFS could be significantly streamlined to reflect this. We think the regulation would be improved by removing the complexity around the treatment of network adjustment costs.
- 4.6 Ofcom must also require BT to update the RFS to reflect the different treatment of PIA productisation costs and the recovery of these costs across all SMP products under the revised policy. It appears to be an omission in Ofcom's proposals for the revised RFS.
- 4.7 We agree that it is not necessary for Ofcom to require BT to supply any information on its compliance with the PIA rental price caps as stakeholders will be able to assess this with reference to the price list.
- 4.8 As noted above and in our response to the April 2017 consultation, Ofcom must work towards introducing a fully cost-based charge control for PIA. Ofcom will need to specify requirements on BT to record and report greater granularity of information regarding the costs of different network components associated with individual products to support this process. We note that it plans to include these considerations for PIA in a broader consultation on financial reporting for the WLA and WBA market reviews, which it will publish in the Autumn.

