

RESPONSE TO CONSULTATION ON CHARGE CONTROLS FOR WHOLESALE LINE RENTAL AND RELATED SERVICES

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Cable&Wireless

EXECUTIVE SUMMARY

We welcome the opportunity to respond to Ofcom's proposals for WLR charge control and we offer this response on behalf of C&W and Thus.

We support the proposal to set charge controls for a single "core" WLR service. Given the absence of significant differences between WLR Basic and WLR Premium, and the potential for the price of the two services to converge, it makes sense to simplify the product set and use the service levels flowing from the service harmonisation work to provide the product differentiation that customers require.

We are not convinced that the existence of the core WLR service provides sufficient constraint on the pricing of the enhanced care services. Firstly, customers need to be able to migrate between care levels and, in particular, from care Level 2 and above down to care Level 1. It is not clear at this stage the extent to which Openreach will seek to impose restrictions on the ability of business users to migrate to Level 1. Secondly, many business customers will regard Level 2 as essential to the service. The existence of the core service will only provide an adequate constraint on the price of the superior care levels if a sufficient number of customers are willing to move to a lower level of care. Ofcom should ascertain the extent to which Openreach intends to limit the ability of business users to opt for the core WLR service with Level 1 care.

Ofcom should apply some scrutiny to the indicative pricing proposed for Service Harmonisation. In its December 2008 consultation on a New Pricing Framework for Openreach, Ofcom found that the current charge ceiling of £110 is in excess of the adjusted and estimated CCA FAC unit cost of providing Business WLR in 2007/8 and 2008/9¹. Ofcom estimated that Openreach's ROCE would be 10-11% for Residential WLR in 2009/10, compared with 14-15% for Business WLR in 2009/10.

At the time, Ofcom suggested that the price of Business WLR should be adjusted downwards. Separating the core element from the enhanced care element, this would suggest that either Openreach is charging too much for the core line rental element or that Openreach is charging too much for the enhanced care element. Openreach's Indicative Pricing for Service Harmonisation proposes £110 for Level 2 care. We believe this price would lead to BT over-recovering on the Level 2 product.

¹ See figure 4.2 <http://www.ofcom.org.uk/consult/condocs/openreachframework/off.pdf>

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?

Yes. We agree with Ofcom that the most significant difference between WLR Basic and WLR Premium is the service levels and options for directory entries. We think it makes sense to reflect this by providing for a regulated basic core service and enabling Openreach to offer premium products based on a range of superior service levels and options for directory entry.

The 2003 market review found separate markets for business analogue WLR and residential analogue WLR and found that BT had SMP in both. In 2006 Ofcom imposed separate charge ceilings for Residential WLR and Business WLR. The proposal in this consultation therefore amounts to a relaxation of regulation. We would only regard this as a positive step in circumstances where the proposed core WLR service gives all of our business customers true flexibility to choose the level of care they require and providing that sufficient safeguards exist as to the price of the care levels. Without such safeguards, we would argue that Ofcom should continue to set charge controls (or, failing that, impose a cost orientation obligation) on both the core WLR service and care Level 2.

We do not believe that a basket containing both core WLR and care Level 2 is appropriate. A basket would enable Openreach to load costs and charges on to business users, if it chose to. This might prove profitable for Openreach since it faces more competition in the supply of products for residential users (from LLU operators) than it does in the supply of products for business users.

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?

The current WLR Premium product can be connected to NTE or a network telephony termination point (NTTP). Given that the core WLR service will now be used by business customers, it should include the ability to be connected to NTTP. It is necessary that current WLR Premium customers with existing NTTP can migrate to the core WLR product if they choose to.

QUESTION 3.3 PLEASE PROVIDE YOUR VIEWS ON THE REQUIREMENT FOR AND IF NECESSARY, DURATION OF ANY TRANSITION PERIOD FOR THE IMPLEMENTATION OF A CORE WLR SERVICE?

We have no particular requirements in this regard. It is important that all current WLR Basic and WLR Premium customers can migrate to the core service plus which ever care Level (1 or above) they choose at no cost. We are happy for this to be done as soon as possible.

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).

Ideally, a requirement of cost orientation would be applied to each care level offered (Option 2), i.e. to the incremental part of the charge, as compared to the core WLR service. However, we understand Ofcom's difficulties in identifying the incremental cost of providing enhanced services.

Option 1 is to apply cost orientation to the full price of the product, i.e. the line rental element *and* the service level element. In view of the complexity of modelling the cost of SLAs as explained in paragraphs 3.58 to 3.62, and in view of the number of care levels available, we believe it would be "cleaner" to keep the line rental element separate from the care level element.

Option 3 is no cost orientation.

Openreach recently published indicative prices for service harmonisation for WLR and LLU rental products²:

Level	Description	Standard Engineering Working Times	WLR Indicative Price	LLU Indicative Price
1	End of next working day + 1 working day	Monday – Friday 08:00 – 18:00	Standard Rental (eg £100.68)	NOT APPLICABLE
2	End of next working day	Monday – Saturday 08:00 – 18:00	+ £10 on L1 (eg £110)	Standard Rental (eg £86.40)
3	In by 13:00 fix same day, in after 13:00 fix by 13:00 next day	Monday – Sunday 08:00 – 18:00	+ £36 on L2 (eg £146)	+ £36 on L2 (eg £122.40)
4	X-hour repair	Monday – Sunday 24/7	Not yet available	Not yet available

Openreach propose an additional £10 for Level 2, which would be in line with the cost of the current WLR Premium product (£110). This suggests that Openreach may not have arrived at a price of £10 as a result of a detailed cost analysis, but rather that they are seeking to some extent to maintain the status quo. We therefore suggest that Openreach be asked to justify the proposed pricing of care levels 2 and 3.

² <http://www.openreach.co.uk/orpg/news/generalbriefings/gen08409.do>

In the second consultation of the Openreach Framework Review, Ofcom demonstrated that the adjusted CCA cost of providing business WLR was a) below the cost of providing residential WLR and b) well below the current charge ceiling.³ In that document, Ofcom states “The price for business WLR appears to be higher than its cost.”⁴ Ofcom therefore proposed that prices for WLR business should fall in real terms over the charge control period and they suggested a charge for 2009/10 of between £106 and £110. We note that an apparent reason for the fact that the cost of WLR Business is lower than the cost of WLR Residential is the fact that business lines tend to be shorter in length than residential lines.⁵

Ofcom argues that the price of the higher care levels will be constrained by the ability of customers to buy the core WLR service. This constraint will only be present if there are no barriers to customers migrating up and down between care levels. We have identified three areas which could pose a barrier to moving up and down the chain of substitution and thus weaken the ability of the core WLR service to constrain the price of care Levels 2 and above.

1. There is no charge for customers migrating between the care levels that are currently offered on WLR Basic and WLR Premium. It is important that this requirement is maintained and no charge is levied on customers who buy the WLR core service and subsequently choose to move between the new care levels that have emerged from the Service Harmonisation programme.
2. Customers currently buying WLR Premium should be allowed to migrate from WLR Premium to WLR Core with Level 1 if they choose, at no cost. Openreach’s current plan is to migrate WLR Premium customers on to the new service harmonisation care Level 2. Ofcom must ensure that Openreach is required to give customers the option to move to a different care level if they wish.
3. The core WLR service must be available to customers whose lines are connected to NTTP, rather than NTE. As discussed below, the existence of NTTP is not, we believe, relevant to the SLA commitment which a customer selects. We would point out that customers who buy WLR Premium today can opt for “Level 1” care within that product today, i.e. 48 hour repair.

We therefore suggest that, in the absence of a cost orientation requirement, Ofcom should monitor the extent of migration between care levels so that it is better able to evaluate the elasticity of demand.

We are sceptical of the idea that requiring cost orientation would remove the incentive on Openreach to innovate in the provision of service levels. Ofcom say “The Service Harmonisation initiative discussed above shows the value of flexibility in the development of care levels.” However, the service harmonisation project came about as a result of long running industry unrest about a) Openreach’s performance against its existing SLAs, b) the absence of higher levels of care at the customer’s option and c) the lack of consistency between LLU products and WLR products. Even so, the current proposals have only arrived after about two years of negotiation and supervision by

³ A New Pricing Framework for Openreach, Second Consultation, December 2008, Figure 4.2

⁴ A New Pricing Framework for Openreach, Second Consultation, December 2008, Para 6.49

⁵ Paragraph 6.16 of the present consultation

the OTA. To imply that they represent any degree of innovation in product development seems very generous to Openreach.

We note that, before the current charge ceilings were set following the 2005 and 2006 reviews, the differential between the charge for residential WLR and business WLR was greater (about £15), which suggests a tendency for BT to seek to exploit business customers.

Openreach has expressed the view that “WLR Premium new provides usually require an engineering visit and WLR Premium repairs are “more likely” to require a visit.”⁶ It is not clear on what basis Openreach makes this claim and we request that they provide further explanation and evidence. Ofcom has already asserted that the only differences between the two products are:

- 1) Faster repair times on WLR Premium;
- 2) An option to be entered in the business directory for WLR Premium; and
- 3) An option to be connected to NTTP for WLR Premium⁷.

Ofcom has also stated that “There is no evidence that the difference between NTE and NTTP affects the cost of providing the services.”⁸

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?

In view of the relationship between the two products, the common cost base and the desirability of maintaining an appropriate differential between the two products, we agree with Ofcom that it makes practical sense to run WLR charge controls in tandem with LLU charge controls.

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's Indicative Pricing for Service Harmonisation, published on July 15th, indicates that Level 1 care is not applicable to, or available with, MPF. Ofcom's analysis of the relative charges for WLR and MPF does not acknowledge this fact. Comparing the price of the core WLR service with the price of the standard MPF rental is not comparing like for like, since both services come

⁶ Paragraph A5.10

⁷ It may be that Openreach believe that connection to an NTTP often entails multiple line installations, which could lead, for example, to added complexity of fault diagnostics or repair. However, the cost of such added complexity could be outweighed by economies of scale (for example on provisioning) so further evidence and explanation is required.

⁸ Paragraph 3.9

with different care levels. In product terms, the relevant comparison is actually between MPF standard and WLR Level 2.

QUESTION 4.3 DO YOU AGREE WITH OFCOM'S PROPOSAL TO SET A THREE AND A HALF YEAR PERIOD CHARGE CONTROL FOR WLR?

We understand that Ofcom's cost modelling starts from April 2009 to ensure consistency with LLU charges. In principle, we agree that a three and a half year charge control period from October 2009 is an appropriate period over which to predict changes in costs, volumes and efficiencies.

However, we believe that this should be subject to the written proviso that, in the event that Ofcom declines to impose cost orientation or charge control other than on the core WLR service, it would be prepared to step in and impose new conditions on BT before the end of this term if this were necessary in the interests of competition and/or to prevent abuse of SMP.

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.

Yes. We agree that it is appropriate to recover a portion of the transfer costs through the line rental for the reasons set out by Ofcom. A low transfer cost is important for promoting and maintaining competition.

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.

The ceiling on the line transfer charge is vital in encouraging a competitive retail environment. We therefore agree that it is appropriate to recover fixed costs of transfers (eg systems costs) through line rental and only recover incremental costs through the transfer charge itself.

Ofcom proposes to increase the transfer charge from £2 to £3 initially, and then in line with line rental charges. Providers of retail line rental services currently absorb the cost of the transfer charge, so an increase of 50% is not insignificant and would impact margins.

If transfer charges do increase, CPs may feel obliged to pass this charge on to customers which would, in turn, constitute a barrier to switching and therefore competition. Ofcom has provided no evidence that the current £2 transfer charge is causing an inefficient level of switching and we would therefore argue that Ofcom should maintain the existing £2 charge.

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 A 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?

We agree that Ofcom should continue to set a charge ceiling for new connections. There are negative aspects to the imposition of one-off adjustments, but these are less significant in relation to up front charges than in relation to on-going rental charges. We therefore accept that, given the re-assessment of common cost apportionment since the 2006 review, it is appropriate to impose a one-off adjustment in the charge ceiling for new line connections and to set a glide path to bring the cost down to FAC by the end of the control period.

We do not believe that the relative charge for MPF line connection and WLR line connection is as important as the relative charges for line rental. However, it may make sense to approximately maintain the differentials that exist today in order not to distort the decision making processes of CPs.

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.

In view of the low volumes concerned, we accept Ofcom's proposal to monitor the level of the MPF to WLR transfer charge in relation to the WLR to MPF transfer charge and to refrain from imposing a charge ceiling at this stage.

Ofcom proposes to impose a cost orientation requirement on:

- rental charges;
- connection, rearrangement and termination charges; and
- network features that comprise the basic service. Ofcom is of the view that these features are largely those agreed by industry as the parity feature set for the deployment of WLR3.

Calling and network features should at least be subject to a cost orientation requirement, and should preferably be included in the scope of the proposed charge control. The importance of these services should not be underestimated; CPs often have no choice but to buy these products from Openreach if their customers request them. They therefore fall within the scope of BT's SMP. There needs to be some control on Openreach to prevent them from abusing their position of strength.

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?

The aggregate unit cost of WLR rental (i.e. WLR Residential plus WLR Business) is £97.10. Openreach estimate that the incremental saving of removing the enhanced care element of WLR Premium would be £0.91, which brings the unit cost of the core WLR service (before adjustment for the WLR transfer charge) down to £96.19.

We accept that the current cost estimates for enhanced care may not be accurate as the costing methodology is not designed accurately to measure such a small and specific element. However, what this does show is that either the £10 premium is too high, or the basic cost of the core rental is too high. Either way, we expect a reduction in the indicative price proposed by Openreach.

We would take issue with Openreach's claim that "Jeopardy Management", i.e. provisioning and repair activity, is weighted towards WLR Premium products. If the product is essentially the same as the basic product, it is unclear why this should be the case. However, this only adds a cost saving of £0.04, so it is not material.

QUESTION 6.2 DO YOU AGREE WITH AN ALLOCATION OF COMMON COSTS TO THE WLR PREMIUM CARE LEVEL SERVICE?

We agree with Ofcom that, when estimating the cost of providing WLR Premium care support, it is appropriate to adopt a fully allocated cost approach and allocate a reasonable proportion of Openreach's overheads to the enhanced care element.

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?

No.

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.

We agree that it is appropriate to set prices by reference to a glide path towards the underlying FAC.

QUESTION 7.2 DO YOU AGREE WITH OUR TREATMENT OF THE FIRST YEAR RPI ADJUSTMENT TO ENSURE CONSISTENCY WITH THE LLU PROPOSALS?

When applying the “RPI-X” formula, Ofcom propose to adjust the value of X to allow for the expected difference between the reported RPI in October 2009 and the actual RPI for 2010/11. This is to allow for the fact that RPI is likely to be unusually low in October 2009. However, we do not believe that Ofcom has accounted for the fact that, if RPI is unusually low due to the impact of changes in interest rates and VAT, then it is likely to be unusually high when these factors step back up to “normal” levels. Because RPI measures the rate of change as compared with the previous year, a return of, for example, mortgage interest payments to early 2008 levels is likely to lead to an RPI of greater than 2.5% initially, before the level of RPI stabilises. By failing to account for this, Ofcom could be allowing prices to increase more in nominal terms than was intended, which might be detrimental to the interest of consumers.

It is also difficult to predict exactly when the readjustment of RPI is likely to occur. The Bank of England is currently predicting that the Consumer Price Index will remain just below the target 2% during 2011.⁹ This may make the Bank inclined to keep interest rates low, which could in turn depress the Retail Price Index (which includes mortgage interest payments) for longer than is predicted by Ofcom.

If Ofcom does anything other than assume stable RPI, it will be speculating on matters which are notoriously difficult to predict.

QUESTION 7.3 DO YOU AGREE WITH THE PROPOSED 25 DAYS IMPLEMENTATION PERIOD? IF NOT PLEASE STATE YOUR REASONS AND A PREFERRED PERIOD?

We understand that Ofcom is in fact proposing a 28 day implementation period, rather than a 25 day implementation period.

Ofcom proposes a 28 day notice period for the proposed changes to the prices for transfer and new connection. In order to pass the increase in transfer charge on to our wholesale customers, we require at least 30 days’ notice in order to comply with notice periods under contracts with our wholesale customers.

In terms of the move to a single core rental service, we have no objection to a 28 day notice period.

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?

Yes.

⁹ <http://www.bankofengland.co.uk/publications/inflationreport/irfanch.htm>