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Verizon Enterprise Solutions response to Ofcom's Narrowband Market Review Consultation on the possible approaches to cost modelling for the Network Charge Control for the period 2013-2016

Verizon Enterprise Solutions ("Verizon") welcomes the opportunity to respond to Ofcom's Narrowband Market Review Consultation on the possible approaches to cost modelling for the Network Charge Control ("NCC") for the period 2013-2016 (the 'consultation document').

Verizon is the global IT solutions partner to business and government. As part of Verizon Communications – a company with nearly $108 billion in annual revenue – Verizon serves 98 per cent of the Fortune 500. Verizon caters to large and medium business and government agencies and is connecting systems, machines, ideas and people around the world for altogether better outcomes.

Summary

Verizon is, overall, in principle in agreement with the broad approach taken by Ofcom; however Verizon is concerned by Ofcom's approach to some specific matters and, in general, the lack of detail provided within the consultation document. Verizon therefore reserves its position with regards to the proposals contained within the consultation document.

In particular, a number of consequential issues will need to be investigated before a final view can be reached. These will include issues such as IECs, caller and called-party location information. Verizon is concerned by the disjunction between Ofcom's theory and what happens in the real world. IP interconnect is still fairly nascent; Verizon would not wish for this consultation document (based on a theoretical modelling exercise) to pre-empt any future practical considerations regarding the network.

As an overarching point, Verizon's directional support is contingent on the NGN as MEA being, in fact, more efficient – i.e. for this approach to be acceptable, actual charges must be lower.

Please note that in its response Verizon has responded to some, but not all, of the questions posed in the consultation document.

Question 1: Do you agree with the proposal that next generation assets ('NGN') can be considered modern equivalent asset ('MEA') for the purposes of modelling call origination and call termination services? If not, please explain why.

Verizon agrees, in principle, with Ofcom's proposal to model NGN as the MEA for the purposes of call origination and call termination services; however, the disjunction between reality and theory raises concerns. It remains unclear how, for example, the hypothetical model's outputs relating to the pence per minute charges, will translate into the cost of services in the working network.

Question 2: Do you agree with the proposal that Ofcom's NGN model should include points of interconnection ('PoI') based on internet protocol ('IP') interconnection? If not, please explain why not.

Verizon agrees, in principle, with Ofcom's proposal that the NGN model should include PoI based on IP interconnection. Theoretically, IP interconnect ought to be more efficient. Verizon therefore considers that it is safe to assume that BT charges will be lower on the NGN; if this is not the outcome, the modelling exercise appears wholly redundant. To be clear: Verizon supports an outcome which results in lower prices. A (supposedly) MEA approach which resulted in higher prices would not be efficient and Verizon would be strongly opposed to such an outcome.

Question 3: Do you agree with Ofcom's proposal on PoIs for our NGN network?

Question 4: Do you consider that if the MEA is NGN, the cost of conversion from time division multiplexing ('TDM') to IP should be excluded from cost-based call origination and call termination rates? If no, please explain why.

We answer these two questions together.

Ofcom (whilst acknowledging the PoI industry agreed Ethernet figures of "27+2" PoIs) have opted for 20 PoIs[1]. Verizon has no special affection for the 27+2 arrangement which was essentially arrived at by three carriers in a now dormant organisation. Therefore, as long as the 20 proposed by Ofcom are the same 20 PoIs as previously proposed by BT, then Verizon supports Ofcom's proposal.

[1] Consultation document paragraph 3.75 and footnote 69

For the record, Verizon assumes that the 1,000 super-access nodes are not intended to be points of interconnect; this is unclear from the current consultation and Verizon would welcome greater clarity on this point.

Verizon is content with BT's original modelling proposal for 20 PoI.

<u>Conversion Costs</u>

In relation to IP / time division multiplexing ("TDM") conversion costs, Verizon takes this opportunity to remind Ofcom that this consultation paper is intended to set theoretical modelling assumptions; as such, the number of PoIs should be hypothetical only.

Verizon is concerned that any policy decisions made at this point might influence, unduly, future decisions. CPs are likely to be interested in the 'real world' consequences of the hypothetical model.[2] A clear statement is required from Ofcom outlining that the model at this point is not intended to spark a policy debate on these practical issues, or indeed to pre-empt the approach Ofcom may take in future disputes.

Verizon is also concerned that by determining a specified number of PoIs in terms of proposed charges, there is danger of pre-empting the practical workings of the NGN network before it has evolved. Verizon does not think it appropriate that a hypothetical model impact on policy decisions regarding who will pay conversion costs in the future.

Verizon urges Ofcom to consider its approach in this area in terms of both the hypothetical model, and its potential implementation in practice in the future. In particular, Verizon would welcome an explicit confirmation from Ofcom that the MEA (in its hypothetical form) will not affect any other decisions or consultations relating to these questions.

Question 5: Should Ofcom use the bottom-up modelling approach for calculating the efficient costs of call termination or call termination and call origination? If not, please explain why.

Verizon agrees with Ofcom's proposal to use the bottom-up modelling approach for calculating efficient costs of call termination or call termination and call origination. Verizon considers this is clearly best practice in any event and, in the

[2] For example, Opal Telecom ("Opal"), now TalkTalk Telecom Group Plc., raised a dispute with Ofcom in June 2009 regarding BT's ability to charge conversion costs arising on BT's network where BT did not offer an end-to-end IP interconnect product.
http://stakeholders.ofcom.org.uk/binaries/consultations/draft_deter_opal_telecom_bt/Final_determination.pdf at paragraphs 3.18-3.19 and 4.40-4.41

context of the NGN model it is difficult to see how a different approach would be easily practicable.

It should be noted that, theoretically there is a much stronger case to make in favour of pure BULRIC for termination than for origination, which is a market with competitive alternatives, which is not the case with termination.

Question 6: Do you agree that Ofcom should use a decremental approach when calculating the pure LRIC of call termination? If not, please explain why.

In principle, Verizon strongly agrees with the move to pure LRIC for call termination and the use of the decremental approach when calculating pure LRIC for call termination. Pure BULRIC for a bottleneck service such as termination where there are no alternatives is the right economic approach. This is also one of the main reasons why the EC in its 2009 recommendation has explicitly recommended pure BULRIC as the appropriate cost model for setting termination rates, both fixed and mobile.

In addition, Verizon raises the following issues:

i) Verizon thinks that it would be beneficial for Ofcom to disclose the model it intends to use so that CPs can review the elements that Ofcom intends to remove when implementing the decremental approach.

ii) Verizon has concerns regarding how common costs currently attributed to call termination will be recovered. Verizon consider that it would be beneficial for Ofcom to consult on how these common costs would be allocated.

iii) Verizon's position is that these common costs should not be simply moved to call origination services as this serves merely to shuffle costs, nor that they should be allocated across other regulated services. Verizon considers that it would be discriminatory for BT to benefit from recovering its call termination common costs from other regulated services, where CPs (who do not provide regulated services) would not be able to recover their costs in the same way.

To be clear, common costs for origination can only consist of common costs that are really attributed to origination.

Question 7: Do you agree with Ofcom's approach to network cost verification? If not, why not.

Ofcom outlines three conditions that it intends to adhere to when modelling the costs of the NGN. In particular, Ofcom says that there should be:

> *"**Fair opportunity for cost recovery:** The unit costs from the NGN model over the 2013-16 period would not deny BT the opportunity to recover its efficiently incurred costs (in particular those of TDM assets)."* [3]

Verizon is curious as to why this has been included in the consultation document. This statement is totally at odds with the approach taken to MEA modelling in the rest of the document. The MEA approach is that BT should only be able to recover for the cost of the modern equivalent asset[4]; for Ofcom to say that BT should be able to recover for the (older, inefficient) network ***as well*** is a fundamental contradiction.

To put this another way: Ofcom has proposed a bottom-up model, but appears to also be permitting actual costs recovery by BT. Ofcom should consider whether it really intends for BT to be able to recover actual costs. Given this ambiguity Verizon seeks clarification from Ofcom that MEA is the efficient network, not TDM as indicated in the quote above.

In addition, any arguments by BT about its costs – whether theoretical or actual – should be robustly tested and audited. Clear visibility of the model is one way to ensure such robust scrutiny. In addition it would be appropriate to have a separate audit to review the costs incurred by BT in terms of the NGN (noting that the TDM is already audited as part of the RFS).

Question 8: Do you agree with Ofcom's proposed approach to traffic forecasting and the modelled market share? If not, please explain why.

The lack of detail provided within the consultation document has made it virtually impossible for Verizon to determine whether it agrees with Ofcom's proposals. With a view to gaining some clarity as to the approach taken by Ofcom, Verizon is keen to see the populated version of the model so as to make a determination on the proposed approach to both the forecasting and the modelled market share. As the model is a bottom-up model, Verizon cannot see why it would be an issue for Ofcom to provide this data. In addition, Verizon would be keen to see the forecasts broken down to indicate usage by residential and business lines.

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[3] Consultation document paragraph 4.17

[4] For example, stated at c paragraph 3.19 of the consultation document: *"…in setting charges, we prefer to base costs and asset values on the most efficient available technology that performs the same function as the current technology…"*

Market Share Assumptions

Ofcom has decided that market shares should be based on:

> *"an even split of the market between the largest direct access operators in recent years. To date BT, Virgin Media, Sky and TalkTalk have accounted for the vast majority of directly connected residential customers across the country. An even split would suggest a 25% share for the modelled operator."*[5]

This approach is wholly unrealistic and does not reflect the representative shares within the market. Ofcom's recent Telecommunications Market Data Update states that a key trend that emerged in that quarter was that BT's share of fixed-originated call volumes increased by 0.3 percentage points to 37%.[6] This clearly illustrates that this type of market share allocation favours and protects BT's position by ignoring its higher market shares, which also shows an increase in BT's market share. Verizon consider that market shares (whether for a hypothetical model or not) should be more representative of the reality and urges Ofcom to reconsider its position.

Question 9: Do you agree with Ofcom's approach to non-network costs and passive network elements? If not, please explain why.

Network Costs – Scorched Node Assumptions

Ofcom has proposed a bottom-up network based on the 'scorched node' approach, using the existing location and serving area of BT's existing exchanges. Verizon considers that in the UK, more consideration should be given to the 'scorched earth' approach.

The 'scorched earth' approach involves locating the model's exchanges in the most efficient formation; as such, this approach works on the premise that BT will be upgrading or closing non-efficient exchanges to optimise the efficiency of the network. In reality, BT has been planning to do this for years and should be implementing their plans imminently. At the PPC Industry Forum in June 2008, BT Wholesale said that:

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[5] Consultation document paragraph 5.15.3

[6] Telecommunications Market Data Update Question 2, 2012 http://stakeholders.ofcom.org.uk/market-data-research/market-data/communications-market-reports/tables/q2_2012/

"BT is currently working on an exchange closure notification plan, which will include details of post code changes where appropriate and their replacements where applicable." [7]

In January 2012 BT issued a presentation slide pack as a "Guide to using the FTTC and FTTP roll out plans".[8] These slides illustrate that BT is planning to build and upgrade exchanges. A further slide pack presented at the ISP Forum on 9th May 2012 also outlines the phased closure of inefficient exchanges over the next few years.[9] Verizon is of the view that that Ofcom should be considering these changes and improvements to the network when modelling and urges Ofcom to reconsider its approach.

Question 10: Do you agree with Ofcom's proposed approach to cost recovery? If not, please explain why.

Verizon comments specifically in respect of Ofcom's proposals for 'Cost Recovery Between Assets', and in particular those relating to adjusting routing factors so that they reflect different proportions of traffic in the 'busy hours'[10]. Verizon considers that it would be unjust for CPs to pay higher rates at times when they are not using the service as much as others, equally, that CPs should be allowed to pay less when they are monopolising the service.

Verizon are keen to see how Ofcom proposes to define the 'busy hours' and how it plans to differentiate between businesses that have different 'busy hours' throughout the day; and in particular, between company and residential lines.

Verizon Enterprise Solutions
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[7] PPC Industry Forum, 12 June 2008, slide 7 https://www.btwholesale.com/pages/downloads/service_and_support/contractual_information/docs/ppcoffer/industry_presentation12June08.ppt

[8] www.btwholesale.com/.../Guide_to-using_the_FTTC_and_FTTP_roll_out_plans.pptx - 31k - 2012-01-10

[9] https://www.btwholesale.com/shared/document/Library/Industry_Engagement/ISP_Forum/ISP_Forum_8th_May_2012_final_2.pdf (in particular slides 2,3 and 4).

[10] Consultation document paragraph 5.48