WLA – Further consultation on proposed charge control for wholesale standard and superfast broadband

Virgin Media's response

06 November 2017

Non-confidential submission

Introduction

Virgin Media welcomes the opportunity to respond to Ofcom's further consultation on proposed charge control for wholesale standard and superfast broadband ("the consultation"). Many of the topics included in this consultation are subject to revision and Ofcom anticipates further information may come to light prior to the Final Statement. We welcome Ofcom's early engagement with stakeholders on these topics despite this uncertainty.

Ofcom's proposed approach to the treatment of uncertain costs is not consistent. Ofcom does not intend to introduce an adjustment for BT's higher pension costs because of insufficient information. In contrast, it proposes to reduce significantly BT's expected non-domestic rates costs, based on the recent revision to Virgin Media's rates.

We do not believe that Ofcom has sufficient evidence to determine the likelihood or scale of a reduction in BT's rates costs at this time; it is not clear that information from Virgin Media has any relevance to BT. Conversely, Ofcom does have sufficient evidence estimate the likely increase in BT's ongoing pension costs.

Consultation questions

Question 3.1: Do you agree with our proposed changes to forecasting BT's cumulo costs and our base case assumption that BT will be able to achieve a 25% decrease in its RV and therefore cumulo costs? Please provide reasons and evidence to support your answer.

Ofcom proposes to apply a 25% adjustment to BT's expected cumulo rates costs, informed by the reduction the VOA applied to Virgin Media following a reassessment of its Draft Rating List valuations in March 2017. In our view this approach is inappropriate.

The adjustment applied to Virgin Media is unlikely to provide much, if any, insight into any adjustment that may be made to BT's non-domestic rates costs, whether this occurs via further engagement with the VOA on its cumulo valuations in England, Wales and Scotland or following a successful appeal. The underlying network, data inputs, operating models and assumptions made by the VOA for Virgin Media may not be consistent, or indeed comparable, to those applicable to BT.

If additional evidence on the likelihood and scale of adjustments to BT's cumulo costs does not emerge prior to the Final Statement, we encourage Ofcom to be more cautious in estimating any adjustment to apply. Ofcom relies on both its ratio analysis and Virgin Media's adjustment. We do not believe that Ofcom has sufficient evidence that the adjustment is appropriate or that the basis for the level specified is well founded.

If the issue is resolved between the VOA and BT prior to the Final Statement, the basis of estimation becomes academic. If not, we encourage Ofcom to instead engage with BT to derive estimates of any potential reduction in non-domestic rates and the likelihood that these will occur. This evidence would provide a stronger foundation than arbitrarily applying a tweaked adjustment based on Virgin Media's evidence and ratio analysis that Ofcom itself admits, "*relies on several assumptions that might not be valid*".[1]

Ratio analysis

Ofcom has undertaken ratio analysis to determine whether it is able make reasonable expectations about the evolution of BT's cumulo costs, comparing data from BT, Virgin Media and KCOM. In doing so, Ofcom recognises that the analysis relies on a number of implicit assumptions that may not hold, for example:

[1] Ofcom, WLA Market Review: Further consultation on proposed charge control for wholesale standard and superfast broadband, paragraph 3.44

- *"that relative movements in RVs should be similar for different companies"; and*
- *"that the final 2010 list RVs were at the "right" level for each company and that the changes between the old 2010 rating list values and the 2017 list values should be similar".*

We suggest that similarly strong assumptions are needed when directly applying the VOA's adjustment to Virgin Media's RV valuation to BT. There should be a similar concern that these assumptions may not hold true. Despite this, Ofcom appears to place significant weight on the single data point derived from Virgin Media.

We agree that the ratio analysis does not reveal any obvious similarities between companies or over time to inform Ofcom's analysis. In our view, the only difference between the ratio analysis and Virgin Media's adjustment is that the latter is a single point estimate and so Ofcom can have no confidence about its applicability.

Range

Ofcom notes that its starting point for the cumulo adjustment is the reduction experienced by Virgin Media. Ofcom then specifies a range of 20-35% reduction and settles on a value of 25%, in part informed by the ratio analysis. It is not clear how this range was determined and it appears to have been arbitrarily defined.

We recognise that estimating any potential reduction is challenging, given the information currently available to Ofcom. However, we believe Ofcom has not been sufficiently conservative given this uncertainty. For example, Ofcom notes that, "*we do not consider it appropriate to assume that BT will not achieve any reductions*".[2] We find it surprising that Ofcom can reach this conclusion without evidence or rationale. Irrespective of whether BT proceeds with an appeal, Ofcom appears to be confident that it would be successful and that this will result in a 20-35% cost reduction.

Given the information available, we suggest this is, at best, a guesstimate. Ofcom has discretion to exercise its professional regulatory judgement, but the scale of adjustment it proposes is large, its cost implications are material and the justification provided is weak.

We believe Ofcom should have specified a more conservative adjustment to account for the possibility that BT does not achieve a reduction (or the reduction is modest) and that any reduction, if achieved via appeal, may come at a much later date.

[2] Ibid., paragraph 3.47

Timing and certainty

We agree with Ofcom that the timing of any adjustment in BT's RV valuation is subject to significant uncertainty. Ofcom notes that BT's previous appeals took five years to resolve. **[✂]**.

As Ofcom notes, if BT does appeal the RV, the appeal hearing would not begin until late 2018 at the earliest. In this scenario, even at the start of the next WLA market review Ofcom is unlikely to have clarity on the status of the appeal or the quantum of any potential adjustments.

If Ofcom does not have enough information to make a well-informed adjustment at this time, it has the option to wait; this is the approach it adopts for ongoing pension costs.

In any event, if BT has been found to over- or under-recover costs, this can be rectified in future market reviews. In our view, Ofcom does not have adequate evidence to introduce an adjustment to BT's cumulo costs at this time.

Consistency – cumulo and pensions costs

In response to the March 2017 consultation, BT informed Ofcom that it expects its ongoing pension costs to increase significantly. Ofcom says that it has insufficient evidence to assess any implications for the charge control because BT has recently announced a review of its defined benefits scheme.

It is not clear to us that the revisions made by the VOA to Virgin Media's RV (and inconclusive ratio analysis) provides stronger evidence to make an adjustment to the charge control, than BT's own recognition of a future cost to its business that is (at least in part) within its gift to effect.

Ofcom notes that it will take account of further evidence submitted prior to the Final Statement. Even if additional evidence is not submitted, Ofcom should reassess the consistency of its approach to BT's pension costs and potential for adjustments to the VOA's assessment of RV.

Question 3.2 Do you agree with our proposed changes to forecasting LRICs for copper services? Please provide reasons and evidence to support your answer.

Virgin Media has no comments on the proposed approach at this time.

Question 3.3: Do you agree with our proposed approach to implementing the QoS-related adjustments in the charge control? Please provide reasons and evidence to support your answer.

We agree with Ofcom's proposed approach to capture the likely increase in average payable days, associated with improvements in overall SLA standards. It is reasonable to expect so-called 'glass ceiling' jobs will constitute a greater proportion of faults that are applicable for SLA payments as Openreach improves overall fault performance.

Question 3.4: Do you agree with our proposed approach to implementing the proposed DPA remedies in the charge control? Please provide reasons and evidence to support your answer.

Virgin Media has no comments on the proposed approach at this time.

Question 3.5: What factors should we take into account in deciding if and how to update our assessment of pension costs in 2018/19?

We believe Ofcom should take full account of expected changes in ongoing pension costs faced by Openreach during the forthcoming market review period; provided these costs are efficiently incurred and can be estimated with an acceptable degree of confidence in Ofcom's regulatory judgement.

If Ofcom were aware of costs that are reasonably expected to occur and did not include the appropriate attribution of these costs to the charge control cost estimate, it would not provide BT with an opportunity to recover these costs.

We believe the increase in ongoing pension costs has already met the threshold for inclusion in this interim consultation.

Ofcom notes that BT is in the process of an employee consultation and that a range of options exists. Ofcom references BT's financial results briefing documents that discuss the future expected quantum of higher pensions costs. BT also provided Ofcom with its estimate of the implied unit cost per MPF rental, GEA 40/10 rental and GEA connection. However, based on information collected from BT using Ofcom's formal data collection powers, it was not able to arrive at an estimate to include in this consultation.

Clearly, BT cannot prejudge the outcome of its employee consultation process and Ofcom expects to have received further information from BT prior to the Final Statement. However, it would have been appropriate to include an estimate of the adjustment as part of this consultation; rather than publish BT's estimates and exclude them from the charge control updates.

As noted in response to Q3.1, Ofcom's approach to the treatment of estimated costs is internally inconsistent. Ofcom has included factors to reflect the potential for further network expansion, subject to agreement between Government and BT. Ofcom has also included a material adjustment for expected reductions in cumulo costs. However, it is not certain that either of these adjustments is needed. Even if they are required, the timing and scale of these cost modifications are subject to uncertainty.

In contrast, the increase in ongoing pension costs has been communicated to BT's shareholders. From a cursory review, BT's publication made no forward-looking statements on the financial implications of either non-domestic rates adjustments or its ongoing negotiations with Government.

Even in the case of consulting on changes to the level of ACPA cost associated with co-mingling rentals (on which we have no comment), Ofcom provided a broad range of estimates despite being unable to acquire sufficiently robust information from BT.

We would encourage Ofcom to take a consistent approach to how it treats adjustments to BT's cost base when the scale and timing of these changes are uncertain and subject to revision. Ofcom's approach seems opaque and its conclusions appear arbitrary.

Question 3.6: Do you agree with our proposed approach to implementing the impact from recovering the cost of investment in network expansion? Please provide reasons and evidence to support your answer.

Please see Virgin Media's response to Ofcom's previous consultation[3] on proposed amendments to the charge control to reflect BT's potential investments, should BT and Government reach an agreed approach.

Broadly, we agree that Ofcom's proposed methodology and approach would be appropriate. We agree with Ofcom's intension to use the WLACC as the mechanism to recover these efficient costs and to spread these costs across all broadband lines supplied by Openreach is reasonable.

Question 4.1: Do you agree with our proposals for controlling charges for GEA Cablelink and VLAN moves? Please provide reasons and evidence in support of your views.

Question 4.2: Do you agree with our proposals for forecasting tie cable service costs? Please provide reasons and evidence in support of your views.

Question 4.3: Do you agree with our proposals for forecasting co-mingling service costs? Please provide reasons and evidence in support of your views.

Question 4.4: Do you agree with our proposals for the MPF New Provides basket, the individual charge controls for MPF order cancellations/amends, and MPF Standard line test? Please provide reasons and evidence in support of your views.

Question 4.5: Do you agree with our proposals to GEA Cancel/Amend/Modify services? Please provide reasons and evidence in support of your views.

Question 5.1: Do you agree with each of our further proposals in relation to the implementation of charge controls for BT's LLU and VULA services? Please provide reasons and evidence in support of your views.

Virgin Media has no comments on the proposed approach at this time.

[3] Ofcom, Wholesale local access market review: Recovering the costs of investment in network expansion, September 2017