



# **Charge controls for Wholesale Line Rental and related services**

## **Openreach Response to the Ofcom Consultation dated 3 July 2009**

**14 August 2009**

**NON-CONFIDENTIAL VERSION**

# 1. Executive Summary

Openreach supplies Wholesale Line Rental (WLR) into an increasingly dynamic and competitive environment. The benefits of this environment are evident in the rising service levels and greater flexibility in terms of pricing and product innovation enjoyed by Communication Providers (CPs) and end-users.

The Ofcom Consultation provides the opportunity to create a regulatory framework that recognises the ability of the market to set its own controls, by regulating prices in a focused way and by providing incentives for continued efficient innovation and investment.

Openreach supports the following proposals within Ofcom's Consultation:

- Development of a "WLR Core" rental service for CPs serving business and residential end-users and which includes the option to select a Business Directory listing.
- Focusing regulation on the new WLR Core rental service; with lighter touch (meaning no cost or price-related obligations, recognising that the existing legal and regulatory framework is sufficient) for value-added services such as the WLR Premium rental product. This approach rightly acknowledges the ability the market has to constrain prices for services whose consumption is discretionary. The approach also gives Openreach incentives to develop value-based services such as the Service Harmonisation portfolio that is being developed in commercial consultation with our customers.
- Limiting the scope of the WLR charge control to the rental element of the new WLR Core service, along with new connection and transfer charges. Existing regulation combined with market forces are sufficient remedies for the WLR Premium rental product, MPF to WLR conversion and Calling and Network Features.
- Ensuring consistent treatment between Local Loop Unbundling (LLU) and WLR services on issues such as the approach to cost modelling and the proposals for the new connection prices.
- Use of the RPI±X approach and the upward moving WLR Core rental glide path which is a step towards appropriate recovery of efficiently incurred costs.

However, Openreach has the following points and concerns, which we ask Ofcom to address in its final statement:

- The scope and implementation of the new WLR Core rental product needs to be delivered in a way that encourages efficient investment; acknowledges the existing development roadmaps agreed with CPs, and provides the appropriate level of service from day one. Specifically, Openreach proposes that the development be mandated for WLR3 only and that the delivery is strategic (i.e. delivered via a highly automated solution appropriate for a volume product).
- The duration proposed for the WLR charge control may result in non-alignment with the LLU charge controls, which rely upon a partly common cost base. The charge control for LLU ends on 31 March 2011 — Ofcom should consider aligning the LLU and WLR controls immediately following that date.

- Ofcom should take into account in the WLR cost stacks the pensions deficit contributions that BT is required to make. BT has provided information to Ofcom detailing the appropriate and reasonable contribution we consider the WLR charge control should make towards the additional “top-up” payments BT will be making to the pension fund moving forward. Given Ofcom's intention to conduct a separate consultation on the issue of funding pension deficit payments, Ofcom should conclude that consultation at the earliest opportunity. Ofcom’s pensions deficit consultation exercise should also result in an actionable decision which is capable of rapidly resulting in the necessary changes to BT’s regulated determined prices and charge ceilings being made, and Ofcom should then immediately adjust such regulated charges on a forward-going basis.
- Bearing in mind the current volatile economic climate, Ofcom should remain vigilant in monitoring the continuing validity of the assumptions used in setting this control.

## 2. Introduction

This document forms Openreach's Response to Ofcom's Consultation entitled "Charge controls for Wholesale Line Rental and related services" dated 3 July 2009 (the "Consultation").

Ofcom's Consultation focuses on WLR analogue exchange lines. Openreach provides around 22 million analogue exchange lines to homes and businesses across the United Kingdom.

At the wholesale level, Openreach currently offers two products, known as WLR Basic and WLR Premium analogue exchange line services which can be purchased as single lines or, in the case of the Premium product, also as multi-lines. In this response, reference is also made to a WLR Core service. For clarity, this refers to proposals set out in Ofcom's Consultation (that Openreach supports) for an enhanced WLR Basic rental product such that it would incorporate the ability for CPs to order either a residential or Business Directory listing.

Ofcom set the current charge ceilings for the services known as WLR Basic and Premium in January 2006. The charge controls were set in nominal terms with no allowance for the impact of cost increases associated with inflation and other factors. As Ofcom recognised in its recently concluded consultation on "A New Pricing Framework for Openreach", continuation of the existing charge ceiling would result in Openreach under-recovering its costs.

Regulation should enable Openreach to recover its efficiently incurred costs and an appropriate return on its (regulated) investments, and create the appropriate framework to incentivise investment. Requirements to invest, where directed by Ofcom, should be appropriately targeted to ensure investment is efficient and does not drive unnecessary costs onto Openreach, CPs or their end-users.

Ofcom's proposal to impose a charge control only on the rental prices for the WLR Core service is an appropriate response to maintain and enhance the benefits already apparent through greater competition in fixed narrowband services. In Openreach's response to Ofcom's Consultation (the "Response"), Openreach will also outline its views in relation to the required investment in product development, which features should be considered appropriate for inclusion within the WLR Core service, and how the development can best be delivered.

The structure of Openreach's Response is set out as follows:

- Section 3 outlines the market context, and includes an overview of Openreach's existing Service Harmonisation plans and their implications for the WLR Basic and Premium products.
- Section 4 provides detailed answers to each of the questions raised in Ofcom's Consultation.

This response is provided by Openreach, a line of business within British Telecommunications plc.

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### **3. The Market and Openreach's Product Plans**

#### **Competition and fixed line volumes**

The market for WLR services is more competitive than it has ever been:

- The number of WLR CPs continues to grow; serving all end-user markets, from consumer to major corporate.
- Underlying the growth in the number of CPs is an aggregate decrease in the analogue line base. Pressure on CPs to differentiate, whether through price, product packaging, service, or by other means, has never been higher; nor has the importance of Openreach being able to respond to CP requests promptly.
- Vigorous competition exists between WLR CPs, and also comes from alternative products and technologies; including Cable, LLU, broadband and (increasingly) mobile-only solutions. Competitive developments at the wholesale level include LLU CPs being able and incentivised to target WLR resellers with Metallic Path Facility (MPF) based alternatives to WLR.
- The economic climate has produced tough conditions affecting the entire market; with volumes in the residential and business end-user markets hit by business failure, cost rationalisation (for example, cancelling second lines) and other factors such as the downturn in new house-build and home movers.
- These competitive and economic forces have driven WLR volumes down. In the past 15 months, for example, Openreach has seen its rental volumes for WLR analogue services decrease significantly. [REDACTION OF CONFIDENTIAL VOLUME NUMBER].

Openreach believes that the decline in volumes for WLR analogue lines is set to continue over the medium to longer term. [REDACTION OF CONFIDENTIAL FORECAST DIAGRAM].

Predicting the future state of the UK economy and its impacts on WLR volumes is not straightforward, for example with economic growth forecasts varying significantly. The impact of Next Generation Access (NGA), mobile-only solutions and Voice Over Internet Protocol (VOIP) represent further potential volatility against existing assumptions, particularly towards the end of the proposed charge control period. In view of this context, it is appropriate for Ofcom to monitor the future movements in WLR volumes to ensure that the assumptions used at the outset remain valid throughout the duration of the charge control period.

## Business and residential split

As noted above, Openreach currently offers two wholesale analogue exchange line products. These are WLR Basic, which is generally purchased by residential and Small Office/ Home Office (SoHo) end-users and WLR Premium, which is almost exclusively used by business end-users.

There are currently several features which are specific to the WLR Premium product, including:

- Service levels: faster contracted provision and repair times (compared to the Basic product), which generally also involve an engineering visit, with higher associated Service Level Guarantees (SLGs) payable;
- Business Directory Entry: the option of selecting either a business or residential Directory Entry into the phonebook. WLR Basic CPs can currently select a residential listing;
- termination points: option of selecting a Network Telephony Terminating Point (NTTP) or Network Terminating Equipment (NTE), whereas WLR Basic only includes the option to terminate on an NTE;
- Multi-line: option to have multi-line auxiliary service using a single main number;
- Special line types: option to select special line types, such as non-served premises, payphones, hot sites etc. (WLR3 only).

## Service Harmonisation

As noted above, WLR Premium already offers faster contracted repair times compared with WLR Basic. As part of its Service Harmonisation proposals Openreach plans to restructure, and improve, the WLR Basic and WLR Premium repair offerings. These plans have been developed through discussion with CPs over the past 16 months and form a strategically important element of the product development roadmaps that have been agreed with industry and OTA2.

Service Harmonisation will align **and improve** repair performance across the WLR analogue products, with entry-level enhancements **within tariff**. In addition, Service Harmonisation will deliver further service-based value-added products and capabilities (for example “X hour repair” plus more flexible appointment slots for provision and repair) which CPs will be able to take advantage of. Delivery of Service Harmonisation will be a key ingredient in providing a value-based differential between the WLR Basic (and latterly WLR Core) and WLR Premium services respectively, which in turn will benefit CPs who will be able to offer differentiated products to their end-users.

The initial proposed delivery programme for Service Harmonisation is in two stages: Phase 1.0 in Release 1200 (scheduled 21 November 2009) and Phase 2.0 in Release 1300 (scheduled for March 2010). This will be subject to contractual amendments as required via consultation with CPs using standard channels.

The headline contents for the Service Harmonisation phases are:

### **Phase 1.0**

- launch of the “X-Hour Repair” product across the WLR and LLU portfolios;
- availability of flexible appointment slots for provision and repair to include early morning, evening appointments up to 9pm (Monday-Friday) plus Saturday working; again available across WLR and LLU products;
- enhancing the Missed Appointments regime to enable a glide path to parity with Abortive Visit Charges raised by Openreach and
- launch of the “Special Fault Investigation 2” (SFI2) product including SLGs.

These services will be delivered initially via a tactical solution and will be available to CPs purchasing both the WLR Basic and Premium rental products, except SFI2 which is an LLU only service. Openreach is reviewing the price points for these services – the intention is to differentiate in commercial terms offered, for example, by providing more Service Harmonisation features within tariff for the WLR Premium product.

### **Phase 2.0**

This phase includes the plans to simplify, improve and align service levels across products and is planned for delivery in March 2010. For both the WLR Basic and Premium products, this will bring improvement, within tariff, to the existing entry-level contractual repair offerings.

As part of these plans, Openreach intends to include the Service Harmonisation “Service Level 1” within the rental price for the WLR Basic (and latterly WLR Core) product, whereas WLR Premium lines will start with “Service Level 2” within the rental tariff, with the ability for WLR Basic / WLR Core to upgrade to “Service Level 2” or “Service Level 3” and for WLR Premium to upgrade to “Service Level 3.” The differences between the Service Levels are outlined in the table below, which has been communicated to industry at various times, most recently via a briefing on 15 July 2009<sup>1</sup>.

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<sup>1</sup> Refer briefing: <http://www.openreach.co.uk/orpg/news/generalbriefings/gen08409.do>

**Table 1 Proposed Service Harmonisation repair times**

<b>Service Level</b>	<b>Description</b>	<b>Standard Engineering Working times</b>
1	End of next working day + 1 day, applicable Monday to Friday (excluding public and bank holidays)	Monday – Friday 08:00–18:00
2	End of next working day, applicable Monday to Saturday (excluding Public and bank holidays)	Monday – Saturday 08:00–18:00
3	In by 13:00 fix same day, in after 13:00 fix by 13:00 next day, applicable 7 days per week (including public and bank holidays)	Monday – Sunday 08:00-18:00

Compared with the existing entry-level “Standard Care” services for WLR Basic and Premium, the Service Harmonisation proposal offers the following respective improvements for these rental services:

- WLR Basic: contractual response time moves from 96 hours to between 48 and 72 hours, depending on when the fault was reported.
- WLR Premium: contractual response time moves from 48 hours Monday to Friday to between 24 and 48 hours Monday to Saturday, depending on when the fault was reported.

The indicative rental prices for Service Harmonisation for Service Levels 1, 2 and 3 are as follows:

**Table 2 Indicative Service Harmonisation prices**

<b>Level</b>	<b>Basic / “WLR Core” Rental Product</b>	<b>Premium Product</b>
1	Included within existing rental tariff (currently £100.68 per annum)	
2	Line rental + £9.32 per annum	Included within existing rental tariff (currently £110 per annum)
3	Line rental + £45.32 per annum	Line rental + £36.00 per annum

## Summary

In this section, we have shown how WLR is provided in an increasingly dynamic and competitive market environment. Our plans for Service Harmonisation are aimed at ensuring that our Basic and Premium WLR products and additional service options are further developed to continue to meet the needs of our CPs and their end-users against this backdrop. These plans are being developed in consultation and with the agreement of our customers. It is important that the reset regulatory regime and charge control for WLR should support and underpin these developments.



In the next section, we provide answers to the specific questions raised in Ofcom's Consultation. We further set out how we would plan to build upon our Service Harmonisation plans to develop a new WLR Core rental service, with an additional WLR Premium service as well as stand alone service options also being offered.

## 4. Answers to Ofcom questions

In light of the plans outlined in Section 3, Openreach believes the appropriate regulatory framework for WLR going forward and therefore the relevant product development should be to:

- set the prices of WLR to allow Openreach to recover its efficiently incurred costs including a reasonable and appropriate return on investment;
- have a consistent cost base with LLU, and as such, broadly speaking, we support the cost analysis presented by Ofcom although we do consider the cost base for LLU underestimates the efficiently incurred costs, which we believe Ofcom should address going forward;
- apply controls only to rentals for the new WLR Core product, and for WLR new connections and transfers;
- impose no cost or price-related regulation beyond the WLR Core service; thereby incentivising further development of value-added services;
- develop the WLR Core product from the existing WLR Basic product, enhanced to include the ability to select a Business Directory Entry;
- set timescales for the WLR Core product introduction which are agreed with industry - noting they are likely to be around July 2010; and
- mandate the enhancement of the WLR Core service solely for WLR3.

This Section sets out Openreach's detailed responses to the questions asked by Ofcom in its Consultation.

Question 3.1 Do you agree with our preferred option to set a control on a WLR core rental service to be available both to residential and business customers with the option for number entry to residential and business directories? Or do you consider that the alternative use of a basket would be a more appropriate control?

Openreach agrees with Ofcom's preferred option to set a control on a WLR Core rental service that is to be freely available to CPs serving residential and business end-users. Openreach notes:

- it supports the focus of regulation on a WLR Core service, with greater freedoms for the pricing of WLR Premium and other value-added services;
- Openreach would continue to supply the WLR Premium product;
- the requirement to add the option for number entry to residential and business directories should be limited to appropriate developments to the Equivalence Of Inputs (EOI) product (WLR3).

In its Consultation, Ofcom outlines 3 potential options for regulating WLR rentals:

- Option 1 considers separate charge controls for WLR Basic and WLR Premium. Ofcom dismisses this option on the basis of its proposed market definition for a single WLR analogue market instead of separate business and residential markets.

- Option 2 considers a single charge control for a WLR Core service. This is Ofcom's preferred option.
- Option 3 considers a basket control containing either both WLR Basic and WLR Premium, or both WLR Basic and a modified WLR Premium.

Openreach supports Option 2 subject to no cost-related or price-related obligations being imposed upon the WLR Premium product. We propose that the Business Directory Entry be added to the WLR Basic product to develop the new WLR Core service, and for this to be exclusively delivered over WLR3.

Openreach does not support Option 3 given its belief that regulation should be focused on the WLR Core service and that enhanced or value-added services should not be subject to price regulation. Extending the principle of price regulation beyond the WLR Core service would be inappropriate and would undermine incentives to invest in value-added services that CPs wish to purchase.

### **Scope of product enhancement**

In September 2005, Ofcom accepted a set of Undertakings from BT under the Enterprise Act 2002 (the Undertakings) which, amongst other things, functionally separates BT's upstream division providing wholesale access and backhaul products (Openreach) and ensures that Openreach provides certain services on an EOI basis. Wholesale exchange lines, referred to as WLR3, are covered by this EOI obligation.

WLR Basic and WLR Premium are currently available from Openreach through 3 different products: BT Retail Classic (BTRC), WLR2 and WLR3. Openreach believes that only WLR3 should be required to be changed. In particular, Openreach notes that WLR2 is scheduled to be withdrawn during the control period; and any development costs incurred could therefore be considered inefficient. This approach is also wholly consistent with the approach since the creation of Openreach to focus development resources and investment on WLR3.

### **WLR2**

On 8 April 2009, Openreach announced that it would close the WLR2 platform via a staged withdrawal, as outlined in the table below.

**Table 3 Staged withdrawal of WLR2**

<b>Date</b>	<b>Withdrawal stage</b>
30 November 2009	WLR2 Product Establishment will be closed. Any new WLR CPs will be established on WLR3.
31 March 2011	Openreach will no longer accept new orders on WLR2. This means that CPs will need to be established on WLR3 by this date to place orders.
30 June 2011	Final WLR2 withdrawal date. CPs will need to be established on WLR3 and have completed the transition of their end-user base from WLR2 to WLR3.

Openreach has undertaken a feasibility study to assess the development required and associated costs of including a Business Directory Entry in the WLR Basic product on WLR3.

The initial feasibility study has assessed the development requirements in terms of systems, xml and process changes. [REDACTION OF CONFIDENTIAL DETAILS ON INDICATIVE COSTS].

Expanding this development; either in terms of product scope (e.g. including the option of NTTP) or in terms of platform scope (e.g. also delivering functionality over WLR2 and BTRC) would inevitably translate into higher cost and complexity. [REDACTION OF CONFIDENTIAL DETAILS ON INDICATIVE COSTS]

In general terms, it is important to recognise that the complexity of the development proposed is likely to have ramifications for timeliness of delivery, cost to Openreach and cost to CPs in terms of levels of change required on their part in order to effectively “consume” the development.

The development that is agreed will also need to fit into the process and approach that Openreach has developed with its customers and the OTA2. This means that the development and confirmation of its inclusion within a future release will need to be ratified as a customer priority and clear demand / user stories developed to ensure the right solution is built that CPs are able to utilise. This process need not introduce delay to the delivery of the service; but it is important to follow in order to ensure that the right solution is developed; and that if other developments are displaced to accommodate this into a particular release then this is done consciously and consultatively.

### **WLR3 establishment**

At 14 August 2009, 90 CPs are already fully established onto WLR3 for analogue services, with a further 70 in establishment and 32 in pre-establishment. Furthermore, establishment onto the service is accelerating, particularly since Openreach announced the withdrawal of WLR2 and made all 3 main products (i.e. Analogue, ISDN2 and ISDN30) available on the platform (both in April 2009).

CPs have options when accessing WLR3: they can opt for a “DIY” approach and develop their own interfaces, or they can use a variety of products offered by Third Party Integrators (TPIs) who are active in the market. The timescales for gaining access to WLR3 have also reduced. For example, fast-track establishment is available for CPs who opt to gain access via an established TPI which has already completed the necessary testing. Establishment can now take as little as 9 weeks from start to full implementation, and has been done faster. Openreach continues to work with CPs and TPIs to reduce establishment timescales without sacrificing quality delivery (bearing in mind, for example, the need to undertake thorough testing as part of the establishment process).

The CPs already fully established on WLR3, or currently in various stages of being established onto WLR3 collectively represent over 50% of the existing WLR Premium line base on WLR2. [REDACTION OF NAMED CPs ESTABLISHED OR WITHIN ESTABLISHMENT FOR WLR3]. With establishment set to rise in the short-term; Openreach believes that this further supports our proposal to focus investment only against the future EOI WLR3 service. Not only will this approach further enhance the EOI product — which is very much in line with the approach taken since the creation of Openreach — it will also be available to a large and increasing proportion of CPs

who currently purchase the WLR Premium product, and will avoid investment being unnecessarily and inappropriately diverted into “legacy” platforms which have a limited life span.

## **Summary**

In light of the above, Openreach considers that developments beyond WLR3 would constitute inefficient investment; and that it is appropriate to mandate development of the WLR Core service solely against this platform.

Question 3.2 If we are setting the control on a core WLR rental service are there any other features of the WLR Premium service, other than entry in a business directory, that would be required in the revised core rental service so that it would be suitable as a basic business product

Ofcom notes that “this option would involve a control focused on a single core WLR rental service. The service would be open to provision to both residential and business users and thus would support the minimum level of service for both groups, e.g. including business listing where required” (para 3.31).

On this basis, Openreach considers:

- it is appropriate to include the Business Directory Entry into the WLR Core service;
- only single lines should be included in the WLR Core service;
- special line types, such as temporary lines, should not be included in the WLR Core service; and
- only NTE should be considered part of the WLR Core service.

Openreach supports the inclusion of the Business Directory Entry into the WLR Core service; and supports making the WLR Core service available for business users should they wish to purchase the service. Other features are currently available within the WLR Premium service – however Openreach believes that the development for a Business Directory Entry would cater for the vast majority of existing business end-users and thus be appropriate and sufficient.

Also, the development costs of including any other additional features would drive unnecessary product development and costs onto both Openreach and potentially other CPs and could introduce delay into delivery timescales.

## **Business Directory Entry**

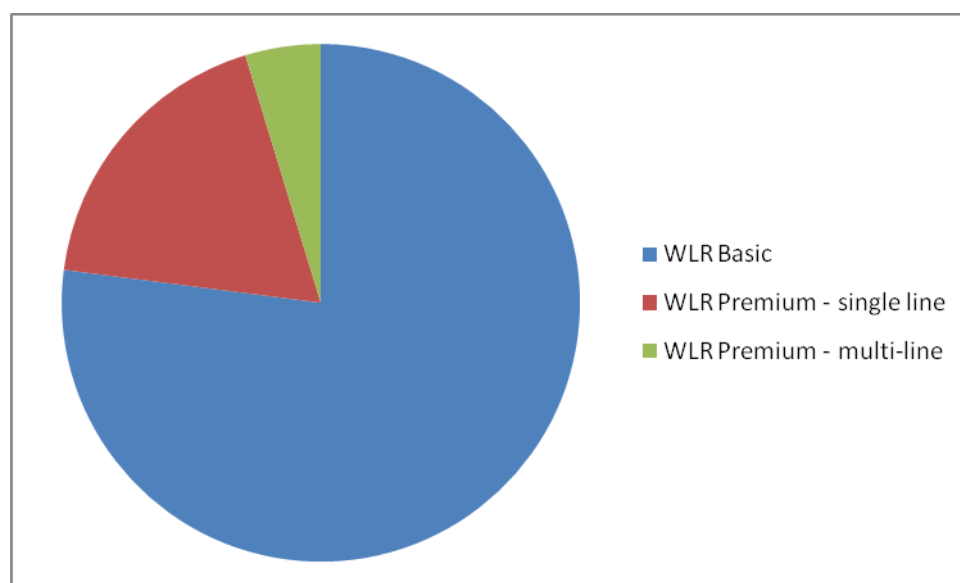
As noted in our response to Question 3.1, Openreach considers it is appropriate to limit regulation to the WLR Core service; for the product to give CPs the ability to order a Business Directory Entry listing; and for this to be delivered solely on WLR3.

As noted previously, WLR Basic offers a single line and WLR Premium has the option to order single or multi-auxiliary lines (also referred to as multi-lines). The breakdown of single and multi-lines is shown in the diagram below.

### Multi lines

WLR Basic offers a single line and WLR Premium has the option to order single or multi-lines. The split of single and multi-lines is shown in Figure 2 below.

**Figure 2 Single and Multi-line analogue lines**



Single line volumes constitute the vast majority of the overall WLR base; whether viewed in totality or as an element of the existing WLR Premium line base; and Openreach considers that multi-lines do not constitute an appropriate element of the “minimum level of service” that the WLR Core service will be required to offer to residential and business end-users. Furthermore, as noted in our response to Question 3.1, the inclusion of any other features in to the WLR Basic product would add cost, complexity and potential delay to the development and delivery of the WLR Core service.

### Special line types

WLR Premium offers a range of line services with value-added features. These lines include Short Duration Lines for events and exhibitions, port-a-cabins at construction sites, and ships-in-dock; Non-Served Premises such as garden sheds and traffic lights; and public and managed payphones. Lines can also be provided to areas known as ‘hot sites’ such as electricity generating stations or transformer sites. These lines are only available to CPs on WLR3.

Oftel reviewed many of these line types in 2003 and determined that they should be excluded from WLR2.<sup>2</sup> The main reason that they were excluded is that the number of lines in service was extremely small. This continues to be the case. For example, Openreach estimates that it only has approximately 5,000 Short Duration Lines currently in service.

<sup>2</sup> Oftel, Wholesale Line Rental: Oftel’s conclusions – statement, 11 March 2003, para 2.37.

Given that these niche line types are not necessary to support the minimum level of service for both groups, Openreach considers that these niche lines should not form part of the WLR Core service.

## **NTE and NTTP**

Ofcom also indicates that a differentiator between WLR Basic and WLR Premium is that WLR Basic can be connected to a NTE, whereas WLR Premium can be connected to either a NTE or NTTP.

NTEs are the standard “line jack” found in the majority of homes. It allows a range of voice and data services to be carried over the line. The most common type of NTE for single analogue lines is the NTE5A, although there are various other NTEs including external NTEs.

A NTTP is primarily used to terminate a line, or lines, on a PABX. Importantly, NTTP is not compatible with broadband or messaging services.

Openreach does not consider that a NTTP, which does not support broadband, is an appropriate element within a WLR Core service. Rather, the use of analogue lines to support a NTTP is a niche business service of relatively low volume [REDACTION OF CONFIDENTIAL NTTP VOLUME DETAILS]. Should they be required as an element within the development of the WLR Core service, this would drive cost, complexity and potential delay to the development of the service and could also impose costs on CPs to consume – whether they finally elected to purchase the service or not.

**Question 3.3 Please provide you views on the requirement for and if necessary, duration of any transition period for the implementation of a WLR Core WLR service?**

Development of a WLR Core service suitable for either residential or business customers inevitably requires development to be made to the existing WLR analogue product set. The approach that Openreach is proposing seeks to balance a number of considerations:

- balancing the need for timely delivery without creating undue disruption to existing industry commitments and product development roadmaps and CP plans;
- developing a solution that provides Quality of Service (QOS) from day one with which customers are satisfied;
- avoiding unwarranted disruption to the existing portfolio;
- being realistic about development timescales and activities – both in terms of Openreach development activities and CP ability to consume developments once they have been delivered; and
- minimising inefficient use of scarce investment resource.

Taking these considerations into account Openreach believes the most appropriate approach is to enhance the current WLR Basic product to include the ability for customers to order a Business Directory Entry, and for this development to be limited

to WLR3 as the EOI product (as already discussed in our responses to Questions 3.1 and 3.2).

Openreach believes that focusing development on the EOI product is the right thing to do; it is consistent with our recent investment programme to make WLR3 the strongest future based service. In addition, as previously noted, WLR2 is set to be withdrawn as a service by June 2011 while CP establishment from WLR2 to WLR3 is progressing well and at an increasing rate.

Openreach has conducted an initial feasibility assessment to deliver Business Directory Entry listings. This was conducted in order to assess:

- delivery options and end to end process / order scenarios;
- levels of systems impact / complexity; and
- cost / training requirements.

The feasibility work that Openreach has undertaken points strongly to delivering this capability strategically rather than tactically i.e. via automated rather than manual delivery process. Tactical options have been explored but are likely to provide unacceptable QOS for what will need to be a high volume service from day one. The ability to deliver this service “off the shelf” is not realistic – particularly since any manual based “overlay” arrangement would require backing into a process (for the WLR Premium service) that is already highly automated. A manual approach would also introduce major concerns in the effective management of data integrity, in ensuring end-user orders were dealt with in a timely and consistent fashion; and in fact be quite likely to drive inefficient cost into both Openreach and CPs. Taking a strategic delivery approach here is the right one to deliver acceptable QOS and would be the appropriate way to deliver a usable volume product to CPs.

We estimate that adding the Business Directory Entry to the WLR Basic product is likely to represent a “medium sized” development in terms of complexity to deliver. It will be necessary to consider when this development can be accommodated within an EMP release schedule and we would expect to agree this in consultation with CPs and Ofcom. As an initial proposal, Openreach suggests that the delivery be made in Release 1400 – which is currently scheduled for July 2010 and for which requirements are currently being captured. Openreach also notes that the principal ingredients for R1300 have been agreed with CPs and OTA2. It is therefore reasonable to assume that if this development were to be mandated for R1300 it would be disruptive for existing content and CPs.

Openreach believes that this proposal is practical and will enable creation of a service that customers will be able to use at volume from day one. We also emphasise that the implementation plan is currently scoped against making Business Directory Entry available for WLR3 CPs only. Were the scope of the development to expand beyond these parameters, the complexity of the development would increase with likely ramifications for delivery timescales.

Openreach recognises that the timescales proposed here go beyond the proposed start of the new control; and also beyond the commencement of the new rental prices for the WLR Basic (to become WLR Core) service. In consequence, it may be appropriate to further review the transitional arrangements required – for example, via further consultation with Ofcom and CPs. Openreach may be able to deliver, as part of transitional arrangements, for example, a voluntary commitment not to exceed



the current ceiling for the WLR Premium rental service until such a time as the WLR Core functionality had been delivered.

It is also important that the development of the WLR Basic product is managed through the existing processes that have been developed with CPs and the OTA2; and which have proved fruitful in delivering product developments that CPs have helped to prioritise. By following this process will also ensure, for example, that the CP “user stories” are developed consultatively with CPs and the appropriate WLR industry interfaces (such as the WLR Process and Commercial Groups), and that CP consumption needs / capabilities are also well understood.

Question 3.4 What is your view on the appropriate basis of charges (cost orientation) regime for WLR Premium and other higher care level services? Do you consider that the other obligations on Openreach (perhaps supplemented by guidance on interpretation) are sufficient control on the WLR Premium charge without an addition basis of charge condition? (Responses to these question will be considered in conjunction to the basis of charges (question 13.3) proposed in the Wholesale Review consultation).

Openreach does not consider that any basis of charges (i.e. cost orientation) obligation should be applied to WLR Premium and other higher care level services. Other obligations that apply to these particular services provide sufficient protection to CPs from adverse pricing behaviour by Openreach, as discussed below in the response to the second part of this question.

In its Consultation, Ofcom outlines 3 options for applying cost-orientation obligations to the enhanced care levels:

- Option 1 considers applying cost orientation to the full WLR Premium charge (i.e. the rental of the WLR Premium product) in total.
- Option 2 considers applying cost orientation to the incremental part of the WLR Premium charge compared to the core WLR service, i.e. just the difference in charges related to the care level.
- Option 3 considers not applying any cost orientation obligation, but giving guidance on how Ofcom might interpret other obligations on Openreach in the event of a dispute.

For the reasons outlined below, Openreach considers that Option 3 is the only appropriate option although we have concerns about the proposal for issuing guidance.

Openreach believes that there should be no basis of charges obligation (i.e. cost orientation) on WLR Premium and other higher care level services (i.e. those features and services not required to provide the “minimum” (as Ofcom put it) level of WLR service). Openreach considers that Ofcom should confirm the suggestion made in the para 13.23 of the Review of the fixed narrowband services wholesale markets consultation dated 19 March 2009 (“Wholesale Review Consultation”) that cost orientation should only apply to “all the elements required to provide the basic level of service by consumers”, which would constitute charges for the new WLR Core service; connection; rearrangement and termination. This would provide Openreach with the clarity and certainty it needs to ensure that it can continue to

invest and develop the WLR product portfolio to the benefit of CPs, end-users and competition in the downstream retail markets.

Openreach outlines its reasons for this view as follows:

- Openreach strongly agrees with Ofcom's statement in para 3.64 of the Consultation that the price of the "WLR Premium service is likely to be constrained by a core WLR service". Accordingly, Openreach considers that the imposition of a basis of charges obligation on WLR Premium would be unjustified and unnecessary.
- The general principles underpinning the EU regulatory framework, through the Framework and Access Directives, are that National Regulatory Authorities should regulate upstream and regulate only when strictly necessary. Any remedy imposed as a consequence of a finding of SMP in a defined market must be related to the problem identified and be appropriate, necessary and proportionate. At a high level, the application of cost-orientation to value-added services and features would not fit with this general approach as it is neither related to any identified problem nor is it appropriate, necessary or proportionate. This is explained more fully in response to Question 7.4 as regards the extent to which Ofcom's assessment meets the tests set out under the Communications Act 2003.
- The application of a basis of charges obligation to WLR Premium and other higher level care services will reduce Openreach's incentives to innovate and develop new services in response to customer demand. Openreach strongly agrees with Ofcom's statement in para 3.62 that there is a risk that "cost orientation could significantly reduce the incentive for Openreach to provide and innovate in the provision of care levels". Openreach's ability to offer value-added features relies on CP demand (which is itself based on end-user demand and discretionary spend). Indeed, Openreach's Service Harmonisation plans, which Ofcom says in para 3.62 "show the value of flexibility in the development of care levels", would not be realised if Openreach did not have charging incentive to innovate and offer these value-added features, which in turn would result in reduced choice and flexibility for CPs and end-users.
- The provision of non-regulated value-added services is consistent with the terms of the Undertakings agreed between BT and Ofcom. The Undertakings stipulate that Openreach can supply non-regulated products, and that when it receives a request from a CP for such a product, Openreach is "free to treat those requests as would any other commercial organisation and to accept or reject them on the basis of, among other things: (a) fit with the assets, skills and resources and terms of reference of Openreach; (b) **commercial attractiveness to Openreach**; and (c) opportunity cost to Openreach" (section 5.11, emphasis added).
- The pricing levels for these services should be constrained by market forces. Openreach's volumes underlying our revenue forecasts are entirely dependent on Openreach's ability to persuade CPs to purchase the services at the prices offered, and CPs will only do this if they believe that these higher level services provide value for money in the context of their commercial business. Charges for these services are commercially set between Openreach and CPs, balancing the CPs willingness to pay – and therefore their view of the economic value of the service – with Openreach's incentives to supply these services at different price points.

- Ofcom's recent announcements in relation to NGA appear to encourage pricing freedom to provide the incentives to develop new products. The extension of the basis of charges obligation to all WLR features would be considered contrary to that intention.

In response to the second part of this question, Openreach considers that the other obligations which apply to Openreach constitute an entirely sufficient control on the charges for WLR Premium and higher care level services without an additional "basis of charge" condition.

As Ofcom has acknowledged at para 3.65 of the Consultation, irrespective of the outcome of this Consultation, Openreach remains subject to a number of regulatory conditions which would constrain its ability to behave unreasonably in relation to the charges for WLR Premium and higher care level services. In particular, Openreach would continue to be subject to obligations on notifying charges (Condition AA6(a)), no undue discrimination (Condition AA2) and providing network access on fair and reasonable terms conditions and charges (Condition AA1(a)). In addition, Openreach is subject to the EOI requirement under the Undertakings such that all CPs (including the rest of BT) obtain the same price, as well as obligations in relation to Statement of Requirements and information sharing which give an additional layer of even-handedness and transparency to Openreach's product development and pricing plans. Finally, Openreach is also mindful of the general constraints of competition law, and in particular its obligation against excessive pricing, in setting its prices.

The extensive protection that the legal and regulatory framework outlined above provides is an entirely sufficient control on the charges for WLR Premium and higher care level services without an additional basis of charge condition. Openreach therefore considers that the extension of the basis of charges obligation to WLR Premium and other higher care level services would be unnecessary, disproportionate and unjustified.

Finally, Openreach does not agree with Ofcom's suggestion that it might supplement the absence of a basis of charge condition for WLR Premium and other higher level services with guidance on how it would expect to interpret the fair and reasonable requirement in the event of a dispute. Ofcom states at para 3.66 that such guidance could include consideration of, among other things, "whether the increment charge [on WLR Premium compared to WLR Basic] was fair and reasonable given the cost of providing the enhanced services."

It should be borne in mind that a dispute would only occur in the event of failure of commercial negotiations. If Openreach failed to set the price of a value-added or enhanced service at a level acceptable to industry, then few, if any, CPs would purchase the service. Therefore, Openreach has the impetus to set prices on a commercially-acceptable basis. This is exemplified by Openreach's recent discussions with industry on its "indicative pricing" for the enhanced care levels. It is unclear what benefit a set of guidelines could provide to supplement any commercially agreed outcome. There is a risk that they would either merely replicate the existing extensive regulation and competition law that already exists, or inappropriately extend regulation to counter the proposed removal of the cost orientation obligation, and thereby, in effect, indirectly reintroduce cost orientation through different means.

Question 4.1 Do you agree that it is important to ensure consistency between the WLR and LLU charge controls? In this context, do you agree that we will need to consider consistency in considering the impact on any challenges to assumptions when we are setting the final controls?

Openreach agrees with the principle of consistency between the WLR and LLU charge controls.

The Openreach Financial Framework Review was initiated to remove the substantial under-recovery of costs across Openreach's regulated copper access products, which was particularly extreme in the case of MPF. This led to price differentials between MPF and WLR+SMPF which had produced a distorting arbitrage between these alternative wholesale inputs, which in turn has market-distorting effects.

Ofcom correctly notes that much of the cost base for the WLR and MPF charges is based on the same methodologies, allocations and elements. On this basis, to minimise any potential distortions in glide paths it is crucial that the methodologies, allocations and assessment of the cost base are conducted in a consistent and aligned manner, where possible concurrently.

Should there be any challenges to the assumptions relied upon when setting the final controls, it would be appropriate for Ofcom to make any consequential adjustments to both WLR and LLU sets of charge controls to reflect this. Not to do so runs the risk of creating artificial arbitrage opportunities with the WLR and LLU controls set on an inconsistent set of cost assumptions.

Question 4.2 Do you agree with Ofcom's analysis on the relative charges for WLR and MPF set out here, in Annex 5 of this document and in the Openreach Pricing Framework?

Openreach broadly agrees with Ofcom's analysis of the relative charges for WLR and MPF set out in the Consultation.

Openreach has previously indicated that it considers that Ofcom's assessment of MPF costs underestimates the efficiently incurred costs in providing the service and, given the commonality of approach with respect to costs, we believe that Ofcom would have similarly underestimated the efficiently incurred WLR costs.

For example, Openreach believes that Ofcom should include in the cost stacks a contribution from WLR to the additional 'top-up' pensions deficit payments that BT is required to make to our pension fund moving forward. These payments are unavoidable and clearly need to be funded from our ongoing cash flows, although Ofcom has not included them in the calculation of the cost base at this time.

As Openreach supports consistency of methodology for calculating the WLR and LLU cost bases, it supports the relative charges. Should amendments be proposed to any element of the cost base, then that should be reflected in both the WLR and LLU charge controls.

Question 4.3 Do you agree with Ofcom's proposal to set a three and a half year period charge control for WLR?

Ofcom has proposed a 3.5 year charge control for WLR to run from 1 October 2009 until 31 March 2013. Openreach supports alignment of the WLR and LLU charge controls at the earliest opportunity. We note that the current LLU charge control expires on 1 April 2011. We therefore urge that Ofcom takes the opportunity to reset the WLR charge control at the same time as it sets new LLU controls. Openreach therefore considers that an 18 month control is preferable in the present circumstances.

Ofcom's approach to timing is influenced by the charge control timing for LLU. Ofcom reviewed Openreach's key copper access products through the lengthy Openreach Financial Framework Review consultation process, in relation to which the final statement "A New Pricing Framework for Openreach" was published on 22 May 2009 (the "OFFR Statement"). The review assessed the costs associated with both LLU and WLR, given the close relationship between these products in terms of market demand and common costs.

As a result of comments from the European Commission, the time periods which the LLU and WLR charge controls cover are not fully aligned. In its OFFR Statement, , Ofcom set a 2 year control for LLU that expires on 31 March 2011 but did not set out any control for WLR. However, Ofcom outlined its assessment of likely costs for LLU for the next 4 years (Openreach notes that changes in the assessment of that cost base would be reflected in the LLU charge controls at a minimum for the period subsequent to 31 March 2011). It appears that Ofcom may intend to set a 2 year LLU charge control for the period 1 April 2011→ 31 March 2013 after completion of Wholesale Local Access (WLA) market review. Theoretically, this would allow for alignment of WLR and LLU charge controls from 1 April 2013.

However, the WLR and LLU charge controls could also be aligned earlier. When the current 2 year LLU control expires in 2011, Ofcom could re-set both the WLR and LLU controls at that time such that they align from 1 April 2011. This means, however, that the WLR Charge control would only apply for 18 months and this would reduce regulatory certainty over the longer term. In its OFFR Statement, Ofcom noted that the economic uncertainty observed in December 2008 still prevailed in May 2009. Cost, volume and inflation assumptions could continue to move unpredictably over the short term. On this basis, a review of the WLR Charge control in 18 months would appear to be both appropriate and preferable. In light of the circumstances outlined above, Openreach's preference going forward is that Ofcom aligns the WLR and LLU Charge control periods from 1 April 2011. In addition, irrespective of the duration of the charge control that is ultimately set, in the light of ongoing economic uncertainty, certain eventualities may present unforeseen challenges that necessitate a review of the controls. This was recognised by Ofcom in its OFFR Statement at paras 1.12 and 1.25. As previously noted, Ofcom should remain vigilant in monitoring the continuing validity of the assumptions used in setting the control.

Finally, we also refer to our comments in Section 1 regarding the need for the outcome of Ofcom's pensions deficit consultation to result in an actionable decision, to enable adjustments in Openreach's regulated determined prices and charge ceilings to be made rapidly.

Question 5.1 Do you agree that Ofcom should continue with its current approach to setting the transfer charge ceiling, recovering the transfer costs primarily through the line rental? If not, please explain why.

As a principle Openreach believes that all prices should recover costs; and notes - based on Ofcom's modelling analysis – that the unit costs for providing the transfer service (including migration WLR CP1→CP2 and also for movements from the WLR Premium to WLR Basic service or vice versa) are set to rise during the period of the proposed control.

Openreach also recognises, however, the policy objective Ofcom has around creating an environment where there are minimal barriers to choice and switching for end-users – and that transfer charges have for some time been set artificially low in order to support this.

Openreach would accept continuation of the existing approach as one that avoids disruption to the existing arrangement – but considers that it is right for the prices to move towards the true costs of service provision – and that Openreach should remain able to recover the full efficiently incurred costs incurred via the WLR rental prices. Moving forward, Ofcom should look further into the continued validity of the linkage between artificially low transfer prices and healthy end-user competition given the possible market distorting effects of the former.

Question 5.2 If we do continue with a low transfer charge do you agree that Ofcom should increase the transfer to £3 with an index? If not, please explain why.

As previously stated, Openreach believes that the continued need for artificially low transfer charges is questionable and notes that it must retain the ability to fully recover its efficiently incurred costs – in this case primarily via the rental charges.

In the absence of a full review of this position within the Consultation, however, it is right that the transfer charges (and associated services) at least directionally move towards the genuine underlying cost for providing the services. It is also right that the new charges come into effect from the beginning of the control period.

The approach that Ofcom has suggested to index the new price is sensible; and should reduce future distortions in cost / price relationship; in practice, this is likely to represent in the region of 6p price increases per annum. Certainly, we agree with the Ofcom assessment that reduction to the transfer charge is unwarranted.

Question 5.3 Do you agree that Ofcom should continue to set a charge ceiling for new connections? Do you agree that it is appropriate to impose of one off adjustment in this case given the difference between existing charges and the CCA FAC cost? Do you agree it is appropriate to consider the relative charge of new line for LLU and WLR in making this adjustment?

Openreach believes that charge ceilings remain an appropriate form of regulation for the WLR new connection service; and that further it is right to maintain relativity between the WLR and LLU connection charges. As a guiding principle, it is also imperative that Openreach is able to fully recover its efficiently incurred costs for providing the service over the period of the control.

The importance of maintaining relativity between the WLR and MPF charges makes Ofcom's proposal a sensible and proportionate one, bearing in mind the scheduled MPF new connection price of £76 that is due to come into effect from 1 September

2009. In view of this, it is right and appropriate that the equivalent charge for the WLR service be brought into effect from the beginning of the new control period

Openreach notified on 3 August 2009 (ACCN OR139) its intention to revise the WLR new connection price to £67 in order to align with the recently mandated reduction in the price of the MPF new connection. The WLR price is currently subject to the standard 90 day notification period, which would see the new price come into effect from 1 November 2009. Openreach has therefore sought a waiver request from Ofcom that would allow the lower price to take effect from 1 October 2009.

Question 5.4 Do you agree that Ofcom should exclude the remaining migration charges and calling and network features from the scope of the charge ceiling? If not, please explain why.

It is appropriate to exclude the migration charges and Calling and Network Features from the scope of the charge control. In the case of MPF to WLR conversion charges, alignment with WLR to MPF conversion price should be sufficient. In respect of MPF to WLR conversion charges, Openreach notes the low volumes associated with this service. Given the similarity in engineering activity for the equivalent WLR to MPF conversion product, and consequential similarities in cost, requiring the prices to be aligned is sufficient and proportionate regulation.

With regard to Calling and Network Features, cost orientation is itself unnecessary since market forces and customer choice already act as clear constraints to inappropriate pricing where these services are very much consumed as optional value-adds the WLR Core service. Openreach significantly reduced prices for these services as part of a six month special offer than ran from 1 February to 31 July 2009. This offer was made to stimulate increased take-up of these services. At the time announcing the offer, Openreach noted that these are mature products and that it reserved the right to review the offer period, particularly if consumption exceeds capacity such that it adversely impacts network stability and service levels or required additional capital investment in infrastructure. During August 2009, Openreach is reviewing the impacts of this activity, taking into consideration a number of factors including the network's capacity to handle higher volumes. We hope to be in a position in September 2009 to introduce significant and longer-term price reductions on many of these products.

Question 6.1 Do you agree with the approach we have taken to derive the core WLR rental? In particular do you consider the estimates for the cost of the WLR Premium care levels to be reasonable?

Ofcom has been consistent with its approach to the OFFR Statement when determining the unit costs for the WLR Basic and Premium products.

Ofcom has then identified three alternative approaches to adjust the cost stacks for "Premium only" costs:

1. Incremental Savings i.e. the costs that would be saved if the service were to be stopped - this information is readily available and formed the basis of internal assessments of the difference between the WLR Core and Premium products.

2. Incremental Costs i.e. identifying the incremental costs of providing the service - this approach can be more difficult to identify as it requires an assessment of the Basic cost stack as if the "premium only" services had never been provided. This may not ultimately lead to a materially different outcome to the Incremental Savings approach.
3. Incremental Savings plus an adjustment for Common Costs i.e. identifying the incremental savings from ending the service plus estimating an adjustment to the allocation of Common Costs whereby the Premium product will absorb a higher proportion of these costs relative to the WLR Core product.

Ofcom has taken the third option as their approach.

Openreach considers that it is appropriate for Ofcom to blend the current Basic and Premium cost stacks, then deduct "Premium only" costs from the blended stack.

The value of the "Incremental Savings" for both Jeopardy Management and Faster Contractual Repair appear to be in line with our own assessments. However, we do question the inclusion of a "Common Costs" adjustment, which we address in our answer to Question 6.2.

Question 6.2 Do you agree with an allocation of common costs to the WLR Premium care level service?

Openreach is concerned with Ofcom's approach to common costs which results in an effective increase in the WLR Premium cost stacks. This allocation is dependent on the assumptions of take-up of volumes for the WLR Premium service which may be impacted by the various proposals in the Consultation.

Ofcom has determined to increase the allocation of common costs to the WLR Premium product reflecting the changing allocation of labour costs (both Jeopardy Management and Faster Contractual Repair are predominately labour costs). Ofcom has assumed that these labour savings would attract a common cost saving in line with the overall labour cost proportion of WLR rentals.

Ofcom has further noted in the Consultation that a commercially unattractive price for the WLR Premium product will encourage CPs to switch from the higher-priced WLR Premium down to the WLR Core product. The additional allocation of common costs to the WLR Premium product would appear to be moving towards fulfilling Ofcom's concern in that regard.

Given the various proposals in this Consultation, Openreach is concerned that the approach to common costs could distort CP choice and if WLR Premium volume assumptions are not realised, could lead to an under-recovery of common costs across the WLR portfolio.

Question 6.3 Do you have any comments on the likely change in transfer or connection volumes in the latter part of this charge control period?

Notwithstanding comments made previously about the duration of the charge control, Openreach supports the amendments which Ofcom has proposed to connection



volumes in the latter part of this charge control period. As we have previously noted, it will be appropriate to monitor assumptions (including volumes) set at the commencement of the control to check continued appropriateness of the control moving forward.

Question 7.1 Please set out your views on the proposals set out in Section 7, together with the potential implications of the those proposals for CPs and for consumers, and the factors you consider we should take into account when determining the final pricing regime.

Openreach has set out its view on many of the proposals discussed in Section 7 in our answers to previous questions. In terms of the additional items covered:

- Regulated prices moving towards FAC. Openreach supports this approach as appropriate.
- The use of October 2009 RPI data / consistency with LLU. Openreach believes that this approach is reasonable; and strongly supports consistent treatment with LLU.
- 28 day proposed notification including our ability to adapt the WLR Basic service and also transfer and connection charge proposals. As indicated in this Response; Openreach is generally of the view that shorter notice periods are warranted in today's world where CPs require flexibility and the ability for Openreach to respond quickly to their demands.
- Openreach believes that the general approach being proposed — to focus regulation against a WLR Core service and take a lighter-touch approach elsewhere — provides Openreach with a strong incentive based framework to be commercial and innovative; whether around service, price or product development. Provided that the approach to development of the WLR Basic into the WLR Core service is pragmatic and enables creation of a service with the right QOS, this will represent a good outcome for CPs and their end-users.

Question 7.2 Do you agree with our treatment of the first year RPI adjustment to ensure consistency with the LLU proposals?

As outlined previously, Openreach supports consistency of assumptions between the LLU and WLR price controls.

Ofcom notes that it proposes “to use October 2009 RPI data for the purposes of applying the indexation in the 2010/11 controls, and have drafted the Condition accordingly” (para 7.15). Openreach requests that Ofcom reviews the draft Condition to ensure that it does reflect the proposal.

Question 7.3 Do you agree with the proposed 25 days implementation period? If not please state your reasons and a preferred period?

Openreach considers that this question intends to ask whether we agree with the 28 day implementation period, as discussed in the Consultation (paras 7.85-7.87) (not 25 days) and we respond accordingly.

As previously indicated, Openreach fully supports Ofcom's proposal for a 28 day implementation period for price changes published in the final statement and Notification. This is consistent with Ofcom's proposals for SMP Condition AA6(a) as outlined in the Wholesale Review Consultation. Indeed, Openreach considers that any notification period greater than 28 days is too long.

Openreach is currently subject to a 90 day price notification period under the SMP Conditions which we consider undermines our ability to respond promptly to CPs' requirements, ultimately to the detriment of end-users. Openreach has recently submitted a notification waiver request to Ofcom to introduce the price discount on WLR connection from £88 to £67 from 1 October, as intended by this Consultation.

Many other regulated services are subject to 28 day notification periods. For example, prices for new Network Access under the Wholesale Local Access and Business Connectivity market reviews, as well as various conveyance and transit services, currently require 28 days notice for price changes, and we consider that the notification periods for WLR should also be aligned to 28 days.

Question 7.4 Do you agree with our assessment that the proposed changes to conditions and directions meet the tests set out under the Act?
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Under Section 87(9)(a) of the Communications Act 2003 ("the Act"), Ofcom is entitled to set charge controls, but in doing so must comply with Section 86, among others, of the Act. Section 86 of the Act sets certain conditions on Ofcom's ability to modify or revoke the SMP service conditions, including the need to review the relevant market power definition that is in force. At para 2.39 the Consultation says that "the scope of this review derives its authority from the proposed market definitions and SMP findings made in the Wholesale Review, the consultation for which was published on 19 March 2009". This review has not yet concluded. In BT's response to question 5.1 of the Wholesale Review Consultation dated 4 June 2009, BT commented that "Ofcom has not undertaken the appropriate analysis to conclude that a single residential and business market now exists" and Openreach is hopeful that Ofcom will address this issue in its final statement expected in September. To the extent that Ofcom is yet to confirm the market definition and SMP findings upon which it will be relying to issue conditions and directions, Openreach reserves its position as to whether the tests in under the Act have been met.

Notwithstanding the above, Openreach makes the following comments in relation to the proposals put forward in the Consultation:

Ofcom has suggested in paras 3.58 - 3.64 of the Consultation that it may impose a basis of charges obligation for WLR Premium and other higher level care services. Openreach does not agree that the imposition of a cost-orientation requirement on value-added services meets the conditions necessary for the application of an SMP condition under the Act. In particular, in accordance with section 88 (1)(b) of Act, an SMP condition requiring cost-orientation cannot be imposed except where it appears

to Ofcom that there is a relevant risk of adverse effects arising from price distortion<sup>3</sup> and the condition is appropriate for the purposes of promoting efficiency, promoting sustainable competition and conferring the greatest possible benefits on end-users. These requirements are not met for the following reasons:

- There is not a risk of adverse effects arising from excessive pricing (which cost-orientation aims to prevent) as Openreach is not “able to set prices freely” for any value-added features and services, as suggested in para 13.25 of the Wholesale Narrowband Review Consultation. Not only is Openreach mindful of the constraints of competition law, but CPs would stop purchasing these value-added services if they considered that the prices charged did not reflect appropriate commercial value for them.
- It does not promote efficiency as it does not provide Openreach with any incentive to improve its efficiency, if all of its products and services are subject to cost-orientation. In some cases, it could even lead to increased inefficiency.
- It does not promote sustainable competition as the practical consequence of requiring value-added services and features to be cost-orientated is that it may stifle Openreach’s incentives to innovate and invest in new additional services and features on top of the regulated product, even where there is a clear demand for such non-regulated services. This is particularly important in today’s economic climate, with the declining take-up of wholesale analogue exchange lines, where Openreach needs to innovate to stimulate demand.
- It does not confer the greatest possible benefits to end-users. In fact, it would be likely to lead to a detriment to end-users through reduced differentiation in terms of services available, as there would be less choice of value-added services and features.

Ofcom has suggested that it might supplement the absence of a basis of charge condition for WLR Premium and other higher level services with guidance on how it would expect to interpret the “fair and reasonable” requirement in Condition AA1(a) in the event of a dispute. Ofcom says at para 3.66 of the Consultation that its guidance could include consideration of, among other things, “whether the increment charge [on WLR Premium compared to WLR Basic] was fair and reasonable given the cost of providing the enhanced services.”

Openreach considers that this action would not be consistent with Ofcom’s duty in Section 3 of the Act to have regard to ensuring that its activities are both proportionate and necessary (i.e. targeted only at cases where action is needed). In relation to the requirement that Ofcom’s activities be proportionate, if cost-orientation obligations are not considered necessary, then it is not a proportionate or appropriate response to issue guidance which introduces basis of charges considerations to Openreach’s charges for WLR Premium and higher care level services as this would, in effect indirectly reintroduce cost orientation through a different means. In relation to the requirement that Ofcom’s activities be targeted only at cases where action is needed, Ofcom already has ample means to intervene under competition law were Openreach to engage in excessive pricing and that should be sufficient, given also the fact that Openreach’s ability to engage in excessive pricing is constrained by

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<sup>3</sup> Defined in section 88(3) of the Communications Act as excessively high prices or the imposition of a price squeeze.

CPS' ability not to purchase these services if the price / value relationship is not correctly set.

Question 7.5 Please provide any other comments you may have in response to the proposals set out in this document.

As noted elsewhere in this Response, and bearing in mind the current volatile economic climate, Ofcom should remain vigilant in monitoring the continuing validity of the assumptions used in setting this control. Openreach has no other comments to make in relation to this question.