

Mr Lawrence Knight  
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12 September 2011

**BY EMAIL**

Dear Lawrence

**Re Dispute relating to LLU — BT's charges for MPF Rental**

We refer to your letter dated 6 September 2011 asking Openreach for any comments that we have on the issues raised by TalkTalk Group plc ("TalkTalk").

We set out below our comments on the dispute relating to TalkTalk's claim that Openreach's current MPF Rental price of £91.50 should be lowered to £90.00, where £90.00 is the midpoint in Ofcom's consultative range for MPF Rental for the period from the start of the new controls to 31 March 2012, as outlined in Ofcom's consultation for the LLU charge controls.

Openreach does not consider it necessary or appropriate for Ofcom to accept the dispute for resolution. We therefore consider that there is no need for Ofcom to consider any repayments to TalkTalk. In particular it is clear from the background set out below that TalkTalk had every opportunity to challenge the approach Openreach proposed in relation to interim pricing (during the price notification period from 9 December 2010 to 31 March 2011) but did not do so. This is despite the fact that it was very clear from the outset that our approach for interim pricing was intended to apply until Ofcom had concluded the next LLU and WLR charge control review, and that it was therefore self-evident that Ofcom would publish a consultation document in the interim.

**Background**

In late 2010, Openreach and Ofcom recognised that the introduction of the next set of LLU and WLR charge controls would be delayed beyond the expiry of the previous controls. In the absence of a new charge control being set, LLU and WLR services are subject only to the general cost orientation obligations. Openreach recognised that this could create pricing uncertainty for its customers and therefore proposed pricing commitments that provided certainty.

In December 2010 Ofcom published Openreach's voluntary commitment as to the maximum charges it would apply for LLU and WLR services listed in Table 1 below from 1 April 2011 until the start of the new controls (or 31 March 2012 if new controls are not in place by that date). These prices were based upon the financial modelling used to calculate the 3<sup>rd</sup> year of the 4 year glide-path determined by Ofcom in its 2009 LLU Statement and 2009 WLR Statement, and adjusted to reflect the CAT Ruling in the LLU and WLR Appeals. Ofcom acknowledged at the time that basing prices on such modelling was "*a reasonable approach to take*".<sup>1</sup>

**Table 1 Interim pricing arrangements**

	<b>Service</b>	<b>01/04/10-14/10/10 (i.e. year 2 of the glide path in the original 2009 LLU and WLR Statements)</b>	<b>15/10/10-31/03/11 (i.e. adjusted to reflect the outcome of the LLU and WLR Appeals set out in the CAT rulings)</b>	<b>Price ceiling from 01/04/11 (voluntary interim price ceilings)</b>
a	MPF Rental	£90.46	£89.10	£91.50
b	SMPF Rental	£15.63	£15.04	£14.70
c	WLR Basic rental	£103.68	£103.68	£103.68
d	MPF New Provide	£75.01	£62.11	£52.79
e	WLR New Provide	£55.74	£55.74	£48.22
f	WLR Transfer	£3.09	£3.09	£3.09
	LLU Ancillary Services			No increase of more than 3%

Openreach understands that Ofcom discussed the interim pricing arrangements with industry in December 2010. Openreach also notified the prices on 9 December 2010<sup>2</sup> and received no comments or objections from industry, and particularly no comments or objections from TalkTalk, during a notification period of nearly 4 months.

Given that the interim prices were explicitly set out to apply until the point at which Ofcom concludes its LLU and WLR charge control reviews, it was very clear that Ofcom would issue a consultation on those new charge controls in the interim.

It is clear that industry, including TalkTalk, accepted both BT's commitments and its charges. Ofcom should not now create industry uncertainty by allowing TalkTalk to seek set aside the settled pricing.

Since Ofcom's 2009 LLU and WLR Statements, and the 2010 CAT Ruling in the LLU Appeal which resulted in forward-looking amendments to the LLU Statement, no legally binding determinations have been made with respect to LLU pricing.

<sup>1</sup> Ofcom, *Charges for LLU and WLR services from 1 April 2011*, 1 December 2010, available from <http://stakeholders.ofcom.org.uk/binaries/consultations/openreachframework/statement/charges>.

<sup>2</sup> ACCN OR217 available from:  
<<http://www.openreach.co.uk/orpg/home/products/pricing/loadPricingNotificationArchive.do>>.

## Interim prices are consistent with regulatory obligations

The MPF Rental price of £91.50 is compliant with its obligations to be fair and reasonable and cost orientated, as per Significant Market Power (“SMP”) Condition FA1.2 and FA3.1 respectively of the 2010 Wholesale Local Access market review. As the table below demonstrates, the MPF Rental price is considerably below the Distributed Stand Alone Cost (“DSAC”) ceiling published in the Regulatory Financial Statements (“RFS”), and thus must be considered to pass the first order test for cost orientation.

**Table 2: MPF Rental per the RFS**

Year	Average Price	Unaudited (D)LRIC floor	FAC	Unaudited DSAC
2004/05	160.31	114.34	163.63	221.75
2005/06	80.00	157.99	221.86	270.67
2006/07	80.00	72.96	127.82	175.60
2007/08	80.00	64.85	105.86	127.14
2008/09	81.16	69.29	120.04	134.58
2009/10	85.46	52.09	85.49	104.28
2010/11 <sup>3</sup>	89.75	60.40	128.75	162.01

Therefore, Openreach considers that the price of £91.50 is consistent with its regulatory obligations, including that the price is fair and reasonable.

### “Correct price”

In its submission, TalkTalk claims that £90.00 is the “correct price” for MPF Rental. This price is, however, simply Ofcom’s proposed midpoint price for industry consultation for the period from the start date of the new controls to 31 March 2012. Ofcom’s consultative price ranges from £88.70 to £91.30 for MPF Rental.<sup>4</sup>

It is important to note that the Ofcom proposals are just that, proposals, and are still in the consultation phase with industry and are far from fixed. The proposals are not binding on BT or Ofcom. The final MPF Rental price will be dependent upon Ofcom reaching its conclusion on the various inputs into the underlying cost modelling, such as the level of the Weighted Average Cost of Capital (“WACC”), the level of the efficiency target, whether or not pensions deficit repair contributions should be included etc. TalkTalk, Openreach and several other CPs have provided views on these parameters to Ofcom in response to the consultation. Importantly, TalkTalk has responded with a substantive number of comments suggesting that the Ofcom’s price range is incorrect and seeking Ofcom to depart from its draft position in its final statement. It is only after taking stakeholder views into account, that Ofcom may determine what the final MPF Rental price should be.

We note that TalkTalk’s submission also recognises that Ofcom’s proposals are not determinative and continue to move. For example, TalkTalk recognises that the prices in Ofcom’s consultation assume that the WACC is 8.6%, but that Ofcom has recently determined a WACC level of 8.8% in the context of the Wholesale Broadband Access market review.<sup>5</sup> It is therefore unclear how TalkTalk could consider the MPF Rental price of £90.00 to reflect the most recent or best available evidence.

<sup>3</sup> 2010/11 RFS due to be published on 15 September 2011.

<sup>4</sup> Ofcom, *Charge control review for LLU and WLR services*, Consultation, 31 March 2011 as updated on 18 May 2011.

<sup>5</sup> Refer TalkTalk submission, page 12-13.

We also consider it unlikely that if Ofcom's consultation had proposed a midpoint of the consultative range for MPF Rental that was higher than the interim price, that TalkTalk would argue that this would be the "correct price" upon which Openreach could set its prices.

### Counter factual

In its recent determination into disputes for retrospective payments for historical LLU charges, Ofcom considered the counter-factual situation where it noted "*In the present Disputes, the price control was found to be too high, but it is possible that a price control could be found to be too low. If we were to apply an automatic presumption [for retrospective payment] in the former situation, we need to consider what our approach should be in the latter situation.*" [context added]<sup>6</sup>

In this case, we note that TalkTalk has limited the scope of the dispute to MPF Rental only. However, the interim price for MPF New Provide is £52.79, which is below TalkTalk's view of the "correct price" of £57.83.<sup>7</sup> TalkTalk has not offered to make any retrospective payments to Openreach for this service.

For the above reasons there can be no effective dispute, TalkTalk having implicitly accepting the charges until the implementation of the charge control. However, if Ofcom were to accept the dispute, we would wish for Ofcom to consider the counter-factual situation whereby the interim price is below the proposed new charge control price, and its view on impacts on incentives if it required purchasers of the price-capped services to make retrospective repayments to Openreach, i.e. for example MPF New Provide.

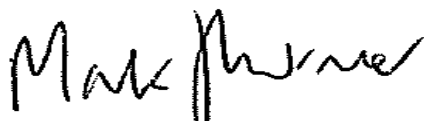
Moreover, if Ofcom were minded to accept the dispute, we note that TalkTalk first raised concerns regarding the interim pricing to Openreach on 3 June 2011, and following an exchange of letters, it was not until Openreach's response on 28 June 2011 that it could be suggested that 'commercial negotiations' broke down. Even if Openreach considered reacting to TalkTalk's concerns, given the 90 day price notification period it would not have been in a position to implement any changes until 28 September 2011.

### Enquiry Phase Meeting

Finally, I note that myself and team are available for an informal Enquiry Phase Meeting on 22 September 2011.

Please do not hesitate to contact me if you wish to discuss.

Yours sincerely,



Mark Shurmer  
Director of Regulatory Affairs and Deputy Managing Director  
Openreach

<sup>6</sup> Ofcom, *Determination to resolve Disputes between BT and each of Opal and Sky about Local Loop Unbundling Charges*, Final Determination, 20 July 2011, paragraph 3.46.

<sup>7</sup> Refer Ofcom, *Charge control review for LLU and WLR services*, 31 March 2011, paragraphs 1.15 and 4.105.