



Dispute between TalkTalk Group and Openreach relating to the MPF rental charge

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Dispute Consultation

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Glossary of terms

2003 Act: The Communications Act 2003.

2011 Consultation: *Charge Control Review for LLU and WLR services*, 31 March 2011, as updated by Ofcom on 18 May 2011, <http://stakeholders.ofcom.org.uk/consultations/wlr-cc-2011/>.

BT: British Telecommunications plc, whose registered company number is 1800000, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006.

CCA FAC: Fully Allocated Current Cost Accounting

CP: Communications provider.

FAC: Fully Allocated Cost

Interim Charge: Openreach's voluntary commitment that from 1 April 2011 until 31 March 2012 (or until a new Ofcom charge control starts, whichever is sooner), it will charge no more than £91.50 for MPF rental.

LLU: Local Loop Unbundling. A regulated wholesale service sold by Openreach. It allows CPs to physically take over or share the copper access network connection (from end-user to the BT exchange building) and to provide data services (e.g. broadband) and voice to retail customers.

MPF: Metallic Path Facility. The copper access network connection from end-user to the BT exchange building.

Openreach: A BT group business offering CPs products and services that are linked to BT's nationwide local access network.

Openreach's comments: Letter from M Shurmer (Openreach) to L Knight (Ofcom) dated 12 September 2011.

SMP: Significant Market Power.

TalkTalk Group or TTG: TalkTalk Telecom Group plc whose registered company number is 06534112, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006.

TTG's Submission: TTG's submission *Dispute relating to BT's MPF Rental Charge*, provided to Ofcom 5 September 2011.

WLA statement: *Review of the wholesale local access market: Identification and analysis of markets, determination of market power and setting of SMP conditions*, 7 October 2010, http://stakeholders.ofcom.org.uk/binaries/consultations/wla/statement/WLA_statement.pdf.

Section 1

Summary

- 1.1 This consultation (the “Dispute Consultation”) sets out for comment the main elements of our provisional reasoning and assessment of the matters in dispute.
- 1.2 This dispute, brought by TTG against Openreach (collectively the “Parties”), relates to the level set by Openreach for its wholesale MPF rental from 1 April 2011 (the “Dispute”).
- 1.3 MPFs (metallic path facilities) are BT’s copper lines between the local telephone exchanges and the customer premises. These can be rented by other communications providers to connect to their own networks and provide broadband and voice services to end users.
- 1.4 The annual charge for MPF rental has previously been subject to a charge control set by Ofcom. The most recent charge control ended on 31 March 2011 and Ofcom is consulting on proposals for a new charge control in its 2011 Consultation, which sets out a range for MPF rental of £88.70 to £91.30, with a base case of £90.00.¹ We expect to publish our conclusions on the LLU and WLR charge controls in the first quarter of 2012, with the charge controls being implemented before 31 March 2012.
- 1.5 Openreach has made a voluntary commitment that from 1 April 2011 until 31 March 2012 (or until a new Ofcom charge control starts, whichever is sooner) it will charge no more than £91.50 for MPF rental.²
- 1.6 TTG contends that the £91.50 charge is too high and that *“the figure of £90.00 is Ofcom’s best current view of the appropriate price and there is no realistic reason why it should not apply now”*.³ TTG claims that the charge of £91.50 represents an *“overcharge by BT [that] has a significant and negative financial impact on TalkTalk”*.⁴
- 1.7 Openreach considers that the £91.50 charge is compliant with its obligations, in particular SMP Conditions FAA1 (requirement to provide network access on reasonable request) and FAA4 (basis of charges).
- 1.8 On 5 September 2011 TTG referred a dispute to us, asking us to determine that BT is required to:
 - 1.8.1 Reduce its charge for MPF rental to no higher than £90.00 with immediate effect; and
 - 1.8.2 Make repayments to TTG for amounts paid in excess of the reduced charge, plus interest.

¹ Charge Control Review for LLU and WLR services, 31 March 2011.

<http://stakeholders.ofcom.org.uk/consultations/wlr-cc-2011/>.

² Letter from Openreach (M Shurmer) to Ofcom (S McIntosh) dated 24 Nov 2010.

³ Page 12 of TTG’s submission *Dispute relating to BT’s MPF Rental Charge*, provided to Ofcom on 5 September 2011 (“TTG’s Submission”).

⁴ Page 4 of TTG’s Submission.

Ofcom's provisional assessment of the matters in dispute

- 1.9 The outcome of our provisional assessment is that the MPF rental charge set by Openreach is compliant with the relevant regulatory obligations, in particular:
- 1.9.1 Conditions FAA1 and FAA9, requiring that MPF rental is provided by Openreach on fair and reasonable terms, conditions and charges; and
 - 1.9.2 Condition FAA4, requiring that Openreach secures, and demonstrates to the satisfaction of Ofcom, that the charge for MPF rental is reasonably derived from the costs of provision based on a forward looking long run incremental cost approach and allowing an appropriate mark up for the recovery of common costs including an appropriate return on capital employed.
- 1.10 On the basis of this provisional view, we have not assessed whether we think it would be appropriate for us to exercise our discretion under section 190(2)(d) of the 2003 Act to require Openreach to make payments to TTG by way of an adjustment for overpayments made.

Structure of the remainder of this document

- 1.11 In line with Ofcom's Dispute Resolution Guidelines,⁵ this document follows a new form for consultation. Instead of publishing a full draft determination, this is a shorter document in which we set out for comment the main elements of our provisional reasoning and assessment in relation to the matters in dispute.
- 1.12 The introduction and background to this Dispute are set out in **section 2** and the analysis underpinning our provisional reasoning and assessment is set out in **section 3**.

Next steps

- 1.13 Given the relatively straightforward nature of the matters in dispute, we consider it appropriate to set a consultation period of 10 working days.⁶ Accordingly, the Parties and other interested parties have until **5pm on 28 November 2011** to comment on this Dispute Consultation.
- 1.14 After considering any comments received, Ofcom will make a final determination. Details of how to respond to this Dispute Consultation are set out in **Annexes 1-3**.

⁵ *Dispute Resolution Guidelines*, 7 June 2011. See: <http://stakeholders.ofcom.org.uk/binaries/consultations/dispute-resolution-guidelines/statement/guidelines.pdf>.

⁶ In line with the *Dispute Resolution Guidelines*, 7 June 2011, we have considered whether to set a consultation period of up to 15 working days. Given the nature of this Dispute, we considered 10 working days appropriate.

Section 2

Introduction and background

Issues in dispute

- 2.1 This Dispute was referred to Ofcom by TTG against Openreach. It concerns the level of charge set by Openreach for MPF rental, which is a wholesale LLU product.

Regulatory requirement for BT to offer LLU

- 2.2 In the WLA statement we concluded that BT has SMP in the Wholesale Local Access ("WLA") market in the UK excluding the Hull area, and imposed a number of SMP Conditions on BT.
- 2.3 Condition FAA1 (Requirement to provide Network Access on reasonable request) requires that BT shall provide network access to third parties and that it does so on fair and reasonable terms, conditions and charges as Ofcom may direct from time to time.⁷
- 2.4 Condition FAA9 (Requirement to provide LLU services) requires that BT shall provide 'LLU Services' to third parties on fair and reasonable terms, conditions and charges, where "LLU Services" means network access to metallic path facilities (MPF) or shared access (SMPF).⁸
- 2.5 Openreach's charges for unbundled loops were subject to a charge control in place until 31 March 2011.⁹ The WLA statement concluded that a new charge control for LLU should be imposed from 1 April 2011 to 31 March 2014. However, the new charge has yet to take effect and Ofcom is currently consulting on proposals for this new charge control (see the 2011 Consultation¹⁰).
- 2.6 The 2011 Consultation, published on 31 March 2011, included proposals on the range for the MPF rental charge to run until 31 March 2014. On 18 May 2011, Ofcom published a revised version of the 2011 Consultation and underlying models to correct for a number of errors in the original consultation.¹¹ The corrected proposals set out a range for MPF rental of £88.70 to £91.30, with a base case corrected downwards from £90.70 to £90.00.
- 2.7 Since 1 April 2011, Openreach's charge for MPF rental has not been subject to a charge control. However, Openreach has made a voluntary commitment that from 1 April 2011 until 31 March 2012 (or until a new Ofcom charge control starts, whichever is sooner), it will charge no more than £91.50 for MPF rental¹² (the "Interim Charge"). This Interim Charge ceiling was based on Ofcom's final statement *A new pricing framework for Openreach* of 22 May 2009 (which forecasted costs to 2013/14) with

⁷ See Condition FAA1.2, as set out in the WLA statement, 7 October 2010.

⁸ Condition FAA9.2 of the WLA statement, 7 October 2010.

⁹ Set in May 2009 as part of the Openreach Financial Framework;

<http://www.ofcom.org.uk/consult/condocs/openreachframework/statement/annexes.pdf>.

¹⁰ See *Charge Control Review for LLU and WLR services*, 31 March 2011;

<http://stakeholders.ofcom.org.uk/binaries/consultations/wlr-cc-2011/summary/wlr-cc-2011.pdf>.

¹¹ See Ofcom update of 18 May 2011; <http://stakeholders.ofcom.org.uk/binaries/consultations/wlr-cc-2011/annexes/Correction18011.pdf>.

¹² Letter from Openreach (M Shurmer) to Ofcom (S McIntosh) dated 24 November 2010.

the outputs adjusted to reflect the conclusions of the Competition Commission in their Determinations on the appeals of that final statement. Ofcom's view was that this was "*a reasonable approach to take*". Details of Openreach's voluntary commitment and Ofcom's view on it were published on Ofcom's website in December 2010.¹³

- 2.8 In addition to Conditions FAA1 and FAA9, in the absence of a charge control the level of the MPF rental charge is also subject to a cost orientation obligation.¹⁴ Condition FAA4 (Basis of charges) requires that BT "*shall secure, and shall be able to demonstrate to the satisfaction of Ofcom, that each and every charge offered, payable or proposed for Network Access covered by Condition FAA1 and/or Conditions FAA9, FAA10 and FAA12 is reasonably derived from the costs of provision based on a forward looking long run incremental cost approach and allowing an appropriate mark up for the recovery of common costs including an appropriate return on capital employed*".¹⁵
- 2.9 Condition FAA4 therefore requires that charges are based on costs, with an appropriate treatment of common costs. Paragraph 6.135 of the WLA statement advises that our interpretation of the basis of charges obligation is that BT's prices must, as a first-order test, be between DLRIC¹⁶ and DSAC,¹⁷ providing BT with pricing flexibility between DLRIC and DSAC, but ensuring its charges remain within an appropriate upper and lower bound, constraining BT from setting excessive charges.¹⁸
- 2.10 Finally, Condition FAA6 (Requirement to notify charges, terms and conditions) requires that BT provides a written notice of any amendment to charges including MPF rental not less than 90 days before any such amendment comes into effect.

Dispute referred to Ofcom by TTG

TTG view that Openreach's charge for MPF rental is too high

- 2.11 TTG submits that the £91.50 charge set by Openreach for MPF rental is too high, on the basis that when the Interim Charge was set by Openreach, it was done so based on the best current view of costs at that time (i.e. December 2010). In TTG's view

¹³ Charges for LLU and WLR services from 1 April 2011, 1 December 2010. See <http://stakeholders.ofcom.org.uk/binaries/consultations/lcc/statement/charges>.

¹⁴ Condition FAA4.2(b) says that the Basis of charges requirement does not apply to MPF rental where it is subject to a charge control. However, as set out in paragraph 2.16 above, MPF rental is not currently subject to such a charge control.

¹⁵ See Condition FAA4.1 – Basis of charges, as set out in the WLA statement, 7 October 2010 http://stakeholders.ofcom.org.uk/binaries/consultations/wla/statement/WLA_statement.pdf.

¹⁶ Distributed Long Run Incremental Cost. LRIC is a forward-looking approach to costing that values assets on the basis of the cost of replacing them today. DLRIC is estimated by defining a broader increment of a product group, and then adding to the incremental cost of an individual product within that product group a share of the intra-group common costs.

¹⁷ Distributed Stand Alone Costs. The stand alone cost (SAC) of a service is the cost of providing that particular service on its own, including common costs. A similar approach to calculating DLRIC from LRIC is adopted with the SAC to generate the DSAC. However, rather than only including a proportion of the intra-group common costs (as is the case with the DLRIC), the DSAC for any individual service also includes a proportion of costs that are common across all groups of services.

¹⁸ Further details of DSACs and DLRICs, and how BT calculates them, can be found in BT's *Primary Accounting Documents* which are available on its website at: <http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements>.

Ofcom's 2011 Consultation has since "*indicated that the appropriate MPF rental price (based on the best / most up-to-date information) for the interim period is £90.00*".¹⁹

- 2.12 TTG adds that as Openreach's voluntary commitment is not binding, that Ofcom's view on it of December 2010 does not amount to regulatory approval and that the voluntary commitment was a price ceiling, meaning that "*there is ample room for manoeuvre in the voluntary arrangements for the price to be reset*".²⁰
- 2.13 TTG suggests that in an interim period between an old and new charge controls "*the best approach is clearly to apply the price which would apply if the correct charge control were in place. Indeed, this approach was arguably implicit in BT's calculation of the price and Ofcom's 'acceptance' of BT's voluntary commitment in the first place*".²¹
- 2.14 TTG's view is therefore that "*the figure of £90.00 is Ofcom's best current view of the appropriate price and there is no realistic reason why it should not apply now*".²²

TTG view that a £90.00 charge would be fair and reasonable

- 2.15 TTG considers that the fair and reasonable charges obligation in Condition FAA1 "*provides ample support for a finding in [TTG's] favour*".²³ TTG suggests that in the absence of a charge control, the £90.00 level in the 2011 Consultation "*must be the sole guide as to what a fair and reasonable price would be*".²⁴
- 2.16 TTG goes on to suggest that the assessment of whether BT's charges are fair and reasonable must be based on a "*cost-reflective approach*". TTG refers to the Competition Appeal Tribunal ("CAT") ruling on Termination Rate Disputes,²⁵ stating "*the CAT concluded in the Blended Rates [i.e. Termination Rate] case that whether prices were cost-reflective (i.e. whether the prices can be related to the underlying cost of provisioning or whether price increase can be justified with reference to an increase in the underlying cost of provisioning) is an important factor in determining whether the prices are fair and reasonable*".²⁶ TTG adds that "*it would be wrong directly to equate the concept of prices being 'cost-reflective' with the concept of prices being 'cost-oriented'*".²⁷
- 2.17 TTG also notes that in the Termination Rate Disputes decision, 3G termination was not subject to *ex ante* rules, and therefore in TTG's view "*the fact that MPF pricing is subject to stronger ex ante rules than the 3G element in the Blended Rates [i.e. Termination Rate Disputes] suggests that a cost-reflective outcome to this dispute is even more appropriate*".²⁸

¹⁹ Page 3 of TTG's Submission.

²⁰ Page 8 of TTG's Submission.

²¹ Page 11 TTG's Submission.

²² Page 12 of TTG's Submission.

²³ *Ibid.*

²⁴ *Ibid.*

²⁵ *British Telecommunications plc v Office of Communications* (Termination Rate Disputes), [2008] CAT 12.

²⁶ Page 13 of TTG's Submission.

²⁷ *Ibid.*

²⁸ Pages 15-16 of TTG's Submission.

- 2.18 TTG suggests that “*the best available evidence and only plausible estimate of what such a cost-reflective approach can reasonably be [is] found in Ofcom’s statements and models of the appropriate charge control for MPF rental*”.²⁹
- 2.19 TTG states that Ofcom should require BT to prove that its prices are cost-based as mandated by Article 13 of the Access Directive.³⁰ Whilst TTG also notes that Condition FAA4 is relevant, it adds that a LRIC-based standard “*is difficult to apply*” and suggests that the standard to apply should be RAV-adjusted FAC.³¹

TTG request for Ofcom to make a determination

- 2.20 TTG claims that it has been overcharged by Openreach and requests that Ofcom determines that Openreach must:
- 2.20.1 Reduce its price for MPF rental to a level no higher than £90.00 with immediate effect; and
- 2.20.2 Repay TalkTalk for amounts paid in excess of the £90.00 level since:
- a) 1 April 2011; or (in the alternative)
- b) 3 June 2011 (being the date at which TalkTalk first asked BT to reduce its price to £90.00);
- Plus interest; or
- 2.20.3 In the alternative to 2.20.2, repay TalkTalk for amounts overpaid representing the difference between:
- a) £91.50 and £90.70 from 1 April to 18 May and
- b) £91.50 and £90.00 from 18 May;
- Plus interest.

Comments from Openreach on TTG’s submission

- 2.21 We provided a copy of TTG’s submission to Openreach on 6 September 2011. In response, Openreach has made the following observations:
- 2.21.1 In Openreach’s view, it is not necessary or appropriate for Ofcom to accept the dispute for resolution, as Openreach provided advance notice of its proposals on 9 December 2010 and TTG did not challenge these during the notification period that ran to 31 March 2011;³²
- 2.21.2 Ofcom’s view on Openreach’s approach to setting the Interim Charge was that it was “*a reasonable approach to take*”;³³

²⁹ Page 13 of TTG’s Submission.

³⁰ Pages 11-12 of TTG’s Submission.

³¹ FAC refers to Fully Allocated Costs. The ‘RAV-adjustment’ refers to an adjustment to the regulatory asset valuation of pre-1997 assets to historic cost accounting.

³² Page 2, Openreach’s comments.

³³ Page 2, Openreach’s comments.

- 2.21.3 The MPF rental charge of £91.50 is below the DSAC ceiling published in BT's Regulatory Financial Statements ("RFS"³⁴), and therefore Openreach believes the £91.50 level to be consistent with regulatory obligations;³⁵
- 2.21.4 The £90.00 level in the 2011 Consultation is "*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*".³⁶ Openreach does not consider Ofcom's proposal to be binding on it or Ofcom, with the future charge control level for MPF rental being dependent on Ofcom reaching its conclusion following the consultation;
- 2.21.5 Negotiations between TTG and Openreach can only be considered to have broken down from 28 June 2011. As Openreach is required to provide 90 days' notice of changes to charges, Openreach could not, in any event, have implemented a new charge before 28 September 2011.³⁷
- 2.22 Openreach also requested that should Ofcom accept the dispute for resolution, Ofcom should consider the counter-factual situation where the Interim Charge was below the level set out in the 2011 Consultation.

Enquiry Phase Meeting

- 2.23 Before holding an Enquiry Phase Meeting ("EPM"), Ofcom issued a pre-EPM questionnaire, to which both parties responded with views on the potential scope of the Dispute. In their responses, both Parties also raised doubts over whether it would be appropriate for Ofcom to send the dispute to ADR.³⁸
- 2.24 On 22 September 2011, Ofcom held an EPM with representatives of TTG and Openreach, in order to clarify the principal arguments and facts raised by the Parties and to discuss views on the potential scope of the Dispute.

Accepting the Dispute for resolution

- 2.25 Having considered TTG's submission and subsequent comments made by both Parties, we were satisfied that the Dispute is a dispute between CPs within the meaning of s185(1A) of the 2003 Act. This is because the Dispute concerns the terms on which Openreach is prepared to provide network access to other CPs, where the network access is required to be provided by or under a condition imposed under section 45 of the 2003 Act.
- 2.26 On 23 September 2011 we informed the Parties of our decision that it was appropriate for us to handle the Dispute for resolution in accordance with section 186(3) of the 2003 Act.

³⁴ Ofcom requires that each year BT publishes its RFS, which contains certain accounting information on markets where BT has been found to have significant market power. BT's RFS is available at: <http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/index.htm>.

³⁵ Page 3, Openreach's comments.

³⁶ *Ibid.*

³⁷ Page 4, Openreach's comments.

³⁸ Alternative Dispute Resolution. See paragraph 2.2 above, which discusses alternative means for resolving disputes.

The scope of the Dispute

- 2.27 On 27 September 2011 we published details of the Dispute, including the scope, on the Competition and Consumer Enforcement Bulletin part of our website:

“The scope of the dispute is to determine:

(i) whether BTs charge of £91.50 for MPF rental is compliant with the regulatory obligations to which BT is subject, including:

- *Condition FAA1 (Requirement to provide Network Access on reasonable request); and*
- *Condition FAA4 (Basis of charges)*

*and (ii) whether a payment of sums by way of adjustment of an underpayment or overpayment should be required.”*³⁹

- 2.28 As set out in paragraph 2.4, Openreach’s charge for MPF rental is also subject to the requirements of Condition FAA9 (Requirement to provide LLU services). As explained in paragraphs 2.3 to 2.4 above, FAA1 and FAA9 place the same requirements on Openreach’s charge for MPF rental.
- 2.29 As noted in Paragraph 2.10 above, Openreach is required to provide 90 days’ notice of amendments to charges, including for MPF rental. However, whether or not Openreach’s MPF rental charge is compliant with FAA6 is not a matter disputed by the Parties and therefore is not within the published scope of this dispute.

Interested parties

- 2.30 Three stakeholders, Sky,⁴⁰ O2⁴¹ and EE⁴² have expressed an interest in the outcome of this dispute. EE has provided a written submission arguing that Ofcom should determine that Openreach’s MPF rental charge is compliant with BT’s relevant regulatory obligations.⁴³

Information relied upon in resolving the dispute

- 2.31 This Dispute Consultation draws on the key information provided by the Parties. This includes TTG’s submission and related correspondence provided by both Parties, including:
- 2.31.1 Openreach’s comments on TTG’s submission, dated 12 September 2011;
 - 2.31.2 TTG’s response to Ofcom’s pre-EPM questionnaire, dated 21 September 2011; and
 - 2.31.3 Openreach’s response to Ofcom’s pre-EPM questionnaire, dated 21 September 2011.

³⁹ CCEB entry at: http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/open-cases/all-open-cases/cw_01075/.

⁴⁰ British Sky Broadcasting Limited.

⁴¹ Telefónica O2 UK Limited.

⁴² Everything Everywhere Limited.

⁴³ Letter from R Durie (Everything Everywhere) to L Knight (Ofcom), dated 11 October 2011.

Consultation concerning a dispute between TalkTalk Group and Openreach relating to the MPF rental charge

2.32 In addition to the information provided by the Parties, our analysis also refers to the WLA statement and the 2011 Consultation.

Section 3

Analysis and provisional conclusions

Questions to be answered

- 3.1 This section sets out our assessment of the issues in Dispute.
- 3.2 As set out in section 2, the WLA statement of October 2010⁴⁴ imposes various SMP Conditions on Openreach relating to LLU. As a result, Openreach's Interim Charge for MPF rental (the charge in dispute here) is subject to the following:
 - 3.2.1 Condition FAA1 (Requirement to provide network access on reasonable request); and
 - 3.2.2 Condition FAA4 (Basis of charges).
- 3.3 In order to determine whether Openreach's MPF rental charge is compliant with these regulatory obligations we have addressed the following key questions:
 - 3.3.1 Is the Interim Charge cost oriented (as required by Condition FAA4.1)?
 - 3.3.2 Are there grounds to believe that the charge is not fair and reasonable (as required by Condition FAA1), in particular:
 - a. Should Openreach have referred to Ofcom's analysis in the 2011 Consultation in order to reconsider the level of the Interim Charge?
 - b. If so, was Openreach in a position to implement a new charge?
 - c. Are there any other reasons for concluding that the Interim Charge is not fair and reasonable?
 - 3.3.3 If, based on the outcome of questions at 3.3.1 and 3.3.2 above, Ofcom's provisional view is that Openreach's current charge for MPF rental is too high, is it appropriate for us to exercise our discretion to order repayments?
 - 3.3.4 Are Ofcom's provisional views in respect of resolving the dispute consistent with our statutory duties and Community obligations?
- 3.4 Our approach to answering these questions is set out in the analytical framework described below.

The analytical framework

- 3.5 In order to provide a provisional view in response to questions at 3.3.1 and 3.3.2, we have considered:
 - 3.5.1 Openreach's approach to setting the Interim Charge and whether this supports a view that it secured compliance with Condition FAA4.1. This included assessment of Openreach's argument that £91.50 is below the

⁴⁴ WLA statement 7 Oct 2010.

DSAC ceiling of £162.01 published in BT's RFS covering the financial year 2010/11. Our provisional assessment of this is set out in Step 1 below; and

- 3.5.2 Whether Openreach's basis for setting its Interim Charge is fair and reasonable. In particular, we have considered the degree to which the 2011 Consultation can reasonably be relied upon and whether other factors are relevant, for example Openreach's obligation to provide 90 days' notice of an amendment to a charge for network access. Our provisional assessment of this is set out in Step 2 below.
- 3.6 On the basis of our provisional assessment in Steps 1 and 2, we also set out whether we think it is appropriate for us to exercise our discretion to order repayments.
- 3.7 Finally, we need to ensure that our proposed determination is consistent with our statutory duties and Community obligations (Step 3 below).

Step 1. Assessing compliance with Condition FAA4.1

Introduction

- 3.8 As set out in paragraph 2.8 above, the Interim Charge, which Openreach has voluntarily set at no more than £91.50, is subject to the requirements of SMP Condition FAA4.1 (Basis of charges), which imposes a cost orientation obligation.
- 3.9 As set out in paragraph 2.9 above, paragraph 6.135 of the WLA statement set out that our interpretation of SMP Condition FAA4.1 is that BT's prices must be between DLRIC and DSAC. Paragraph 6.135 of the WLA statement explains that this "*would provide BT with pricing flexibility between DLRIC and DSAC, thus ensuring its charges remained within an appropriate upper and lower bound, constraining it from setting excessive charges*".
- 3.10 TTG argues that: "*Since it is difficult to apply a LRIC based standard [i.e. the range suggested in the WLA statement], the correct standard (indeed the only practicable standard) is RAV-adjusted FAC*".⁴⁵

Openreach's arguments

- 3.11 Openreach submits that the £91.50 charge is compliant with Condition FAA4.1, on the basis that "*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*".⁴⁶
- 3.12 Openreach refers to RFS data⁴⁷ to support its view that the £91.50 level it has set for MPF rental falls between the unaudited DLRIC value of £60.40 and the unaudited DSAC value of £162.01.⁴⁸

⁴⁵ Footnote 9 to Page 12 of TTG's Submission.

⁴⁶ Page 3 of Openreach's comments.

⁴⁷ Ofcom requires that each year BT publishes its RFS, which contains certain accounting information on markets where BT has been found to have significant market power. BT's RFS is available at: <http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/index.htm>.

⁴⁸ We have verified that the data referred to in Openreach's Comments matches data in BT's Regulatory Financial Statement ("RFS"), published 15 September 2011. See <http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2011/index.htm>.

- 3.13 The Interim Charge came into effect on 1 April 2011, which is outside the period covered by the 2010/11 RFS. The relevant data for 2011/12 will not be reported until the end of the financial year and reported DSACs can vary considerably year-on-year.

Ofcom's provisional views on the basis of the Interim Charge

- 3.14 When Openreach made its voluntary commitment to setting interim charge ceilings for LLU and WLR, Ofcom said that this was a “*reasonable approach to take*”⁴⁹ (although we did not say whether or not we considered that BT was complying with its regulatory obligations, including SMP Condition FAA4.1).
- 3.15 Openreach's approach to setting the Interim Charge was to refer to the financial modelling set out in our final statement *A new pricing framework for Openreach* of 22 May 2009 (the “2009 Statement”).⁵⁰
- 3.16 The 2009 Statement sets out Ofcom's approach to setting a charge control based on CCA FAC principles.⁵¹ The 2009 Statement sets out Ofcom's use of CCA FAC to provide a cost base for the MPF rental charge in order to establish a four year glide path (i.e. to 2013/14) to set a price ceiling for MPF rental.
- 3.17 Ofcom's modelling in the 2009 Statement provides a cost forecast for each financial year to 2013/14. Openreach used the cost forecasts established by the 2009 Statement for 2011/12 (adjusted to reflect the conclusions of the Competition Commission in their Determination of the appeals of the 2009 Statement)⁵² as a basis for setting the charge ceilings. The Interim Charge is therefore based on Ofcom's estimated FAC for 2011/12 and is at a level similar to that which might have been expected had the charge control run into the 2011/12 financial year.
- 3.18 Condition FAA4.1 does not require BT to base its charges on FAC. Nevertheless, a charge based on FAC is highly likely to be below DSAC⁵³ and therefore would also satisfy the use of DSAC as a primary cost benchmark for considering cost orientation.

Provisional view on Step 1: compliance with Condition FAA4.1

- 3.19 Based on the analysis in paragraphs 3.14 to 3.18 above, our provisional view is that the Interim Charge set by Openreach is compliant with Condition FAA4.1.

⁴⁹ See <http://stakeholders.ofcom.org.uk/binaries/consultations/lcc/statement/charges>. See also paragraph 2.18 above, which discusses Openreach's approach and Ofcom's comments at that time.

⁵⁰ A new pricing framework for Openreach, Statement, 22 May 2009, <http://stakeholders.ofcom.org.uk/consultations/openreachframework/statement>.

⁵¹ Page 18 of the 2009 Statement.

⁵² See: http://www.competition-commission.org.uk/appeals/communications_act/llu_determination.pdf

⁵³ We note that in the PPCs judgment ([2011] CAT 5, paragraph 249(1)), the CAT discussed what cost allocation methodologies could be considered appropriate to meet BT's cost orientation obligation. The CAT found that there is no one way of allocating common costs and that there will generally be several “appropriate” ways. It is then for BT to select an appropriate method and justify its approach to the satisfaction of Ofcom. The CAT went on to find that CCA FAC would have been one such appropriate approach for BT to adopt.

Step 2. Is the Interim Charge fair and reasonable?

- 3.20 Condition FAA1.2 requires Openreach to provide MPF rental on fair and reasonable terms, conditions and charges.
- 3.21 As discussed at paragraphs 2.15 to 2.19 above, TTG submits that the £90.00 figure in the 2011 Consultation is “*determinative*”, since “*in the absence of a charge control, this price must be the sole guide as to what a fair and reasonable price would be in these circumstances*”. TTG also submits that we should use the best available information in determining the Dispute, and that in this case the best available information is the data set out in our 2011 Consultation.
- 3.22 We do not agree with TTG’s view that only a charge based on the £90.00 figure in the 2011 Consultation would secure compliance with Condition FAA1.2. To assume that it would, suggests that Openreach is required by Condition FAA1.2 to set the Interim Charge no higher than the level of FAC, which would impose obligations for the level of charge that would be at least as restrictive as with the requirements of a charge control, even where no charge control is in place.
- 3.23 TTG’s view would also suggest that Openreach was in some way obliged to rely on the 2011 Consultation. The 2011 Consultation does not provide Ofcom’s final view on charge ceilings for the MPF rental charge. In paragraph 7.5 of the 2011 Consultation, in setting out the proposals for charge controls we noted that “*it has been necessary to make a series of assumptions relating to Openreach’s costs and how costs will change over time*”, and as part of the 2011 Consultation Ofcom has sought stakeholders’ views on these assumptions. Accordingly, the consultation MPF rental base case figure of £90.00 set out in the 2011 Consultation is subject to a degree of uncertainty. In that context, we do not agree that the data set out in the 2011 Consultation constitutes data on which we must rely in reaching any conclusions in this Dispute; that data is not settled. For the same reason, we do not agree with TTG’s suggestion that Openreach should have revised its charges as soon as it had seen the 2011 Consultation; again, the data set out in that document was for consultation, and not a settled position.
- 3.24 As set out in paragraphs 2.16 to 2.18 above, TTG also suggests that the assessment of whether BT’s charges are fair and reasonable must be based on a “*cost-reflective approach*”, and that “*the best available evidence and only plausible estimate of what such a cost-reflective approach can reasonably be [is] found in Ofcom’s statements and models of the appropriate charge control for MPF rental*”.⁵⁴
- 3.25 In raising the concept of ‘cost-reflection’, TTG refers to the (“CAT”) ruling on Termination Rate Disputes⁵⁵ adding that “*the fact that MPF pricing is subject to stronger ex ante rules than the 3G element in the Blended Rates [i.e. Termination Rate Disputes] suggests that a cost-reflective outcome to this dispute is even more appropriate*”.⁵⁶
- 3.26 It is not clear to us how reference to the CAT ruling on Termination Rate Disputes supports a view that the Interim Charge is not compliant with Condition FAA1.2. Because the Interim Charge is subject to a cost-orientation obligation, it is already required to reflect costs on the basis set out in Condition FAA4.1. As noted in

⁵⁴ Page 13 of TTG’s Submission.

⁵⁵ *British Telecommunications plc v Office of Communications* (Termination Rate Disputes), [2008] CAT 12.

⁵⁶ Pages 14-15 of TTG’s Submission.

paragraphs 3.14 to 3.18 above, the Interim Charge was based on Ofcom's modelling in the 2009 Statement and our provisional view is that the Interim Charge set by Openreach is compliant with Condition FAA4.1.

- 3.27 Further, for the reasons in paragraph 3.23 above, we do not agree that Openreach should have revised this basis by relying on data in the 2011 Consultation, when this data is not settled. We therefore cannot see how TTG's reference to the ruling on Termination Rate Disputes supports a view that the Interim Charge is not compliant with either Condition FAA4.1 or Condition FAA1.2.
- 3.28 We also note that if we did agree with TTG's view that Openreach should have revised this basis by relying on data in the 2011 Consultation, this would be a change from the position that we took when Openreach set the Interim Charge. At that time, we set out our position that Openreach's approach to setting the Interim Charge for the period from 1 April 2011 until 31 March 2012 (or until a new Ofcom charge control starts, whichever is sooner) was a "*reasonable approach to take*".⁵⁷ It was in our view clear to all parties at the time that the Interim Charge would be in place until 31 March 2012 or, if sooner, until a new Ofcom charge control started, notwithstanding that Ofcom would clearly be consulting on a new charge control during that period, which would inevitably entail setting out for consultation a range within which that new charge control would fall. When Openreach notified the Interim Charge, it received no comments or objections from industry.⁵⁸ We consider that (as we set out at the time) Openreach's approach was reasonable, and provided beneficial certainty for all affected stakeholders for the period between the old and new charge controls. To unpick the approach after the event, as TTG now proposes, would remove that certainty. It may also remove the incentive for Openreach to act reasonably in future analogous circumstances.
- 3.29 Noting our provisional view that Openreach's Interim Charge complies with Condition FAA4.1, we do not consider that we have seen further evidence to suggest that the charge is not also fair and reasonable in compliance with the requirements of Condition FAA1.2.

Provisional view on Step 2: compliance with Condition FAA1

- 3.30 For the reasons set out in paragraphs 3.20 to 3.29 above, our provisional view is that the Interim Charge is compliant with the requirements of Condition FAA1.
- 3.31 Openreach has noted that in order to change the level of the MPF rental charge, there is a requirement in Condition FAA6.2 for Openreach to first provide a 90-day price notification period.⁵⁹ As our provisional view is that Openreach's MPF rental charge is compliant with the requirements of Conditions FAA1 and FAA4, we do not consider the requirements of Condition FAA6.2 to be applicable in resolving this Dispute.

Summary of provisional assessment

- 3.32 Based on the analysis set out in this section, the outcome of our provisional assessment in respect of the MPF rental charge set by Openreach is that it is compliant with Openreach's relevant regulatory obligations, namely:

⁵⁷ See <http://stakeholders.ofcom.org.uk/binaries/consultations/lcc/statement/charges>. See also paragraph 2.18 above, which discusses Openreach's approach and Ofcom's comments at that time.

⁵⁸ Page 2 of Openreach's comments.

⁵⁹ Page 4 of Openreach's comments.

- 3.32.1 Condition FAA4, requiring that Openreach secures, and is able to demonstrate to the satisfaction of Ofcom, that the charge for MPF rental is reasonably derived from the costs of provision based on a forward looking long run incremental cost approach and allowing an appropriate mark up for the recovery of common costs including an appropriate return on capital employed, and
- 3.32.2 Conditions FAA1 and FAA9, which provide that MPF rental should be provided on fair and reasonable terms, conditions and charges.
- 3.33 On the basis of this provisional view, we do not need to consider whether it would be appropriate for us to exercise our discretion under section 190(2)(d) to require Openreach to make payments to TTG by way of an adjustment for overpayments made.
- 3.34 Whilst we note that Openreach has requested that Ofcom should consider the counter-factual situation where the Interim Charge was below the level set out in the 2011 Consultation. However, in light of our provisional conclusions we do not consider this is necessary.

Step 3. Assessment of consistency of Ofcom's provisional conclusion with our statutory duties and Community obligations

- 3.35 As part of our analysis, we have also considered our general duties in section 3 of the Act and also the six "Community requirements" set out in section 4 of the 2003 Act, which give effect, among other things, to the requirements of Article 8 of the Framework Directive.⁶⁰
- 3.36 We consider that our provisional assessment is consistent with these duties.
- 3.37 We note that TTG has maintained that we should require Openreach to reduce the relevant charges in order to further the interests of consumers, and to promote competition.
- 3.38 Our provisional conclusion as set out above is that Openreach's charges are compliant with its regulatory obligations. As those regulatory obligations were themselves imposed in order to secure our statutory duties, including our duty to further the interests of consumers, where appropriate by promoting competition, we consider that charges which are compliant with such obligations are therefore themselves consistent with our duties.
- 3.39 In setting out our provisional assessment, we have kept in mind our duty under subsection 3(3)(a) of the 2003 Act to ensure that our regulatory activities are, among other things, transparent, accountable, proportionate and targeted only at cases where action is needed. In particular, this document sets out the Parties' arguments and the reasoning that underpins our provisional assessment, and the Parties will have an opportunity to comment on this in advance of our final determination of the Dispute.

⁶⁰ Directive 2002/21/EC.

Annex 1

Responding to this consultation

How to respond

- A1.1 Ofcom invites written views and comments on the issues raised in this document, to be made **by 5pm on 28 November 2011**.
- A1.2 Ofcom strongly prefers to receive responses using the online web form at <http://stakeholders.ofcom.org.uk/consultations/talktalk-openreach-mpf/> as this helps us to process the responses quickly and efficiently. We would also be grateful if you could assist us by completing a response cover sheet (see Annex 3), to indicate whether or not there are confidentiality issues. This response coversheet is incorporated into the online web form questionnaire.
- A1.3 For larger consultation responses - particularly those with supporting charts, tables or other data - please email lawrence.knight@ofcom.org.uk attaching your response in Microsoft Word format, together with a consultation response coversheet.
- A1.4 Responses may alternatively be posted or faxed to the address below, marked with the title of the consultation.
- Lawrence Knight
4th Floor
Competition Group
Riverside House
2A Southwark Bridge Road
London SE1 9HA
- Fax: 020 7783 4109
- A1.5 Note that we do not need a hard copy in addition to an electronic version. Ofcom will acknowledge receipt of responses if they are submitted using the online web form but not otherwise.
- A1.6 It would be helpful if you can explain why you hold your views and how Ofcom's proposals would impact on you.

Further information

- A1.7 If you want to discuss the issues raised in this consultation, or need advice on the appropriate form of response, please contact Lawrence Knight on 020 7981 3411.

Confidentiality

- A1.8 We believe it is important for everyone interested in an issue to see the views expressed by consultation respondents. We will therefore usually publish all responses on our website, www.ofcom.org.uk, ideally on receipt. If you think your response should be kept confidential, can you please specify what part or whether all of your response should be kept confidential, and specify why. Please also place such parts in a separate annex.

- A1.9 If someone asks us to keep part or all of a response confidential, we will treat this request seriously and will try to respect this. But sometimes we will need to publish all responses, including those that are marked as confidential, in order to meet legal obligations.
- A1.10 Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use. Ofcom's approach on intellectual property rights is explained further on its website at <http://www.ofcom.org.uk/about/account/disclaimer/>.

Next steps

- A1.11 Following the end of the consultation period, Ofcom intends to publish a determination by 20 January 2012.
- A1.12 Please note that you can register to receive free mail updates alerting you to the publications of relevant Ofcom documents. For more details please see: http://www.ofcom.org.uk/static/subscribe/select_list.htm.

Ofcom's consultation processes

- A1.13 Ofcom seeks to ensure that responding to a consultation is easy as possible. For more information please see our consultation principles in Annex 2.
- A1.14 If you have any comments or suggestions on how Ofcom conducts its consultations, please call our consultation helpdesk on 020 7981 3003 or e-mail us at consult@ofcom.org.uk. We would particularly welcome thoughts on how Ofcom could more effectively seek the views of those groups or individuals, such as small businesses or particular types of residential consumers, who are less likely to give their opinions through a formal consultation.
- A1.15 If you would like to discuss these issues or Ofcom's consultation processes more generally you can alternatively contact Graham Howell, Secretary to the Corporation, who is Ofcom's consultation champion:

Graham Howell
Ofcom
Riverside House
2a Southwark Bridge Road
London SE1 9HA

Tel: 020 7981 3601

Email: Graham.Howell@ofcom.org.uk

Annex 2

Ofcom's consultation principles

A2.1 Ofcom has published the following seven principles that it will follow for each public written consultation:

Before the consultation

- A2.2 Where possible, we will hold informal talks with people and organisations before announcing a big consultation to find out whether we are thinking in the right direction. If we do not have enough time to do this, we will hold an open meeting to explain our proposals shortly after announcing the consultation.
- A2.3 We will be clear about who we are consulting, why, on what questions and for how long.
- A2.4 We will make the consultation document as short and simple as possible with a summary of no more than two pages. We will try to make it as easy as possible to give us a written response. If the consultation is complicated, we may provide a shortened Plain English Guide for smaller organisations or individuals who would otherwise not be able to spare the time to share their views.
- A2.5 We will consult for up to 10 weeks⁶¹ depending on the potential impact of our proposals.
- A2.6 A person within Ofcom will be in charge of making sure we follow our own guidelines and reach out to the largest number of people and organisations interested in the outcome of our decisions. Ofcom's 'Consultation Champion' will also be the main person to contact with views on the way we run our consultations.
- A2.7 If we are not able to follow one of these principles, we will explain why.

After the consultation

- A2.8 We think it is important for everyone interested in an issue to see the views of others during a consultation. We would usually publish all the responses we have received on our website. In our statement, we will give reasons for our decisions and will give an account of how the views of those concerned helped shape those decisions.

⁶¹ In the case of disputes we will consult for ten working days from the publication date of the draft determination; this reflects the four month deadline for Ofcom to issue its final determination.

Annex 3

Consultation response cover sheet

- A3.1 In the interests of transparency and good regulatory practice, we will publish all consultation responses in full on our website, www.ofcom.org.uk.
- A3.2 We have produced a coversheet for responses (see below) and would be very grateful if you could send one with your response (this is incorporated into the online web form if you respond in this way). This will speed up our processing of responses, and help to maintain confidentiality where appropriate.
- A3.3 The quality of consultation can be enhanced by publishing responses before the consultation period closes. In particular, this can help those individuals and organisations with limited resources or familiarity with the issues to respond in a more informed way. Therefore Ofcom would encourage respondents to complete their coversheet in a way that allows Ofcom to publish their responses upon receipt, rather than waiting until the consultation period has ended.
- A3.4 We strongly prefer to receive responses via the online web form which incorporates the coversheet. If you are responding via email, post or fax you can download an electronic copy of this coversheet in Word or RTF format from the 'Consultations' section of our website at www.ofcom.org.uk/consult/.
- A3.5 Please put any parts of your response you consider should be kept confidential in a separate annex to your response and include your reasons why this part of your response should not be published. This can include information such as your personal background and experience. If you want your name, address, other contact details, or job title to remain confidential, please provide them in your cover sheet only, so that we don't have to edit your response.