Vodafone's response to Ofcom's consultation

"Fixed access market review and charge control"

NON CONFIDENTIAL VERSION

September 2013

EXECUTIVE SUMMARY AND INTRODUCTION

In the last years, as Openreach has established itself, we have witnessed four service crises (copper product installation and repair crisis – twice, Ethernet product installation and repair crisis and now cable link installation crisis). [confidential material removed] It is clear that something is fundamentally wrong with regulation and BT's incentives.

Today, BT concentrates almost exclusively upon beating Ofcom's charge control targets regardless of its impact on service quality. This approach cannot continue as it will not support Ofcom's objective of world-class communication services. This problem does not require more money, but rather a change to those incentives. [confidential material removed], it is evident that:

1. Ofcom needs to tighten its efficiency assumptions in this and future price controls to reduce this anti-competitive distortion to the market and deadweight cost on the rest of the industry;
2. [confidential material removed] far better service levels across the Openreach organisation.

We agree with Ofcom that the proposals made for quality of service are necessary and we fully support them. We consider the proposals a critical step forward in remedying BT's behaviour. Moreover, we consider that SLAs need further development where Fixed Access Market services are used as business inputs. We are discussing such options with BT and would expect Ofcom to support the development of 'business-grade' SLA for such services.

In safeguarding quality of service for UK businesses and consumers Ofcom must be prepared to end any benefit that BT Group receives from poor Openreach service performance. Ofcom must also make clear what sanctions will automatically apply should SMP conditions on Quality of Service be breached.

A sufficiently robust regime requires:

1. Incentives to reward accurate forecasting;
2. Tougher SLG payments for failure, with appropriate levels for services used to supply business customers;
3. BT demand throttling in the event of a service crisis; and
4. The automatic imposition of punitive financial sanctions for a breach of the SMP conditions on quality.

Turning to NGA regulation, Ofcom has imposed a lighter touch regulatory approach which overly favours BT:

1. In return for rolling out NGA BT is permitted pricing freedom. Yet the numbers do not support the case that this is necessary. BT's accounts show that year on year capital expenditure has not changed or grown between the period prior to NGA

investment and during the course of the NGA investment. BT is likely to have benefited from £1.2 billion of public money toward rural broadband rollout while again itself investing far less than was anticipated[2].

2. Alternative CPs are restricted in their ability to rollout competing access networks fixed or mobile due to “permitted use” rules that Ofcom has tied to PIA as a result of unproven cost recovery concerns for BT.
3. BT has gained the lion share of NGA connections on its network at a retail level with 87% share for fibre and increased market power at all levels of the value chain. It will take years for alternative CPs to compete back this first-mover advantage.

Given this backdrop, we support Ofcom’s proposed ex-ante margin squeeze test and its indication that NGA price-controls are likely to be necessary in the next market review. However, in themselves, these remedies are not sufficient. Ofcom must consider what more it can do to encourage competition in the market, particularly from alternative infrastructures such as mobile 4G

Vodafone is investing £900m in its network and the rollout of its 4G services in this financial year alone. We accept that during the period of this review, in the main, NGA delivered over a mobile network will be complementary to fixed NGA with substitution only at the margins or in particular geographic areas. That said, the level of competition in the fixed market, especially NGA, is so limited and virtually all based upon BT’s infrastructure Ofcom should do all it can to encourage competing infrastructure over the longer term.

The higher costs of mobile NGA currently act as a competitive barrier to wider substitution even though 4G is, today, capable of delivering the full range of NGA applications at relevant download speeds and this is forecast to improve considerably with the advent of LTE-Advanced. Therefore, the correct approach for Ofcom to consider the substitution possibilities of 4G is against a counter-factual where, at least, regulatory barriers are removed. Ofcom’s policy not to allow PIA for mobile backhaul is key amongst these as it fails to implement technology neutral regulation and prevents mobile operators from accessing a lower fixed cost base for backhaul and transmission. This, in turn leads operators to throttle speeds or impose lower data caps, reducing mobile’s ability to compete as a fixed NGA substitute in the retail market. Ofcom should remove the limitation of use from the PIA product via this market review. Vodafone has intervened (together with four other supports of PIA availability) in support of Colt’s appeal of the PIA decision within the BCMR. We would urge Ofcom to escalate any revisions to PIA to be included within this market review as well as being potential amendments to the BCMR.

The rest of our response is structured as follows:

Section 1 describes how BT has over-recovered from regulated services in the past and continues to do so today.

Section 2 sets out Vodafone’s views on service quality.

Section 3 comments on Ofcom’s proposals for NGA.

[2] www.nao.org.uk/press-releases/the-rural-broadband-programme-2/

Section 4 comments on Ofcom’s proposals for current generation access products; and

Section 5 and 6 answers Ofcom’s consultation questions.

1. BT HAS OVER RECOVERED IN THE PAST

[Confidential material removed]

Understanding of BT's general profitability is important when setting the scene for a forthcoming charge control and the inevitable discourse over the appropriate level of those controls. We consider the heart of this market review is the setting of appropriate quality of service levels and rules. The inevitable question will arise of how BT can achieve an appropriate return given the increases in costs that will arise in providing an improved level of service. On the facts, no such trade-off arises. Over recovery by BT for regulated services can (and should) be reduced without impacting service quality at the levels proposed.

2. QUALITY OF SERVICE

We welcome the focus that Ofcom has placed upon the issue of Quality of Service within this consultation, believing it to be one of the most important issues that impacts consumer welfare, market development and competition. At the same time that BT has been generating super-normal profits on its SMP products, service levels for these products have been at an all-time low. We therefore welcome Ofcom's proposals to bring service into the heart of SMP conditions and the new requirement for a minimum acceptable level of service as an SMP obligation.

Within this section we discuss the following recommendations in detail:

- Ofcom needs to develop a range of tools to tackle the issue of service performance. The issue is too important and too complicated to resolve with a single remedy.
- Ofcom needs to get the foundations of the regime right and that means a more meaningful approach to forecasting with industry working together to improve accountability in the forecasting regime, tougher SLGs including explicit recognition of the needs and impact on UK business.
- In the event that a service crisis commences, BT internal lines of business should be subject to demand throttling in order to create the right commercial incentives to end the crisis quickly, thus removing the consumer behaviour advantage that BT currently enjoys.
- Finally, punitive sanctions should apply if BT breaches its QoS SMP condition. Both the threshold for a breach and the consequences stemming from it need to be spelled out from the outset so as to ensure that the new SMP condition has a powerful incentive impact on BT behaviour.
- While the OTA is the correct place to commence discussions, 2 months is sufficient time to enable agreement on matters of principle. After this point if no industry consensus is forthcoming Ofcom needs to step in and dictate terms as UK businesses and consumers can't wait another year for these problems to be rectified.
- Ofcom needs to act with uniformity across all markets on this issue to prevent BT moving resource to the market with toughest sanctions, such an approach may solve a service crisis in one market only to create one in another market.

As Communication Providers are largely compelled to buy regulated WLA products from Openreach there is no opportunity for purchasers to vote with their feet and switch to an alternative wholesale provider if service experience dips, as there would be within a competitive market situation. Instead Communication Providers must put up with prolonged periods of poor service and suffer reputational damage as Openreach fails to deliver an acceptable level of service. In such circumstances consumers naturally blame the Communication Provider they contract with, rather than Openreach as the root cause of the service failure, as it is not the concern of consumers and businesses to whom their CP entrusts vital aspects of the underlying service.

We also have no doubt that there remains a perception among a significant proportion of consumers (however inaccurate that perception may be) that the best way to avoid any protracted delays is to contract with BT's own retail lines of business directly as they will somehow be able to secure a better level of service than any of BT's competitors. Ofcom's own market research published alongside this consultation has accurately picked up on those consumer perceptions, which indicated that more than one in four (28%) businesses agreed that *'you are less likely to have a problem with service installation or repair from BT than with competitors'* and over a third (35%) of residential consumers agreed 'strongly' or 'slightly' that '*you are less likely to have a problem with service installation or repair from BT than with competitors*'[3] even more worryingly <u>three in five (58%) agreed strongly/ slightly that *'If I had a bad experience with a provider other than BT with service installation or repairs I would consider switching to BT'*</u>.[4] Such research results are sadly not a surprise to us and it is clear that BT's legacy incumbent position in the market still casts a shadow that influences consumer behaviour in a way which is adverse to competition. Ofcom should conduct more research into this very important area to understand the influence that consumer perception and sentiment has on purchasing behaviour.

THE IMPACT ON BUSINESS CONSUMERS

An important distinction needs to be drawn between the differing requirements of business and residential consumers. Business users have very different expectations[5] to that of residential consumers and these differences must be reflected in both SLAs and SLGs. The impact and ramifications stemming from a failure to deliver an acceptable level of service to a business user is often significantly greater than the effect on a residential user[6]. Without wishing to downplay the significant disruption caused to residential consumers who have every right to expect a good standard of service, the consequences for business users often go far beyond prolonged inconvenience. Business users can suffer long term financial consequences as a result of a service failure, with lost trading, staff time wasted, lost customers and contracts that can't be easily made good. Any failure on BT's part harms the competitiveness of business, which in turn harms the international competitiveness of the UK. To this end effort must be put into ensuring that business SLGs reflect the enhanced cost to UK business of service failure. To continue with the current simplistic approach that sees business and residential consumers covered by the same SLGs when the losses to business are far greater is something that needs to be addressed as part of this review.

HIERARCHY OF INCENTIVES

In order to resolve quality of service concerns, Ofcom needs to give serious policy consideration to the incentives that are in place to ensure that BT is able to organise its business in an acceptable way to prevent future service failure. Ofcom should also give thought to the means open to them as the regulator to act swiftly should a new crisis

[3] P7 & P67– BDRC Research: http://stakeholders.ofcom.org.uk/binaries/research/telecoms-research/telecoms-market-data/fault-repair-research.pdf

[4] P65 – BDRC Research: http://stakeholders.ofcom.org.uk/binaries/research/telecoms-research/telecoms-market-data/fault-repair-research.pdf

[5] P7 – BDRC Research *For a repair taking longer than considered 'reasonable' 27% of businesses and 20% of residential consumers would consider switching provider*

[6] In saying this we recognise that some residential consumers rely upon fixed lifeline telephony services due to their particular circumstances.

emerge. In our view it is not appropriate to leave such a regulatory response to consideration within the context of a market review. In order to improve quality of service, Ofcom must tackle the issue on a number of different fronts, making use of a sequential approach to delivering a fair and acceptable quality of service on regulated products:

1) Incentives for Accurate Forecasting.
2) Tougher SLG payments for failure, with appropriate recognition for UK business
3) Demand throttling of BT lines in the event of a service crisis.
4) Ofcom imposed punitive financial sanctions for a breach of the SMP conditions on quality.

FORECASTING

Taking these issues in turn, we believe that encouraging more rigour around CP forecasting is an important tool. We are therefore open to moves to improve how all CPs forecast demand into Openreach and believe that greater thoroughness in forecasting will lead to better demand management and a smoother service experience for all, thus improving service levels for those CPs who have submitted meaningful demand forecasts. We believe in taking our own medicine and CPs who submit accurate forecasts should be rewarded for it, while those that don't should see a proportion of their orders delivered out of SLA as a consequence.

The details need to be workable but the onus should be on making forecasts more accountable. Those CPs who don't forecast correctly should be prepared to face a much lower guaranteed SLA delivery rate on a proportion of their orders, with SLG payments only paid if the longer SLA timescales triggered by inaccurate forecasting are triggered.

HARSHER SLG PAYMENTS

In our view the incentive regime is heavily skewed in favour of BT and while effort should be made to reform the service credit regime to cover real losses (including reflecting the true cost to UK business of service failure). If incentives on BT were set appropriately such Ofcom interventions would be very rare. Where a CP has qualified for an SLA delivery of their order and that is not met, then harsher Service Level Guarantee payments should apply to act as strong incentive to improve quality of service and discourage service level breaches. This simple yet effective approach has been underused to date and the current SLG regime has not had the desired impact, failing to prevent a series of service crises. As well as the impact on end customers, we believe the current payment scheme grossly underestimates the true cost to CPs of failure. We would therefore urge Ofcom to undertake a review of the current regime with a view to proposing a significant across the board increase in SLG payments to greatly improve the incentive effects of the regime and better reflect the impact on UK business consumers.

THROTTLE BACK BT INTERNAL DEMAND

The Undertakings were designed to prevent discriminatory conduct, with Openreach having to treat internal and external orders equitably. However it is clear that the Undertakings have done little to remedy the perception in consumers' minds when they make their purchasing decisions, and this will ultimately dictate the level of competition in the retail market, with Ofcom's market research pointing to BT lines of business being the clear beneficiary in the retail market of any Openreach service issues.

In the event that BT has breached the SLA on qualifying orders (i.e. those that have been accurately forecast) then as well as triggering enhanced SLG payments Ofcom should impose upon BT a demand cap for internal orders until such time as quality of service has returned to acceptable levels.

In a competitive market, commercial incentives alone are strong enough to ensure that good service is delivered first time and where this fails to occur, lessons are learned and repetition of poor service is a rare event for successful suppliers as customers are unforgiving when faced with repeated service failure. This market led outcome ensures that the best suppliers who compete on both quality and price increase their market share, with poorer performing suppliers having to address supply and quality issues (or drop their price accordingly) if they want to build or restore their reputation and gain market share.

In these markets we rely upon Ofcom to impose appropriate remedies to correct for market failure and while a good deal of policy work has rightly focused on price control matters, far less time has been spent on the non-pricing aspects of market failure. Openreach appears to lurch from one service crisis to another. These dips in acceptable service levels impact other CPs and, of course, end consumers who rightly care little for problems further down the supply chain.

To this end we would urge Ofcom to look to the competitive market for inspiration over what incentives should exist. We would propose that if Openreach were to fail to deliver 95% of valid orders within its SLA then 40% of BT's orders from its own lines of business should be held back until other Communication Provider orders were back on track. This approach would replicate the incentives that would be felt in a competitive market situation, ensuring BT's main PLC board would take the appropriate action to remedy the situation within Openreach.

The current situation allows BT, through Openreach to slow down the whole market with no adverse impact on their own business over their competitors (indeed if consumer perceptions are anything to go by, periods of poor service may encourage migrations to BT lines of business and increase BT market share in the retail market!). A 40% hold back on BT lines of business orders / requests would allow BT to prioritise its own order queue to fulfil the most urgent without disadvantage, whilst not weakening the wider incentive on BT as a whole to remedy the service issue, as BT non-urgent orders would remain in the stack until Openreach service performance returned to normal levels, thus eliminating any commercial advantage gained from poor service performance elsewhere in the BT Group. We would not of course advocate such a hold back approach if service levels fell as a result of an unavoidable situation, such a force majeure events. However some independent assessment would be needed to ensure that cases of avoidable poor service were identified as there will be a natural incentive to point to external factors as the cause of all service issues. For example we remain unconvinced by Openreach's repeated attempts to blame poor service on UK weather patterns and while Ofcom's research in this area does point to elevated rainfall in some parts of the UK in 2012, in our view this alone is insufficient evidence of a weather related problem. BT cannot claim it to be a surprise that winter occurs every year. We believe weather events should not act as cover for poor service and that the underlying cause can be traced back to Openreach itself, rather than anything meteorological.

While the spirit of the Undertakings is about ensuring that all external and internal lines of businesses are treated equally, the case for an internal holdback doesn't compromise this. In fact if BT at a group level is the entity perpetuating poor levels of entirely avoidable bad service then it is only right and proper that it is also the entity that experiences an outcome that would occur in a competitive market and it is therefore not appropriate for CPs who have no control over Openreach service delivery to take the pain when it is entirely beyond their control. Currently Ofcom's evidence points to a BT Group gain in periods of bad service and action needs to be taken to rectify this.

CLEAR CONSEQUENCES FOR AN SMP BREACH

We believe Ofcom needs to spell out in precise detail what circumstances will trigger an SMP condition breach on quality of service and the consequences of any breach. In the event that the three other incentives outlined above fail to stop a service crisis, then as a matter of last resort Ofcom must impose a substantial fine on BT for a breach. Any ambiguity around both the definition of a breach and the consequences of a breach will create problems in the future and weaken the incentive effect of the new SMP condition.

CHARGE CONTROLS HAVE BEEN GENEROUS

Ofcom proposes to consider in greater detail whether the charge control as proposed provides sufficient funds to BT for the delivery of the minimum service level. [confidential material removed] It is evident that the problem lies not with the lack of funding to cover costs but the willingness by BT to divert sufficient funds to the establishment and maintenance of acceptable services levels. [confidential material removed] any attempt by BT to claim that BT's service problems relate to a poor regulatory pricing outcomes are groundless and should not be entertained. As we highlighted in the efficiency section below, BT has considerable room to remove excessive costs from its business and it therefore has sufficient scope to invest in service performance if direct commercial pressure was brought to bear. Ofcom should not seek to either excuse BT for its past poor service performance, or seek to cushion it from commercial reality through taking any action that ring fences the inefficiency bubble that BT's business appears to inhabit.

If market failure is to be addressed in a meaningful and sustainable way then BT must be forced to transform its business into an efficient provider of services. In a market that is dominated by enduring bottleneck services this business transformation will only come about through the correct regulatory approach and Ofcom must provide leadership on this issue to ensure that UK consumers are not left paying for BT inefficiencies for years to come while benefits flow to BT staff and shareholders as a result of a reluctance on the part of BT management to undertake difficult but necessary reforms over how the business is structured, particularly around labour productivity and efficiency. Other nationalised companies such as British Airways (now part of IAG) have had to tackle such problems and modify their business models and approach to efficiency when faced with stiff competition from new entrant carriers. The UK regulatory approach to pricing BT's regulatory products has to a large extent made BT immune from having to bear the full burden of its own inefficient practices and it is important that steps are taken to end this practice.

OTA

While we recognise the need for the OTA to play a role in improving the service levels and negotiating improved terms on service guarantees available to communication providers, we believe the six month timescale is far too long to resolve an issue which relates to established services. Every day this matter remains unresolved, UK businesses and consumers are being impacted.

Ofcom should recognise that the OTA lacks the power to impose a solution and that CPs have little bargaining power in any discussions with Openreach. If Openreach does not agree, matters quickly reach deadlock. Instead Ofcom should set a maximum of 2 months for any discussions to play out and if agreement in principle is not forthcoming then Ofcom should be prepared to proactively take steps in line with its duties to protect consumer welfare. It should achieve this by intervening through the use of directions to mandate a regime that is capable of safeguarding levels of service.

ETHERNET SERVICE QUALITY

While we recognise this consultation is focused on fixed access markets, the issue of service quality arises in other markets served by Openreach, most notably Ethernet, where a 12 month service crisis has occurred, with considerable disruption to end customers. Openreach's attempt to control the situation and return service levels to an acceptable standard have been very poor and, there remains significant uncertainty around Openreach Ethernet service performance. In short the Ethernet market can't wait for the next market review and we would urge Ofcom to roll out a standard policy approach to service quality and performance across the range of Openreach SMP products delivered to the market. There is a real danger that if Ofcom deploys a new tougher approach in one market and not another, Openreach will focus resourcing on the market where the toughest sanctions apply and other markets and consumers will suffer. There is therefore a compelling reason for Ofcom to act with uniformity across markets in a simultaneous way, as the concerns around consumer perception picked up within Ofcom's market research conducted for the fixed access market review would equally apply to Ethernet consumers.

CONCLUSION ON QOS

While we welcome Ofcom's recognition of this issue within this market review, we feel Ofcom's response to the service crisis should have been both bolder and executed with greater speed. UK businesses and residential consumers are today placed at a disadvantage as they indirectly consume bottleneck products within a failed market. While regulation has largely focused on price, it has not given the issue of quality of service sufficient prominence. It is within Ofcom's gift to create the correct regulatory approach to incentives and while it is right and proper that the OTA play a significant role in the day to day contractual arrangements that should apply, Ofcom needs to have a simple and effective regulatory lever at their disposal to ensure alternative CPs are not disadvantaged when service dips. The fact is that today there are insufficient incentives in place to compel Openreach to deliver an acceptable level of service to Communication Providers and their end consumers. While the work of the OTA may help, it will not remedy the matter and it therefore incumbent on Ofcom to take firm action to ensure that BT feels real commercial pressure to deliver a good standard of service. We would therefore urge Ofcom to focus on introducing a better forecasting regime, tougher SLG payments and in cases where forecast demand is not met, a 40% throttle back on BT's own lines orders until such time as service levels return to acceptable levels. Ofcom also needs to be explicit about what sanctions would apply for non-compliance of the SMP condition at the outset, thus ensuring that the incentive effective of the new SMP condition is not lost.

3. NEXT GENERATION ACCESS

We set out our concerns with the development of competition for the provision of NGA services in our response to the call for inputs[7]. In summary:

1. Ofcom's light touch regulatory approach has weakened CP's competitiveness;
2. BT has total control of NGA product development;

[7]http://stakeholders.ofcom.org.uk/binaries/consultations/fixed-access-markets/responses/Cable_Wireless_Worldwide.pdf

3. BT has control of the value chain by setting the wholesale input cost and having the leading market share for retail broadband;
4. The above had disincentivised other CPs from heavily engaging in and promoting NGA.

Past policy has permitted BT pricing freedom for the rollout of NGA networks. These decisions were taken at the time pre-dating the award of circa £1.2 billion of public funds to BT for the rollout of parts of its NGA network. BT was expected to incur considerable costs to roll out NGA and contribute vastly to rural NGA rollout. Neither of these predictions has borne out. BT's accounts do not reflect largely inflated year on year capital expenditure. Capital expenditure has not radically grown. BT's contribution to rural broadband is now predicted to be only 23% of the cost some £207 million less than that modelled in 2011.

In this market review Ofcom has proposed modest increases in regulation. The main competitive tool proposed is the margin squeeze test. We further propose that Ofcom needs to remove the barriers to mobile competing effectively for NGA service supply. Our detailed comments on these are below.

MARGIN SQUEEZE TEST PROPOSALS

Competition development for this review period is reliant upon the proposed margin squeeze test proving to be successful. We consider the present proposals for the margin test needs a little refinement. The test and model that Ofcom ultimately uses must be transparent to all stakeholders and its variables must be predictable. The benefit of transparency and predictability are that as soon as BT is ready to launch a new service/offer BT can test the model itself (as can Ofcom in confirmation) without causing delay to the service /offer launch. We consider that transparency of the model will also result in an efficient, lower cost process as it is likely that more of the compliance can be attended to in advance of BT bringing an option to market and CPs can run tests independently in advance of bringing concerns to Ofcom. The model must cover all of the services intended to be in the market. We do not support a model which would only apply to a benchmark service akin to the way that Ofcom charge controls a benchmark WBA service. Where model parameters might change the model needs to be able to account for these in a timely manner.

Taking this option forward we consider that Ofcom should consult upon a proposed model outline including the range of assumptions. The final model should be available on Ofcom's website. Ofcom would notify any changes to the model by way of supplementary consultation and update the model format held on its website.

BT must be obliged to ensure that new services/offers are assessed against the margin test. Ofcom could obligate BT to carry out this work and to provide the detail of compliant output to Ofcom. No service/offer would be launched absent confirmation that the test was passed. We consider it key that the test assessment is carried out prior to market launch to avoid possible negative competitive outcomes even if the service / offer is withdrawn / modified at a later date.

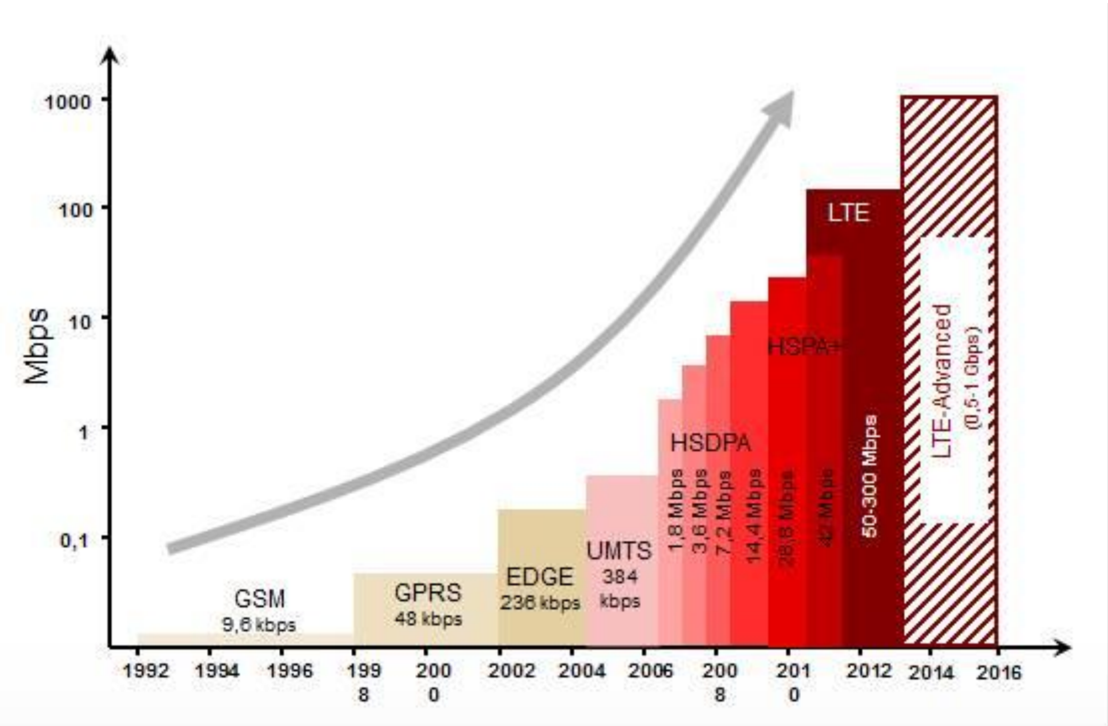
We consider that Ofcom should have a 12 month stakeholder review on the functioning of the margin squeeze test variables and test process to ensure that this remedy is indeed fulfilling its important objectives.

In the situation that a product / offer has been launched despite on first assessment passing the test variables but it is later found to breach the test – due to errors in projected costs or volumes, there needs to be an effective and fast mechanism in place to withdraw the product / offer.

MOBILE AS A PROVIDER OF NGA

Ofcom should not frustrate mobile NGA whether it be: complementary provision; rural alternative provision or generally substitutional provision. In the course of the forwarding looking review period Ofcom will be aware of the plans the mobile providers have for higher bandwidth service availability. Vodafone and O2 plan to cover 98% of the population with indoor LTE by the end of 2015 and there are known technological developments such as LTE-A which can be deployed before the end of the review period. NGA infrastructure competition is so poor that even marginal substitution (like we have seen with traditional mobile broadband dongles) which will bring some form of differentiated competition and should be encouraged. The policy question for Ofcom in this review is to what extent would an expansion of the existing PIA remedy promote this development? Improved backhaul costs together with the improved capabilities of LTE and LTE-A[8] would help enable LTE to reach its full NGA potential.

Figure to show bandwidth capability of mobile technologies



Source Vodafone

[8] Note that the axis on the left is logarithmic. LTE-A is 3 times faster than LTE which is itself up to seven times faster than HSPA+

CONCLUSIONS ON NEXT GENERATION ACCESS

We support Ofcom's proposals for the margin squeeze test and make our own proposals on how the detail of the test should work in practice.

We consider that Ofcom should remove / remedy any market barriers that prevent full NGA competition in particular the artificial regulatory barriers that preventing mobile from being a more prevalent option. Mobile technology can meet the requirements the standing blocks are regulatory barriers to cost improvement.

4. CURRENT GENERATION ACCESS

We continue to consider that current generation broadband has an important role over the coming years. We consider that in setting the charge control for LLU services that Ofcom should specifically reconsider its efficiency target and separately remove supplementary discretionary labour (SDL) costs which BT, but no other CP chooses to incur.

THE EFFICIENCY TARGET

Ofcom proposes an efficiency range of 4% to 6% and proposes 5% as the mid-range proposal for inclusion into the charge control formula. [confidential material removed] We consider that some of this super-normal profit is attributable to BT beating low efficiency assumptions set in charge controls over that period.

The data behind Ofcom's assumptions has been marked confidential so we are therefore unable to comment fully on the findings. In our view Ofcom should reconsider whether the range it has concluded upon is sufficiently ambitious. Furthermore we consider that Ofcom should cease its practise of taking the middle of road approach by picking the number in the middle of the range and instead push efficiency to the fore of the operating agenda of regulated services by selecting the highest efficiency factor in the range.

SDL (SPECIAL DISCRETIONARY LABOUR) COSTS

We consider that for charge control modelling purposes BT's SDL costs should be removed. BT's SDL costs cannot be regarding forward looking or efficiently incurred. They relate to labour practises that are unique to BT so for the purposes of setting of forward looking efficient charges for SMP services Ofcom should make an adjustment to remove BT's SDL costs in the same way that it disallows certain 21 CN costs. A confidential paper discussing this in more detail is attached.

5. RESPONSES TO QUESTIONS WLA CC

Question 3.1: *Do you agree with our proposal to impose an inflation indexed price cap? Please provide reasons to support your views.*

This is standard and a well understood approach and we agree it is appropriate.

Question 3.2: *Do you agree with Ofcom's proposal to use a CCA FAC methodology to establish the cost base for the next LLU and WLR charge controls? Please provide reasons to support your views.*

Yes.

Question 3.3: *Do you agree with our proposal that, for the purposes of these charge controls, BT's pre-1997 duct assets should continue to be valued on an indexed historic cost ("RAV") basis? Please provide reasons to support your views.*

The RAV adjustment for pre-1997 assets is soundly justified. We agree that it is proportionate and reasonable.

Question 3.6: *Do respondents agree with our proposal that the contribution to common costs should be the same for each wholesale access line service by the end of this control period? Please provide reasons to support your views.*

The contribution to common costs from MPF and WLR should be set in order to not choose winners and losers between the products. We favour a methodology that would not require reallocation of common costs if the balance of usage of services changes over time. Having the same allocation to MPF and WLR units would appear the best option to achieving this.

In the situation of common cost allocation to FTTP we presume that this product would have an allocation reflective of the fact that it is a fibre based product not a copper based product. It would be useful to understand BT's common cost allocation method for this service.

Question 3.7: *Do respondents agree that we should remove the TAMs price adjustment by the end of the charge control period? Please provide reasons to support your views.*

We consider that charges should be truly cost reflective. However where regulatory adjustments have been made in the past for justified reasons it is essential that adequate notice of reversal of such adjustments is provided and that it is certain that the conditions that warranted the adjustment in the first place no longer hold.

Question 3.8: *Do respondents agree that we should not make an adjustment to MPF charges to allow for shorter than average line length? Please provide reasons to support your views.*

We consider that charges should be truly cost reflective. However where regulatory adjustments have been made in the past for justified reasons it is essential that adequate notice of reversal of such adjustments is provided and that it is certain that the conditions that warranted the adjustment in the first place no longer hold.

Question 3.9: *Do you agree with our proposal to remove printed directory costs from WLR rental, and to do so immediately? Please provide reasons to support your views.*

Yes

Question 3.10: *Do you agree with Ofcom's proposal to set charge controls for LLU and WLR to expire on 31 March 2017? Please explain your reasoning and propose an alternative approach with supporting information if applicable.*

Yes

Question 3.11: *Do you agree with our proposal to use glide paths to align charges with costs for these charge controls? Please provide reasons to support your views.*

Yes

Question 3.12: *Do you agree that CPI and RPI are the main indices to consider for the LLU and WLR charge controls proposed in this consultation? Please provide reasons to support your views.*

Yes

Question 3.13: *Do you consider that we should use CPI to index the LLU and WLR charge controls proposed in this consultation? If not please explain why using the factors identified above, or any others you consider important.*

Yes

Charge control design

Question 4.1: *Do you agree that we should set separate line rental charge controls for (i) MPF rental, (ii) SMPF rental and (iii) WLR rental? Please provide reasons to support your views.*

Yes. We consider that separate controls are necessary to reflect the different costing for the different services and are necessary for the outcome of the charge control to be appropriate cost reflective pricing for these services. Given the divergence in purchasing patterns between BT and some CPs it would not be appropriate to bundle these services together and allow BT any greater freedom in setting individual charges.

Question 4.6: *Do you agree that we should charge control migration services at incremental cost? Please provide reasons to support your views.*

Yes, we consider there are pro-competitive reasons for charging certain services at incremental cost and support Ofcom's proposal to calculate the cost of migration services based on incremental costs alone.

Question 4.7: *Do you agree that we should align all migration charges involving jumpering to a single target price ceiling by the end of the charge control period in 2014 and set a separate target price ceiling for WLR Transfers to its incremental cost using glide paths? Please provide reasons to support your views.*

We consider that Ofcom should treat WLR transfer charges differently to the approach proposed.

WLR remains a key product for both CGA and NGA service provision.

Ofcom proposes that the WLR transfer charge increases over the term of the charge control. Vodafone proposes an alternative option for transfer cost recovery which we regard to be a more pro-competitive solution for this services' cost recovery.

Despite the current transfer charge being shown to be below cost the charge represents a considerable hurdle for customer switching. As the transfer cost increases CPs will see less benefit in attempting to attract consumers to switch due to the longer payback periods involved to recover the transfer cost.

We consider that a better cost recovery option is akin to the approach that Ofcom takes for LLU cease whereby the cost is distributed across all users and included in the rental charge[9]. An approach such as this would make the annual rental charge for WLR users increase very marginally from Ofcom's current proposals.

Spread across all users the inclusion of transfer costs would add 23 pence per user. Where Ofcom proposes that base year charge is £90.66 we propose that inclusion of the transfer would make this £90.89.

Question 4.9: *Do you agree that the charge for MPF and SMPF cease should be zero and costs recovered from MPF and WLR rental charges on an equivalent per line basis? Please provide reasons to support your views.*

Yes, we advocate a similar treatment for WLR transfer.

Question 4.10: *The complete list of ancillary services considered in the MPF, SMPF and Co-Mingling baskets for the charge control period 2014/17 is included in the "Legal Instruments" Annex. Do you agree with our proposal to control three ancillary services baskets and with the proposed lists of ancillary services for the MPF, SMPF and Co-Mingling baskets? Please provide reasons to support your views.*

Yes

Question 4.11: *Do you consider that X in CPI-X for the ancillary service baskets should be determined as: the same X for both SMPF and MPF ancillaries baskets based on the pooled costs and pooled revenues of SMPF Ceases, MPF Ceases and MPF New Provide; and X for Co-Mingling ancillaries basket based on the pooled costs and pooled revenues of Room Build, Hostel Rentals and Tie Cables? Please provide reasons to support your views. If you consider a different basis is more appropriate please set out what this approach would be and why.*

We agree with the proposals as set out.

Question 4.16: *Do you agree that the existing obligation to align LLU Enhanced Care service charges with WLR Enhanced Care service charges should be retained? Please provide reasons to support your views.*

Yes

Question 4.20: *Do you agree that with basket controls coupled with sub-caps on individual services, a cost orientation obligation is unnecessary for the ancillary services? Please provide reasons to support your views.*

Ancillary services are important and can represent a significant uplift in the overall charge for services. We consider that Ofcom's approach to charge controlling these services is appropriate. We assume that any particular concerns about the level of individual charges could be progressed via the fair and reasonable pricing obligation that exists. If this this not the case then we would certainly advocate backstop cost orientation obligations to ensure that Ofcom has the necessary information means to investigate any pricing disputes.

[9] This is also an approach that BT is presently tabling in the context of future ECC recovery

Quality of service review and fault rate effects

Question 5.1: *We would welcome the views of stakeholders on our proposed approach to estimating the cost of changes to service levels.*

Please see section 1 and 2.

We disagree fundamentally with any approach that seeks to charge consumers more to secure quality of service and this initiative needs to be put into context. BT's recent returns illustrate that it is both over-recovering on a range of regulated products and deploying a number of very inefficient and costly practices which are fed through into regulated charges. To ask CPs to pay more to receive regulated products in a failed market when the supplier is both inefficient and making excessive returns is not something that should be contemplated. The evidence clearly shows that BT earns more than sufficient funds to deliver better service levels without charging CPs and consumers more. We would urge Ofcom to focus its effort in properly understanding BT inefficiency problems, which are so significant that they cannot be ignored and not pursue an initiative which will see consumers pay more than they need to ensure an acceptable level of service.

Efficiency

Question A7.1: *Do you agree with our proposed approach to modelling efficiency, both in general and in particular in applying a single efficiency target to both operating costs and capital expenditure? Please provide reasons to support your views.*

Please see section 1 and 4.

We have serious reservations that Ofcom's approach to efficiency modelling is adequate. {confidential material removed].

We consider that this is in part due to Ofcom putting in place charge control efficiency requirements which are far too low.

Question A7.2: *Do you agree with our proposed net efficiency range of between 4% and 6% and base figure of 5%? Do you agree with the levels proposed? Please provide reasoning to support your views.*

Please see section 1 and 4.

No, we consider that Ofcom should be seeking to promote top of the range efficiency levels.

In order to promote adequate efficiency within BT, Ofcom should cease its practice of selecting an efficiency number from the middle of the range and instead encourage ambition from BT by selecting the top range number if not higher.

We discuss in the earlier sections our concerns that regulated charges are contributing to BT's outdated labour practices. We consider the contribution is not warranted and that Ofcom should make an explicit adjustment to remove these costs from the charge control cost base.

6. RESPONSES TO QUESTIONS FAMR

Market definition and SMP analysis: WFAEL

3.1 Do you agree with our provisional view that, during the period covered by this market review, BT and KCOM will have SMP in the WFAEL markets we define above? Please provide reasons in support of your views.

WFAEL markets have significant barriers to market entry. Although in decline both of these markets remain important over the coming review period and most likely some time beyond. SMP designation is not going to change within these markets as new market entry simply will not occur. We support Ofcom's findings.

Market definition and SMP analysis: ISDN30

4.1 Do you agree with our provisional view that, during the period covered by this market review, BT and KCOM will have SMP in the wholesale ISDN30 markets we define above? Please provide reasons in support of your views.

We share Ofcom view of the continued importance of ISDN30 in the short and medium term. It continues to be valued by customers, maintaining its reputation for reliability and ease of use. The advent of new technology and products means ISDN30 services are gradually being replaced with more feature rich offerings, provided at competitive prices.

At the time when Ofcom set the current ISDN 30 charge control, while we[10] acknowledged the case for a charge control, we sounded a note of caution, raising concerns that reducing prices too steeply and too suddenly would undermine other forms of access provision and remove choice from consumers. It would also place an unfair burden on alternative infrastructure providers who face with the prospect of managing a product in decline. Rapid price reductions in the wholesale market would hit alternative providers first, due to their higher cost of provision and as a result it may cause more consumers to migrate to a BT based solution (possibly based on wholesale ISDN30), diminishing competition and actually entrenching BT's SMP in the wholesale market.

These concerns remain valid today as we face the prospect of having rising unit costs over the years ahead as volumes decline as consumers migrate. However we still have to accommodate the potential for a sizable minority of consumers still hoping to remain with the product until it is declared end of life and mandatory migration occurs. It is with this in mind that we welcome Ofcom's simple approach to charge control setting, introducing a basket approach with a cap based on nominal pricing at the end of the current control period. We believe this is a proportionate approach to take, recognising both the stage in the life cycle that the product is at and takes account of concerns from alternative communication providers about the disproportionate impact on them from destabilising reductions in wholesale prices as well as safeguarding the interests of consumers who continue to purchase the product.

We would repeat our call for Ofcom to impose a remedy on BT that provides customers of their Featurenet product with a means to migrate to another supplier, as under the current arrangement many find themselves locked into the product, with no opportunity to change the underlying provider due to the lack of a migration process. While we

[10] Within CWW responses to the various ISDN30 charge control consultations

acknowledge that the Featurenet product may not fit formally under the ISDN30 banner, it is a clear substitute product and the competition concerns around it should be addressed somewhere in Ofcom's work program. If all market review projects that Ofcom undertake refuse to accept ownership of the issue it will remain unresolved. We believe that the FAMR remains the most appropriate place for this issue to considered and we would urge Ofcom to set out a clear commitment to resolve it.

15.1 Do you agree with our proposal to continue to require BT to provide wholesale ISDN30? Please provide reasons in support of your views.

Yes

15.2 Do you agree with our charge control proposals for ISDN30? Please provide reasons in support of your views.

Yes.

15.3 Do you agree with our proposed approach for cost accounting for ISDN30? Please provide reasons in support of your views.

We will respond separately to the consultation on accounting reform.

Market definition and SMP analysis: ISDN2

Do you agree with our provisional view that, during the period covered by this market review, BT and KCOM will have SMP in the wholesale ISDN2 markets we define above? Please provide reasons in support of your views.

Vodafone supports Ofcom's proposals to move ISDN2 from a cost orientated product to a charge controlled product. Ofcom proposes to treat ISDN2 akin to ISDN30. However where there is alternative competitive supply for ISDN30 this is not the case for ISDN2. We consider high returns on ISDN2 would contribute further the generic over recovery of WACC we identify that BT has made over the period 2006 to 2012. We consider that Ofcom should be more stringent with its assessment of cost bearing in mind the depreciated nature of ISDN2 costs. Given the complexity of assessing the true cost base for ISDN2 and the lack of available data we would suggest that the WLR charge control represents a reasonable proxy.

We identified to Ofcom our concerns with respect to BT's recent price increase for ISDN2 transfer charge and how this was out of line with other similar products. We welcome Ofcom's proposal to make a one off reduction to this charge to £10 per channel.

5.2 Do you agree with our provisional view that, during the period covered by this market review, BT does not possess SMP in the retail ISDN2 market we define above? Please provide reasons in support of your views.

Subject to appropriate wholesale remedies being in place (including Ofcom's proposals for the ISDN2 transfer charge) we agree that BT would not have SMP in retail ISDN2.

15.4 Do you agree with our proposal to continue to require BT to provide wholesale ISDN2? Please provide reasons in support of your views.

Yes

15.5 Do you agree with our charge control proposals for ISDN2? Please provide reasons in support of your views.

Yes

15.6 Do you agree with our proposed approach for cost accounting for ISDN2? Please provide reasons in support of your views.

Yes

Market definition and SMP analysis: WLA

7.1 Do you agree with our provisional view that, during the period covered by this market review, BT and KCOM will have SMP in the WLA markets we define above? Please provide reasons in support of your views.

Yes, alternative entry into the WLA markets is not feasible where the technology requires replication of BT's duct network in addition to the laying of fibre/copper/cable connections to individual user premises. Even in higher value business markets new network construction to end user sites is a niche occurrence.

Whilst services continue to rely upon physical access to the user's premise, BT will retain its SMP in the provision of WLA services.

Alternative supply of NGA services using either public funds and or BT's duct network has failed to make any significant impact on the market. We consider this failure is in part due to the unrealistic restrictions upon PIA preventing alternative suppliers for achieving necessary economies of scope across any network they would build.

Remedies: General Remedies for wholesale fixed access markets

10.1 Do you agree with our proposals regarding requirements on BT and KCOM to provide network access on reasonable request? Please provide reasons in support of your views.

While we remain reliant upon SMP inputs it is essential that BT is responsive to product requests / enhancements from CPs.

The obligation to provide network access on reasonable request is key to BT being responsive to CP requests although Ofcom will be aware that this process continues to result in conflict between CPs and BT.

CPs are currently reviewing industry interaction between the stakeholders and OTA and we hope the Ofcom will support any proposals to improve the current situation.

10.2 Do you agree with our conclusion not to seek to modify SLAs or SLGs as a mechanism for quality of service improvement? If not, how would you modify the SLAs and or SLGs and on what basis and how would you ensure that such changes did not have unintended incentive consequences? Specifically do you consider that the existing SLA for provisioning appointments (12 days from next year) is adequate? Please provide reasons in support of your views.

There needs to be an incentive to improve quality to the business market where late delivery and extended loss of service has a greater customer impact. A combined regime for residential and business does not resolve the QoS problems adequately for business customers. Under a combined approach BT's incentives will lie with resolving volume residential market issues.

10.3 Do you agree with our proposals regarding requirements on BT and KCOM in relation to handling requests for new network access? Please provide reasons in support of your views.

Yes we support the proposals.

10.5 Do you agree with our proposals regarding requirements on BT and KCOM in relation to accounting separation? Please provide reasons in support of your views.

We will respond to the separate consultation on accounting reform.

10.6 Do you agree with our proposals regarding requirements on BT and KCOM to publish a reference offer? Please provide reasons in support of your views.

Yes, reference offers are key documents in relation to regulatory compliance.

10.7 Do you agree with the proposal to specify the services for which BT is to provide SLA/SLGs? Also do you consider that we have identified all appropriate services that should be subject to an SLA/SLG requirement at this time? If not, please set out what services should be included and provide reasons in support of your views.

Yes the current regime excludes business type products such as ISDN30 and Multiple MPF (the input product for EFM). Current SLA/SLG regime focuses upon appointment availability. There are no penalties for despatch of an inappropriately skilled engineer or incorrect/poor quality installations for which CPs have to pay for correction i.e. circuit installed in incorrect location results in CPs having to raise and pay for a shift of circuit.

10.8 What are your views on whether you consider a need for Ofcom to require BT to offer an SLA in relation to GEA appointment availability? Please provide reasons in support of your views.

Yes this should be across all products, as above other products are also excluded.

10.9 What are your views on the principles for negotiations on SLA/SLGs? Please provide reasons in support of your views.

We discuss that a 2 month time frame monitored by the OTA would be appropriate in the section at the beginning of this response.

10.13 Do you agree with our proposal to extend the direction for specific KPIs to LLU and GEA services? Please provide reasons in support of your views.

Yes we would also like to see a split of KPIs across business and residential markets. Performance in each of these markets will result in differing concerns and solutions. Inability to understand performance hampers resolution.

10.14 Do you agree that it is appropriate to include a common core set of KPIs across WLR analogue, LLU and GEA given the competition between these services? Please provide reasons in support of your views.

Yes, end user experience should feel the same for these products.

10.15 Do you agree with our proposals to include a record of the number of services affected by MBORC in the KPIs? Please provide reasons in support of your views.

Yes, so we can better inform customers of services impacted and identify trends in re-occurring incidents.

10.17 Do you agree that it is appropriate to set minimum standards for Openreach services? Please provide reasons in support of your views.

Yes, please see section 2.

10.18 Do you agree that the minimum standards should only be applied to WLR and MPF provisioning appointment and fault repair? If not what else should be included and why? Please provide reasons in support of your views.

No it should include quality not just availability of appointment. The business market is less likely to require an appointment immediately, it is most likely that they will request a date greater than 12 days therefore what is required is greater certainty that the order will be completed on the agreed date.

10.21 Do you agree with the structure of the standard – yearly, forecast region targets? Please provide reasons in support of your views.

Please see section 2.

10.22 Do you agree with our proposals regarding requirements on BT in relation to cost accounting and not to impose cost accounting requirements on KCOM? Please provide reasons in support of your views.

We will respond to this in the separate consultation on accounting reform.

Remedies: WLA next generation access

11.1 Do you agree with our proposal to require BT to offer VULA and with the five key characteristics identified? Please provide reasons in support of your views, including, if you think alternative or additional characteristics are required, evidence of how you would use them to offer services to your customers.

We support the on-going requirement for BT to provide VULA.

11.2 Do you agree that BT should continue to be allowed general pricing flexibility on VULA, subject to a fair and reasonable charges obligation? Please provide reasons in support of your views.

Please see section 3.

11.3 Do you agree that the charge for a GEA migration should be subject to a charge control at some point in the range of £10 to £15? If so, please indicate where in that range the charge should be, supported by evidence. If not, please state the reasons why.

We agree that Ofcom has correctly identified that the present GEA migration options are a barrier to consumer switching. We agree with the proposals that Ofcom makes to remedy this.

11.4 Do you agree with our proposal that BT offer a minimum contract term of no more than one month following a GEA migration? Please provide reasons in support of your views.

Yes

11.5 Do you agree with our proposed approach to regulating the margin between the VULA price and BT's downstream prices? In particular:
(a) Do you agree that our objective should be to ensure that BT sets a VULA margin that allows an operator with slightly higher costs than BT (or some other slight commercial drawback relative to BT) to profitably match BT's retail superfast broadband prices?

Yes

(b) Do you agree that we should achieve this objective by requiring BT to set fair and reasonable terms, conditions and charges and setting out guidance on how we would interpret this requirement?

Yes. In section 3 we give our views of how the *ex ante* margin squeeze test should be established.

(c) Do you agree with our draft guidance? In particular, do you agree with our benchmark operator and the ways in which such an operator differs from BT?

Yes, we propose further consultation around the model parameters which will address this is greater detail.

11.8 Do you agree that we should continue to require PIA and that it should be offered subject to a Basis of charges requirement? Please provide reasons in support of your views.

Yes. We further consider that the limitations on use should be lifted to allow the use of PIA for leased lines and mobile backhaul. Vodafone is an intervener in the current BCMR PIA appeal.

11.9 Do you agree that PIA should continue on the same bases as it is currently applied? Please provide reasons in support of your views, including, if you disagree with our approach, evidence of specific business plans or intentions to invest in deploying NGA networks that are currently unviable, but would become viable with your suggested changes.

No, we consider that Ofcom has incorrectly identified common cost recovery concerns with its BCMR PIA decision. PIA should be available without usage restrictions. Vodafone has provided Ofcom will details of its requirements for PIA in the context of the BCMR.

Remedies: WLA current generation access

12.1 Do you agree with our proposal to continue to require BT to provide LLU? Please provide reasons in support of your views.

Yes LLU continues to be an important product with a lifetime of many years to come. LLU supports both voice, broadband and Ethernet first mile services.

12.2 Do you agree with our proposal to continue to apply a charge control on LLU? Please provide reasons in support of your views. (Comments on the specifics of the charge control should be made in response to the forthcoming 2013 LLU WLR Charge Control Consultation.)

Yes we consider the imposition of a charge control continues to be appropriate and warranted. Notably the charge control equally applies and is necessary in the context of NGA services provided using WLR and SMPF.

Remedies: WFAEL
14.1 Do you agree with our proposal to continue to require BT to provide WLR? Please provide reasons in support of your views.

WLR is a fundamental service for both CGA and NGA service provision we agree with Ofcom's proposals.

14.2 Do you agree with our proposal to continue to apply a charge control on WLR? Please provide reasons in support of your views. (Comments on the specifics of the charge control should be made in response to the forthcoming 2013 LLU WLR Charge Control Consultation.)

Yes.

14.5 Do you agree with our proposed approach to cost accounting for WLR? Please provide reasons in support of your views.

We will respond to the separate consultation on accounting reform.

Vodafone Limited
September 2013