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Dear Markham

Charge Controls for Wholesale Line Rental (WLR) and related services

We welcome the opportunity to comment on the above consultation. SSE uses WLR as a wholesale input to its telephony service and is obviously affected by the outcome of Ofcom's review of charge controls for this and related services provided by Openreach.

Our responses to the specific consultation questions are attached as an appendix, with some overall thoughts on the main elements of the proposals set out below.

<u>Disaggregation of WLR products into core and value-added components</u>
We welcome the main element of Ofcom's proposals to replace the current charge controls for separate residential and business WLR products with a single charge control for a core rental service. This disaggregates the WLR product into component parts so that the communication provider (CP) customers of Openreach can have greater flexibility in the wholesale products they are able to choose to support their chosen retail propositions. It also follows the logic of the service harmonisation project in having a greater standardisation of Openreach services across different wholesale products. We look forward to further developments along these lines across the portfolio of Openreach products that build on the core facility of a wire or "metallic path" connection facility.

<u>Treatment of Transfer Charges</u>
We also welcome Ofcom's support, in section 5, for low WLR transfer charges – as being an important element in promoting competition and maintaining choice for end customers. However, we are very opposed to any increase in the current level of the charge, in relation to which Ofcom's deliberations lead it to propose an increase from £2 to £3 per transfer. We would, in fact, seek to see this charge reducing to zero with the whole cost of the WLR customer transfer process recovered through standard network charges, as is the case in other utility industries. As Ofcom notes in paragraph 5.12, a large proportion of the transfer costs (as would be expected from a computer-based transfer system) are fixed system-related costs. We are not therefore

clear of the economic grounds of the case for increasing the charge made on a per-transaction basis for using the system.

As Ofcom notes, there are clear benefits to competition and consumer protection in having a transfer process with low/zero charges. However, we disagree with the comments in paragraph 5.8 that with the establishment of retail competition, it could be argued that the policy of low upfront transfer charges could be removed. Competition, effective customer choice and quality of service to customers, whatever their starting levels, would in our view quickly reduce in a market environment where suppliers – and hence their retail customers – had to pay material transaction charges to move away from their current supplier.

Ofcom comments in paragraph 5.13 on the apparent unit costs of the transfer systems as rising from £9 in October 2009 to about £13.50 in the final year of the proposed control. These costs seem high and we would, in fact, expect to see efficiencies and costs on a downward trend. We believe it would be useful for this area of costs to have greater transparency and supervision by the market as a whole going forward due to its critical importance in the competitive framework.

Other WLR-related charges
We also have some concerns about the proposals not to put in place any cost orientation requirements for the value-added enhancements to the basic WLR product. These "value added" services can still only be provided by Openreach and, in our view, protection for the CP community who have no choice but to purchase these elements of wholesale service from Openreach, is still required. We discuss this in further detail in our response to question 3.4 of the consultation.

Transparency and Industry Involvement
We would recommend that consideration is given to developing a framework which would both increase the transparency of how Openreach sets its wholesale charges and provide a mechanism for industry input to that methodology.

I hope these comments are helpful and would be happy to discuss them if that would be useful.

Yours sincerely

Aileen Boyd
Regulation Manager

Consultation Questions

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?
We agree with Ofcom's proposed approach of capping the price of a core WLR rental service.

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?
We do not provide a retail service to business customers and have no particular comments on this subject.

Question 3.3 Please provide you views on the requirement for and if necessary, duration of any transition period for the implementation of a core WLR service?
No comment.

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).
As discussed in our covering letter and in our response to question 13.3 in the Wholesale Review consultation, we believe that some form of protection for Openreach's wholesale customers is required in the form of cost orientation and, preferably, greater transparency for its customers on how charges relate to underlying costs.

Ofcom discusses the options on applying a cost orientation requirement and we consider that the simplest approach would be to apply this to the increment of the value-added service/charge, which is Ofcom's option 2. We do not agree with Ofcom's comment at paragraph 3.62 that a disadvantage of this approach would be to significantly reduce the incentive on Openreach to innovate and provide additional services, as the upper limit of the cost orientation range would have a positive value. However, we do think it would be useful for Ofcom to set out guidance on cost orientation, as is proposed in the consultation, in order to provide both Openreach and its customers with some clarity on what will be expected in terms of pricing.

A key requirement for the pricing of value-added services is that strict non-discrimination should apply – for example, it should not be acceptable for Openreach to offer volume discounts in the pricing structures for these services. We note that Ofcom mentions that the existing special conditions on Openreach of no undue discrimination, obligation to notify charges and to provide network access on fair and reasonable terms would continue to apply to Openreach. However, we are puzzled by the comment in paragraph 3.66 that "it might be reasonable for Openreach to recover a higher proportion of common costs from the users who place the highest value on some of the enhanced features" as there is no apparent justification for this.

Ofcom also mentions, in paragraph 3.68, the potential issue of margin squeeze depending on the behaviour of BT Retail in its retail pricing of enhanced WLR-based services in comparison to the Openreach prices for the underlying wholesale services.

There are clearly a number of areas of potential concern and valid industry interest about the methodology that Openreach will use to set its charges for the value-added elements of the WLR service. The importance of this area to Openreach's wholesale customers and to the maintenance of competition in the retail telephony market does justify, in our view, continuing regulatory oversight and the development of greater involvement and transparency for Openreach's customer base.

In this context, we think it is relevant to consider how these issues are dealt with in the framework of energy network regulation, particularly as the Digital Britain report published in June confirmed the Government's view that the UK's communications infrastructure represents an essential support to the functioning of society in a similar manner to energy and other "utility" infrastructure networks.

Value-added services, for example, are dealt with through a mechanism known as "excluded services". Essentially, all the costs of providing regulated services are taken into account in setting an overall revenue requirement for the regulated network. It is recognised that various additional services can be provided by the network at the request of users – the excluded services – and a forecast of the revenue from these is subtracted from the overall revenue requirement to provide an overall allowable revenue that the charge controls are then designed to allow the network to recover. The rationale for this is that it is regulated assets that are being used to provide the excluded services and so the revenue from providing them should contribute to the overall revenue requirement and thus reduce the cost of other regulated charges.

However, to the extent that the network provides a greater number of such services, or introduces new services, it will keep the benefit of the revenue from these, outside the revenue control, until the price control is re-set. Thus the network business still has incentives to innovate, to provide additional services that its customers want at prices they are prepared to pay. This approach would also seem to avoid consideration of the apportionment of common costs in setting prices for particular services.

It is also a feature of energy network charging that charging methodology statements are published. In electricity, these are also subject to governance and change control such that the regulatory objectives of, amongst other things, facilitating competition and reasonable cost-reflectivity are maintained and enhanced over time.

Whilst we recognise that the regulatory framework governing Openreach would not currently allow an overall revenue approach, we believe that the Government's Digital Britain initiative and planned legislative programme may allow some elements of these approaches, as appropriate to the communications market, to be developed. It may also be the case that consideration of other approaches may be helpful in the current context.

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?

We agree it is important for there to be consistency between the WLR and LLU charge controls. Challenges to the assumptions of setting the WLR charge controls could also affect how the LLU controls are allowed to continue.

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?
We would rely on Ofcom's scrutiny and analysis to support any necessary charge differentials. Ultimately, as discussed in our covering letter and in our response to question 3.4 above, we would hope for greater transparency in Openreach costs across its portfolio of metallic path/wire connectivity products and in the methodology applied to price the different products.

Question 4.3 Do you agree with Ofcom's proposal to set a three and a half year period charge control for WLR?
It seems sensible to seek to align the end points of the WLR and LLU controls given the common costs between the two product areas. It does appear likely that, prior to the end of the proposed period in March 2013, there will have been a significant roll-out of fibre in support of BT's public commitments to provide higher speed broadband via investment in fibre to the cabinet (FTTC). We believe that there is likely to be scope for significant reductions in the costs of delivering Openreach's products where there is a greater proportion of fibre in the access network and suggest that it may be appropriate to review the cost stacks for WLR as an interim adjustment to the charge levels, if this proves to be the case. We would also note that adopting one access network for both telephony and voice products would appear to be likely to lead to greater cost savings than continuing to maintain two, which we understand is entailed in BT's more recent decision not to provide wholesale voice products on its developing fibre access platform.

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 would like to see the approach further developed to cover <u>all</u> transfer costs through the rental charge, as discussed in our covering letter.

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.
No. We are strongly against an increase in this charge, as again discussed in our covering letter.

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?
We agree that Ofcom should continue to set a charge ceiling and that a one-off adjustment is appropriate, given the relatively high difference between the current charge (£88) and the charge that Ofcom has assessed as appropriate (£36). If the latter is the appropriate charge level, we are not convinced that keeping it artificially high due to considerations of recent adjustments to new provide charges for LLU is valid. Our understanding is that while many elements of cost for a new WLR connection are the same as those for a new connection allowing an LLU-based service, LLU connections involve more work and are therefore more expensive. We look forward to a situation where there is a common and transparent methodology supporting the basis of different charges for similar Openreach services.

We also have a concern about the volume figure used to derive unit costs. Ofcom states that the new line connection charge (£88) is paid by customers who have no telephone line connected to BT's network. However, our own experience in dealing with house-moves indicates that this same charge is also levied in some circumstances when the

customer's new premises are actually connected to the network but, for example, their line capacity has been reassigned. We have made comments about this in response to Ofcom's recent informal surveys about the house moves process.

Our concerns are two-fold.

Firstly, do the figures that Ofcom uses in its analysis include all occasions when the charge is being made (paragraph 5.34 suggests that only "new connections" – perhaps meaning new house builds – are being taken into account)? All other things being equal, if a greater number of chargeable events should be used, the unit cost/charge should reduce.

Secondly, we would welcome greater clarity on the rules for when the connection fee can be charged for a property where a BT Openreach line apparently exists but has not been used for a period. Transparency in this area would improve the information that suppliers can provide to their customers about the potential liability for connection charges in a house move situation and would, in our view, support competition.

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.
We agree it would not be appropriate to include network feature charges in the WLR basic price controlled charge. However, we would like to see these charges covered by the cost orientation and transparency protections that we discuss in our response to question 3.4 above.

In relation to the remaining migration charges (LLU to WLR conversion and vice versa), we are of the view that these should be minimised to help promote competition and avoid barriers to switching. In particular, we would like to see the LLU to WLR charge reduced. We agree with Ofcom's comment in paragraph 5.42 that monitoring of these areas of charging is required. However, rather than just rely on the industry to monitor the level of charges for migration, we strongly believe that these should also be covered by Ofcom's proposed guidance and also ultimately by the framework for industry involvement proposed in other parts of this response.

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?
Question 6.2 Do you agree with an allocation of common costs to the WLR Premium care level service?
We appreciate these calculations and judgements are difficult, in the absence of the overall revenue control approach that we have discussed in response to question 3.4 above. We would query why the premium or value added services would need to attract common costs if, in fact, these services could be considered as services provided for a marginal cost and price, once overheads have been covered by the basic rental charge.

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?
We have comments on the quantum of "connection" volumes, in relation to the calculation of the WLR connection charge, as discussed in response to question 5.3 above.

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 support stability in pricing and in general support the glide path approach, recognising that there may be circumstances, such as the WLR connection charge, when underlying differences between current and required charges are particularly large and a one-off adjustment is justifiable.

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

We found the proposed RPI adjustment rather complex and do have concerns, as Ofcom discusses in paragraph 7.20, about increases in nominal charges in a year (2010/11) when Openreach's returns are already expected to exceed their cost of capital. Coupled with the likelihood that Openreach's costs may reduce still further in the later years of the control due to fibre deployment, we would urge Ofcom to ensure that the net present value to Openreach of this front-loading of revenue is taken into account such that Openreach is neutral to the exact phasing of the profile of the control.

Question 7.3 Do you agree with the proposed 28 days implementation period? If not please state your reasons and a preferred period?

We would firmly object to increases in charges being introduced on a shortened timescale. We have commented on this point in our response to question 11.7 of the wholesale market review.

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?

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

No further comment.