Virgin Media's response to Ofcom's Business Connectivity Market Review Consultation – Leased Lines Charge Control and Dark Fibre Pricing

10 August 2015

Non-Confidential Version

Leased Line Charge Control

Summary

1.1 As with Ofcom's review of the Business Connectivity Market (BCMR), the accompanying Leased Lines Charge Control (LLCC) consultation is a critical exercise: its outcome will have far-reaching consequences across the communications sector and for the UK economy in general, for years to come. In particular, it will serve as a key determinant of how private investors view the sector.

1.2 We set out in our response to the BCMR consultation why Virgin Media does not believe the proposed Dark Fibre Access (DFA) remedy is either necessary or appropriate, and why we consider there to be no case for its imposition. The concerns that we have identified have been a key factor in our consideration of the LLCC consultation – and we ask that our response to it be read in conjunction with our BCMR submission.

1.3 We reiterate, however, our view that the very imposition of a dark fibre remedy is likely to have damaging consequences for infrastructure investment incentives and undermine existing competitive markets. This will deprive the sector of the desired further investment in networks and services and lead, ultimately, to worse outcomes for end users and consumers.

1.4 Notwithstanding our objections to the imposition of a DFA remedy, in the context of the LLCC, we have serious concerns about the proposed form of the remedy and the approach to pricing.

1.5 We consider that the proposed approach would do little to mitigate the risks of imposing a DFA remedy and would, in fact, remove value from the infrastructure market, undermining both existing and future investments. In particular, we do not see a justification for the implementation of a 1Gbit/s sub-basket.

1.6 More generally, and as noted in our response to the Review of BT's Cost Attribution Methodologies, Virgin Media disagrees with the classification of certain attribution methodologies by Ofcom as "clearly inappropriate". Ofcom's proposed adjustments to address this "inappropriateness" would in practice decrease the transparency of the cost attribution process, in comparison to BT's existing approach, and provide no meaningful increase in the extent to which the attribution of costs would better align with Regulation Accounting Principles.

1.7 Consequently, we do not believe these changes should be introduced and the adjustments should not therefore be reflected in the charge control.

1.8 Virgin Media believes that the adjustments for QoS costs are reasonable. The proposed adjustments are expected to encourage efficiency and improved QoS standards in the future, while still ensuring that BT is able to recover its reasonable, efficiently incurred costs.

1.9 Above all, we consider that in setting new charge controls, it is vital that Ofcom seeks to preserve investment incentives for the industry as a whole and does not undermine existing investments or markets. This will ensure that the substantial private investment in infrastructure that has been made to date remains sustainable and the further investment to which Ofcom aspires can take place.

Question 3.1: Do you agree with our proposal to use an Inflation-X form of charge control? If not, what alternative would you propose and why?

Virgin Media broadly agrees with the inflation-X form of charge control.

As Ofcom notes, the proposed charge control mechanism strikes a reasonable balance between dynamic and allocative efficiency; encouraging BT to effectively manage its cost base whilst also providing an incentive to invest. The proposed form of charge control has also been demonstrated to continue to provide a basis for competitive entry of other providers of these services and has seen competition flourish in the market.

Question 3.2: Do you agree with the use of CPI as the relevant benchmark for inflation? If not, what alternative would you propose and why?

While Virgin Media has previously been in favour of retaining the RPI measure of inflation we accept that as other market reviews have led to the adoption of CPI there is merit in adopting a consistent approach. CPI is widely used and understood and Virgin Media agrees that it is appropriate to move to this inflation index as a basis for the charge control.

Question 3.3: Do you agree with our proposal for the duration of the charge controls to be three years? If not, what alternative would you propose and why?

Virgin Media agrees with the three year duration of the charge control. The need for market reviews to be conducted on a three yearly cycle means that there is a strong pragmatic factor in favour of aligning the control period with the life of the underlying market review. However, we also consider that this duration provides BT with a positive incentive mechanism to make efficiency gains, whilst ensuring that any gains rapidly translate back into benefits for consumers. Based on previous reviews we believe this has been shown to capture a reasonable balance between the two competing factors.

Question 4.1: Do you agree with our proposed five stage framework setting out the key economic principles that we propose to take into account in designing our proposed charge controls? If not, what alternative would you propose and why?

In general, Virgin Media has no comments on the proposed five stage framework for designing the charge control. We do however have some concerns on the design of the glide path and corresponding starting charge adjustment.

(4) Starting charge adjustment

Virgin Media welcomes Ofcom's reiteration of, in principle, adopting a glide path approach to adjustments.

Virgin Media believes that the price adjustments should be introduced by a glide path only approach as opposed to any form of one-off starting charge adjustment. As Ofcom notes, the ultimate endpoint is consistent under a one-off starting charge adjustment, glide path-only or a hybrid.

Volatility and discontinuity in pricing can be disruptive to the market and provide uncertainty to both customer and OCPs operating in the market. They can make economic incentives less coherent as compared to gradual adjustments to price changes that a glide path allows.

As both a customer and provider in the relevant markets, Virgin Media believes that on balance a glide path only approach is necessary for a properly functioning market in these services in general.

However, Virgin shares the same concerns as Ofcom regarding the distortionary signals that may arise due to erroneous underlying cost allocation that attributes costs to regulated services. That is to say, where logical errors in attribution methods are identified, Virgin Media agrees with Ofcom that in this specific case, there is a reasonable rationale for a starting charge adjustment.

Virgin Media however would not agree that any changes that Ofcom mandates due to being "clearly inappropriate" should be implemented in this way. Virgin Media's response to the BT Cost Attribution Methodology consultation (for example in response to Q8.2) makes clear that in many cases we do not agree with the specific changes proposed as part of this review which are categorised as "clearly inappropriate". Virgin Media does not believe that these should be reflected in the starting charge adjustment and does not believe they should be reflected in the charge control at all.

Furthermore, Virgin Media would be concerned that a principle is not established that starting charge adjustments should be used in all cases where cost attribution changes lead to net inflows or outflows of attributed costs between regulated and unregulated services. We believe that this should be reserved for cases where logical, objective errors are discovered only and we do not believe that changes that are viewed to be improvements in Regulatory Financial Reporting Principles should be implemented in this fashion. Doing so is likely to raise the risk of greater volatility, potentially provide an incentive for BT to make tactical changes/undertake regulatory gaming in its attribution process (under the guise of improved attribution methodologies).

Question 5.1: Do you agree with our proposal to adopt broad baskets for leased lines services, but separate TI and Ethernet baskets? If not, what alternative would you propose and why?

Virgin Media agrees that a broad basket approach is appropriate and that, due to the distinct market of TI and Ethernet baskets (in terms of customers, technology and the use of the services), these should be defined separately.

Question 5.2: Do you agree with our approach to deriving our base year costs for Ethernet and TI services, including:
a. our proposal to forecast costs based on BT's costs of providing business connectivity services;
b. our proposal to apply CCA FAC as our cost standard; and
c. our proposal that the base year for the 2015 LLCC Model is the financial year 2013/14 and that our base year for the model for the 2016 BCMR Statement should be the financial year 2014/15?

If not, what alternative would you propose and why?

Virgin Media agrees with the use of BT's cost base from a productive efficiency perspective, the use of CCA FAC is an appropriate cost standard and adoption of the respective 2015 and 2016 base years are appropriate.

Virgin Media strongly agrees with Ofcom that it would be both inappropriate and distortionary to exclude "IGCCs" from BT's cost base for this analysis. This would send distortionary signals to BT, consumers and to upstream competitors.

Question 5.3: Do you agree with our approach to forecasting costs and revenues over the period of the charge controls for Ethernet and TI services, including:
a. our AVEs and CVEs assumptions;
b. our input price inflation assumptions; and
c. our WACC assumptions?

If not, what alternative would you propose and why?
Question 5.4: Do you agree with our proposals in relation to the types of discount that would contribute towards BT meeting its charge control obligations for Ethernet and TI services? If not, what alternative would you propose and why?

Virgin Media has no comments on the approach adopted for the above assumptions at this stage.

Question 6.1: Do you agree with our basket design proposals for Ethernet services, including the need for sub-caps and/or sub-baskets? If not, what alternative would you propose and why?

Virgin Media is broadly in favour of a 'broad basket' approach. As Ofcom notes, a broader basket can provide BT with some price flexibility, ability to respond to changes in patterns of demand for services within the basket and can be used as a tool to facilitate technology migration. However, we do recognise that in principle, there may be circumstances in which an approach that combines a broad basket with limited and specific sub-baskets can be used to achieve specific regulatory goals. However, overuse of sub-baskets will clearly undermine the advantages of a broad basket approach.

Virgin Media notes that Ofcom's justification for the imposition of a sub-basket on 1Gbit/s is so that BT does not manipulate its 1Gbit/s EAD service prices to influence the take-up for dark fibre. As noted in this response and our response to the BCMR consultation, Virgin Media strongly advocates separating the consideration of the dark fibre remedy from this review and also does not believe 1Gbit/s EAD is the appropriate benchmark for the proposed remedy. Therefore, Virgin Media does not believe the current sub-basket is necessary or appropriate. BT should be allowed to maintain pricing flexibility for 1Gbit/s EAD services as part of the broader basket and therefore allow market participants to benefit from the full benefits of the broad basket approach identified above.

The imposition of a sub-basket, in concert with the proposed dark fibre remedy is a material increase in regulatory intervention. Applying tighter active remedies and introducing passive remedies is counterintuitive. Alternative infrastructure providers are applying significantly more competitive pressure on BT as compared to the previous review period and therefore more onerous intervention is not justified. In the context of this growing competition and the constraint this places on BT, the proposed increase in regulatory intervention runs counter to Ofcom's stated strategy of deregulating where appropriate.[1]

Question 6.2: Do you agree with our approach to deriving our base year costs for Ethernet services, including in particular:
a. our proposal in relation to the technology assumed for supplying controlled Ethernet services for modelling purposes;
b. our proposed cost adjustments to BT's 2013/14 RFS to form the base year costs; and
c. our proposed treatment of BT's costs relating to QoS?

If not, what alternative would you propose and why?

Assumed technology

Virgin Media has no specific comment at this time in relation to the MEA technologies assumed.

Cost base

Virgin Media broadly supports the proposed adjustments to the 2013/14 RFS cost base, except in relation to the general overheads pool of costs. As noted in response to questions on the BT Cost Attribution Methodology consultation, Virgin Media does not agree with the proposed changes to these attribution methodologies. Virgin Media does not believe the attribution methodologies Ofcom has identified as "clearly inappropriate" should be categorised as such and Virgin Media has a principled objection to the specificity of Ofcom's proposals. Furthermore, Virgin Media believes many of the proposed changes mandated by Ofcom lead to a reduction in the transparency of the underlying cost attribution process and in many cases do not lead to more causal or objective attribution methods.

QoS

[1] Ofcom DCR discussion document, paragraph 1.12

Virgin Media agrees with Ofcom's approach to the treatment of QoS costs. It is appropriate that BT is allowed to recover its efficiently incurred costs provided that appropriate safeguards are in place to ensure that BT is not incentivised to manipulate its cost base.

Virgin Media does not believe that it is appropriate to act retrospectively in relation to BT's previous QoS costs. Setting such a precedent would lead to regulatory uncertainty and would send potentially misleading incentive signals to the market during the forthcoming price control period.

Virgin Media agrees that it is reasonable put in place restrictions on the level of SLG costs that should be recovered and the methodology adopted appears to be sensible. Setting this level based on adjustments referenced against 2011 payments is a pragmatic choice given 2013/14 QoS performance. Going forward, BT should be allowed to recover efficiently incurred QoS costs to ensure incentive are in place to encourage efficient QoS costs and improved QoS standards.

Question 6.3: Do you agree with our approach to forecasting costs and revenues over the period of the charge control in relation to Ethernet services, including in particular:
a. our volume forecasting assumptions;
b. our efficiency forecasting assumptions; and
c. our proposal to reflect the impact of the proposed dark fibre remedy?

If not, what alternative would you propose and why?

As noted in our response to BCMR 2015, Virgin Media does not believe that it is necessary or appropriate at this stage to introduce an adjustment to forecasted active Ethernet services volumes to take account of the introduction of dark fibre services. Instead, Virgin Media believes this remedy should be considered further and in the event that an alternative version of the proposed remedy is adopted, the resulting adjustments to the charge control forecast volumes and glide path can be made at a later date.

At this stage, due to the degree of uncertainty of demand and the competitive landscape of alternative dark fibre suppliers, Virgin Media has no comment on the forecast assumptions. As part of the analysis presented in the BCMR, Virgin Media presents impact analysis based on Ofcom's adopted assumptions as well as assumptions derived by IIG members and Virgin Media's own internal assumption set.

The wide variation in underlying cannibalisation assumptions reflects the extent of uncertainty that Ofcom is introducing into this charge market review period by its hasty consideration and adoption of the proposed dark fibre remedy.

We would however note that a likely outcome of the proposed remedy is that it would cannibalise a significant volume of existing active circuits currently provided by OCPs across the active bandwidth services and across all geographically defined markets. Therefore we do not believe Ofcom's approach to forecasted volumes is appropriate and believe further analysis is required to ascertain a more reasonable scenario on take-up and cannibalisation assumptions.

Question 6.4: Do you agree with our proposals in relation to starting charge adjustments for Ethernet services? If not, what alternative would you propose and why?

As noted in response to Q4.1, Virgin Media is, in principle, not in favour of starting charge adjustments as a mechanism to change the charge control for Ethernet services. Reflecting changes via the glide path, as opposed to starting adjustments, provides greater certainty and stability for pricing in the market.

In the case of logical calculation errors that lead to costs being erroneously attributed to regulated services instead of the residual, we consider a starting charge adjustment may be appropriate. We would expect that the distortionary effect of the misattribution would likely outweigh the benefits of using a glide path.

As Virgin Media discusses in response to the BT Cost Attribution Methodology consultation, we do not consider the changes to cost attribution bases, proposed by Ofcom on the basis that they are "clearly inappropriate", to be justified. Consequently, we would not agree that these changes should be reflected in the starting charge adjustment. Even if Virgin Media did agree with these changes, we believe such changes should be reflected in a glide path. Were Ofcom or BT to identify changes to attribution methods in the future where it is agreed these better reflect the Regulatory Financial reporting Principles, we would expect these to be reflected in the glide path of any charge controls that they impact.

Question 6.5: Do you agree with our proposals in relation to the value of X for Ethernet services. If not, what alternative would you propose and why?

As noted elsewhere, Virgin Media disagrees with any approach which reflects the current proposed implementation of a dark fibre access remedy which we believe the design of (and consequences of), have not been considered in due detail to warrant such a remedy. It is disappointing to note that Ofcom has not even conducted sensitivity analysis regarding a 'high' and 'low' assumption set for forecasting. This demonstrates that Ofcom has undertaken less analysis of the future landscape of the market than under previous reviews, despite the fundamental changes it is proposing to implement.

Virgin Media believes that the approach adopted in previous reviews should be applied to an active-only forecast and that scenarios including dark fibre remedies should be considered as part of a separate review which will allow Ofcom to devote adequate time and resources to estimating the impact of such a remedy.

Question 7.1: Do you agree with our basket design proposals for TI services, including the need for sub-caps and/or sub-baskets? If not, what alternative would you propose and why?

Question 7.2: Do you agree with our approach to deriving our base year costs for TI services, including in particular:
a. our proposal in relation to the technology assumed for supplying controlled TI services for modelling purposes; and
b. our proposed cost adjustments to BT's 2013/14 RFS to form the base year costs?

If not, what alternative would you propose and why?

Question 7.3: Do you agree with our approach to forecasting costs and revenues over the period of the charge control in relation to TI services, including in particular:
a. our volume forecasting assumptions; and
b. our efficiency forecasting assumptions?

If not, what alternative would you propose and why?

Question 7.4: Do you agree with our proposals in relation to starting charge adjustments for TI services? If not, what alternative would you propose and why?

Question 7.5: Do you agree with our proposals in relation to the value of X for TI services. If not, what alternative would you propose and why?

Virgin Media has no comments on the proposals for implementation at this time.

Question 8.1: Do you agree with our proposals regarding dark fibre pricing? If not, what alternative would you propose and why?

As we have set out in our response to the main BCMR consultation, we consider the imposition of a dark fibre remedy to be wholly inappropriate and unnecessary. However, notwithstanding this view, we have set out below our comments on the proposed pricing approach to the remedy, which we believe contains fundamental flaws.

Virgin Media does not agree with Ofcom's proposals regarding dark fibre pricing. Ofcom considers how to structure DFA pricing in Annex 26 of the BCMR. Ofcom creates a short list of 'possible' approaches: cost based; active basket; and single active reference product, before deciding on the reference product approach.

Ofcom believes that the risks identified in imposing a passive remedy are best allayed by pricing based on EAD 1Gbit/s less the LRIC of the 'active' elements.

This prices DFA under 1Gbit/s active connections and significantly below the higher bandwidth and optical solutions that have been the main uses for dark fibre to date. [✂].

Ofcom suggests on the one hand that this approach to pricing will "*preserve more value in the high value part of the leased line market*",[2] yet on the other it acknowledges that use of a 1Gbit/s reference product will cannibalise the higher bandwidth active market, with no new active connections assumed from the second year of the control.[3] Ofcom compares the short list of approaches and concludes that using the reference product approach will preserve more value than the other considered options. This conclusion is flawed. There are other, far more appropriate, approaches than the use of an EAD 1Gbit/s reference product that have not been considered (discussed below).

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[2] 2015 BCMR, paragraph A26.127
[3] 2015 LLCC, paragraph 6.16

This passive remedy will also undermine the existing commercial dark fibre market because the regulated price of dark fibre is significantly below the current market price. The CLA dark fibre market could also be affected because, although it is unregulated, should BT offer national pricing for dark fibre (as it has done for active services within the WECLA) this would leave current OCP pricing as uncompetitive. OCPs would be required to reduce prices to stay competitive; we can expect this to lessen the incentive to invest further in CLA networks.

[✂]

The materiality of this impact means that Ofcom should consider further analysis. The fact that the estimates also indicate the result of the remedy could be a substantial gain in market share for BT in the CLA supports our assertion that one of the results of DFA will be to undo the increases in competition that have been achieved since the previous BCMR review.

Aside from the impact of DFA on providers of alternative infrastructure, we consider that Ofcom has not undertaken a full assessment of the pricing of DFA. In particular:

- there is no consideration of the commercial pricing of dark fibre in the UK, including the competitive CLA market (as prospectively defined);
- there is a only a partial examination of a 'fair and reasonable' requirement for pricing;
- there is inadequate consideration of appropriate reference products above 1Gbit/s; and
- there are a number of important and interrelated policy reviews being undertaken simultaneously, including Ofcom's own Digital Communications Review (DCR) and DCMS's implementation of the Civil Infrastructure Directive (CID). Ofcom has failed to consider the potential impact of these reviews on the appropriateness of a passive access remedy; and
- there is no consideration of how passive access is regulated by other NRAs.

The Commercial Pricing Factor

Ofcom has not assessed or considered the current state of the dark fibre market. The London area has a number of competing operators offering dark fibre (see Annex 1 of our response to the BCMR for examples) and the market has grown considerably since the 2013 BCMR. Under section 88(4)(a) of the Communications Act 2003 (the Act), Ofcom is required to have regard to the prices at which services are available in comparable competitive markets[4] in order to determine whether any pricing regulation is appropriate in the circumstances.

The number of competitors and BT's lower market share compared with other geographic areas, provides evidence that the market is competitive and therefore that the prices charged are at or around the competitive level. The latter should be viewed as a reasonable proxy for the efficient cost (including a return on investment) of the provision of dark fibre. Given Ofcom's intent in seeking to regulate in a manner that replicates the effects of a competitive market, this pricing benchmark is an important factor that Ofcom has failed to take into account.

[4] Section 88(4)(a) Communications Act 2003

Fair and Reasonable

Ofcom dismisses the potential to regulate pricing on a 'fair and reasonable' basis by saying that such a condition would lack any regulatory certainty; that this uncertainty would lead to disputes and that a more specific pricing approach would therefore be appropriate.

This fails to acknowledge the role of a 'fair and reasonable' remedy as a light touch approach with a backstop ability to regulate on an ex ante basis should problems arise.

Fair and reasonable is defined in the 2002 Access Guidelines as requiring "*amongst other things, that terms and conditions under which products are offered are consistent with those which would be offered in a competitive market, sensible, practical, and do not impose a margin squeeze on competitors*"[5]. Similar conditions appear to work well in other countries where the pricing of dark fibre is simply required to be agreed on a commercial basis. Furthermore, as we have a competitive benchmark market in London, there is already good guidance as to what a commercial price would be, minimising the risk of disputes or enabling their early resolution.

Fair and reasonable pricing was required of BT at the outcome of 2010 WLA market review. VULA and Dark Fibre have very similar characteristics, in that both are a new product designed to give passive (in the case of VULA, virtual passive) access to BT's network. At the time of implementation of VULA, demand and take-up was unclear (as is the case for DFA), and there was a need to ensure that investment incentives were not skewed. Indeed, in the 2014 FAMR, Ofcom noted the success of the fair and reasonable approach in maintaining investment incentives given the expenditure made by both BT and Virgin Media in continuing to upgrade their networks for the provision of higher speed broadband.[6]

This approach also accords with the European Commission recommendation in relation to VULA style remedies that provides NRAs with greater discretion over appropriate pricing methodologies for products where there is significant demand uncertainty. The Commission states that:

> *"Due to current demand uncertainty regarding the provision of very-high speed broadband services it is important in order to promote efficient investment and innovation, in accordance with Article 8(5)(d) of Directive 2002/21/EC, to allow those operators investing in NGA networks a certain degree of pricing flexibility to test price points and conduct appropriate penetration pricing. This would allow SMP operators and access seekers to share some of the investment risk by differentiating wholesale access prices according to the access seekers' level of commitment. This could result in lower prices for long-term agreements with volume guarantees, which could reflect access seekers taking on some of the risks associated with uncertain demand. In addition, pricing flexibility at wholesale level is necessary to allow both the access seeker and the SMP operator's retail business to introduce price differentiation on the retail broadband market in order to better address consumer preferences and foster penetration of very high-speed broadband services. In line with points 48-57, to prevent such pricing flexibility leading to excessive prices in markets where SMP*

[5] 2002 Access Guidelines, paragraph 3.39
[6] 2015 FAMR – Approach to the VULA Margin, paragraph 3.120

> *has been found, it should be accompanied by additional safeguards to protect competition. To this end, the stricter non-discrimination obligation, i.e. EoI and technical replicability, should be complemented by guaranteed economic replicability of downstream products in conjunction with price regulation of copper wholesale access products"*[7].

Whilst this recommendation applies to broadband access, it could equally apply to DFA in the context of the BCMR. The approach taken in regulating VULA allowed for a light touch approach following the 2010 WLA market review in which the remedy was introduced, and then a more detailed consideration of the remedy in the second round 2014 FAMR review when uptake and future demand was more certain. This allowed Ofcom to implement an additional control in the form of the VULA Margin Condition.

Appropriate Reference Products over 1Gbit/s

Ofcom also dismisses the use of 10Gbit/s EAD services as a reference product. Virgin Media submits that the impact assessment conducted by IIG clearly shows the high risks associated with using 1Gbit/s EAD as the reference product; this alone should prompt a more thorough consideration of alternative higher bandwidth products as a reference.

Ofcom's rationale for not fully considering 10Gbit/s EAD is that it is a new product and its pricing is uncertain. In rejecting 10Gbit/s EAD, Ofcom has failed to adopt the forward look approach required under the market review process. Although 10Gbit/s EAD is a new product, it will not be new at the commencement of this market review control period (1 April 2016), and it will have been available to customers for a considerable time by 1 April 2017 when Ofcom is proposing that DFA should be made available.

As Virgin Media sets out above, the potential usage for Dark Fibre is likely to be in relation to higher bandwidth solutions, and indeed Ofcom expects *all* active connections above 1Gbit/s to be cannibalised due to the introduction of DFA. If the predominant commercial use of dark fibre is as an alternative to high bandwidth active circuits, this supports the use of a high bandwidth reference product.

The acknowledged need (from the 2013 review) for Ofcom to be 'wary' in its approach to regulation of Dark Fibre also supports taking a less aggressive approach to pricing. The risk of the damaging consequences associated with 'getting it wrong' are substantially greater if Ofcom over-regulates, by imposing more stringent price controls, as opposed to under-regulating with a more light touch approach to pricing in the context of DFA. To over-regulate pricing at this stage would, as is clear from this response, and the response submitted by IIG, have significant adverse effects on the market.

To take a lighter touch approach to regulation would substantially lessen any risk and have the advantage of allowing Ofcom to assess the effect of the remedy ahead of the next market review.

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[7] Paras 49 to 50 of Commission recommendation on consistent non-discrimination obligations and costing methodologies to promote competition and enhance the broadband investment environment - C(2013) 5761

A full consideration of less intrusive remedies, such as a 10Gbit/s reference product, is essential. Were a 10Gbit/s reference product to be adopted, it is unlikely that CPs would be deterred from purchasing the dark fibre input if their intent is to develop innovative services. Furthermore, this approach would also accord with the sentiment of the EC recommendation set out above. In addition, a 10Gbit/s reference would likely reduce the potential for arbitrage-motivated take-up of DFA from lower bandwidth services. As we discuss later in this response, a large proportion of the negative impact of the DFA remedy on Virgin Media stems from the impact on 1Gbit/s volumes.

In any event, Virgin Media disagrees with Ofcom's assessment that there is too much uncertainty surrounding the current proposed pricing of 10Gbit/s EAD. As Figure 4.1 shows the BT's proposed pricing has been set with reference to other products available, in particular, the OSA products offered by BT. Ofcom notes that 10Gbit/s EAD will be a likely constraint on the price of OSA products (and vice versa), so although the introduction of a new product does involve the setting of a new price, BT has set its provisional 10Gbit/s EAD pricing with reference to the comparable OSA product. This is likely to be the case in the future.

Ofcom suggests that the remedy could be 'gamed' if 10Gbit/s EAD was selected as a reference product. Given the proposed safeguard cap on high bandwidth services, and the ability of a fair and reasonable pricing requirement to frustrate BT from raising the reference price in advance of the introduction of a DFA product, this is a concern without foundation.

The reference product is 1Gbit/s EAD and 1Gbit/s EAD Local Access

Ofcom considers that dark fibre should be priced relative to a single reference product.[8] It then considers that dark fibre should be available in two forms – local access (LA) and standard. LA circuits run from a customer circuit to a BT telephone exchange known as an Access Service Node (ASN), whereas standard circuits can run between any two locations.

Ofcom proposes a LA dark fibre price benchmarked to the EAD 1000 LA price, and a standard dark fibre price benchmarked to the EAD 1000 price.[9]

We note the following:

- The EAD 1Gbit/s service consists of a variety of different variants. For example there is EAD Enable, EAD SyncE and standard EAD. All of these have different charges. Ofcom has not explained how the prices for this would be turned into a benchmark for the dark fibre price.

- The route / radial restrictions on EAD circuits are 25km radial/40km route. Ofcom has proposed that the radial restriction for dark fibre is 50km, which is inconsistent with the product offering.[10]

- Ofcom considers that there is no need to provide an extended reach version of EAD 1000, as the difference in charges is explained by differences in costs.[11] This may

[8] 2015 BCMR, paragraph A26.148
[9] 2015 BCMR, paragraph A26.159
[10] 2015 BCMR, paragraph 9.30
[11] 2015 BCMR, paragraph A26.156

well lead to arbitrage opportunities between the price of EAD 1000 ER and the dark fibre prices.

Question 9.1: Do you agree with our proposals for charge controls for accommodation? If not, what alternative would you propose and why?

Question 9.2: Do you agree with our proposals for charge controls for ECCs? Please explain your answer with supporting information.

Question 9.3: Do you agree with our proposals for charge controls for TRCs? If not, what alternative would you propose and why?

Virgin Media has no comments on the proposals for implementation at this time.

Question 10.1: Do you agree with our proposals for implementation of the proposed new charge controls and for ensuring compliance with the proposed new charge controls. If not, what alternative would you propose and why?

Virgin Media has no comments on the proposals for implementation at this time.

However, insofar as it impacts on the DFA, we note that the proposals for implementation allow for flexibility in the event that BT introduces new services which wholly or substantively replace existing services.[12] We therefore maintain, as discussed in Virgin Media's response to the BCMR, that it is not necessary to introduce the DFA remedy in conjunction with the LLCC on the grounds that it is necessary to reflect this change at the outset of the charge control period. Ofcom and BT have the necessary flexibility as defined in the proposals for implementation, to introduce the DFA (or an adjusted version of it), after the conclusion of the BCMR and LLCC consultation process.

Question 11.1: Do you agree with our proposals for BT's Regulatory Financial Reporting, including in particular:
a. the proposed Consistency with Regulatory Decisions Direction; and
b. the proposed Direction modifying requirements relating to the preparation, audit, delivery and publication of the Regulatory Financial Statements, and Direction modifying requirements relating to the form and content of the Regulatory Financial Statements?

If not, what alternative would you propose and why?

Virgin Media agrees with the need for further transparency of reporting by BT. The proposed additional public and private disclosures are welcomed and we believe these will support the industry and Ofcom in reviewing BT's treatment of costs in these markets and allow industry to have greater confidence in the basis on which BT determines the attributed cost base of services within the BCMR. However, we draw attention to our response on the proposed requirements to change the treatment of General Overheads as part of the BT Cost

[12] 2015 LLCC, paragraphs 10.34-10.37

Attribution Methodology consultation. We do not consider these changes are justified or appropriate and do not believe these should be reflected in BT's reporting.