

Wholesale Line Rental: Reviewing and setting charge ceilings for WLR services

Consultation document

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Section 1

Summary

Wholesale Line Rental – regulatory history

- 1.1 Wholesale Line Rental (WLR) allows alternative suppliers to rent access lines on wholesale terms from BT, and resell the lines to customers, providing a single bill that covers both line rental and telephone calls. Its introduction has been a significant stage in the development of competition in retail markets in the UK. A fully effective WLR product will bring major benefits to consumers in terms of increased choice, innovation and lower prices. Consumers in all parts of the country will have the opportunity to choose alternative suppliers who provide combined access and call services.
- 1.2 In August 2002, Oftel modified BT's then licence to make the provision of a WLR product a regulatory obligation in accordance with the conclusions of the Director's Review of the fixed telephony market published in the document *Protecting consumers by promoting competition: Oftel's conclusions* (20 June 2002)¹. This document also set the starting charges for the WLR product. BT launched a basic WLR product (WLR1) in September 2002. Oftel considered that this basic product needed enhancing in order for it to be an effective mass-market product that was commercially attractive to service providers and to end users.
- 1.3 Therefore, Oftel consulted upon (in November 2002) and then published a statement (in March 2003) setting out the requirements for an enhanced, automated WLR product suitable for mass-market use, i.e. WLR2.
- 1.4 On 28 November 2003, Oftel published the conclusions of the *Review of the fixed narrowband wholesale exchange line, call origination, conveyance and transit markets* (the "Call Origination Market Review statement")², which, among other things, restated BT's requirement to offer analogue WLR services and additionally required BT to offer similarly enhanced and automated WLR services for ISDN2 and ISDN30. (There were previously ISDN2 and ISDN30 reseller products sold as Digital Calls & Access.)
- 1.5 BT launched WLR2 on 29 March 2004. BT informed Ofcom that it considered the upgrade of the ISDN2 and ISDN30 WLR products carried out in January 2005 substantively met the requirements of the Call Origination Market Review statement.

Reason for review

- 1.6 Charges for WLR products were last set by Oftel in August 2002. At that time, the rental charges for residential and business analogue WLR were set at £28.00 per line per quarter (£112.00 / line / year) and £29.87 per line per quarter (£119.48 / line /

¹ <http://www.ofcom.org.uk/static/archive/oftel/publications/pricing/2002/pcr0602.pdf>

² http://www.ofcom.org.uk/consult/condocs/narrowband_mkt_rvw/nwe/

year), respectively. At the same time, these charges were also subject to a charge cap set at RPI-2%.

- 1.7 On 19 December 2003, Ofcom opened an own-initiative investigation into BT's charges for business ISDN2 WLR. On 17 June 2004, BT announced that it was reducing the price of business ISDN2 WLR to £55.00 per quarter, i.e. £220.00 per year (from £71.88 per quarter, i.e. £284.88 per year). Ofcom closed its investigation following the changes in BT's charges, but noted that it would be necessary to review these charges once Ofcom's review of the cost of the copper loop was completed and once there was more evidence on the take up of business ISDN2 WLR.³
- 1.8 On 18 August 2005, Ofcom published its statement entitled *Valuing BT's copper access network*⁴. Also on 18 August 2005, Ofcom published the statement *Ofcom's approach to risk in the assessment of the cost of capital*⁵. These documents were significant because a high proportion of the total cost of the WLR charges charge is determined by the cost of laying and maintaining the copper loop. As a result of these statements, Ofcom considers that the WLR charges – as set in August 2002 and changed in line with the charge control – do not adequately reflect BT's costs.
- 1.9 BT voluntarily reduced the residential analogue WLR charge on 1 August 2005 from £9.24 / month (£110.88) to £8.74 / month (£104.88). However, no changes were made to either business analogue WLR or business ISDN2 WLR charges.
- 1.10 Despite BT's charge reduction for residential WLR, Ofcom considers it appropriate to review the WLR charges for residential and business analogue WLR and business ISDN2 WLR to assess whether BT's charges adequately reflect the costs that it incurs in providing these services and, if necessary, to set charge ceilings for these charges in order to ensure that BT's charges are both certain and transparent and that BT is not able to increase its charges to excessive levels. For the reasons set out below, Ofcom considers that it is necessary to set charge ceilings for certain of the WLR services.

Approach to setting the WLR charge ceilings

- 1.11 The following sets out Ofcom's proposed approach to setting the residential and business analogue WLR charge ceilings only:
 - Ofcom has used cost data for 04/05 from BT's audited regulatory financial statements (published 2 September 2005);
 - Ofcom has used the same methodology for projecting cost as used in setting the LLU charges, i.e. projecting costs for 2005/2006 (for further details see the document *Local loop unbundling: setting the fully unbundled rental charge ceiling and minor amendment to SMP conditions FA6 and FB6* (published 7 September 2005)⁶;
 - Ofcom is proposing to apply an efficiency factor of 1.5% to 05/06 operating costs;

³ http://www.ofcom.org.uk/bulletins/comp_bull_index/comp_bull_ccases/closed_all/investigation_closed/#content

⁴ <http://www.ofcom.org.uk/consult/condocs/copper/value2/statement/#content>

⁵ http://www.ofcom.org.uk/consult/condocs/cost_capital2/statement/#content

⁶ <http://www.ofcom.org.uk/consult/condocs/llu/>

- A 10.0% rate of return on capital employed has been applied, as set out in the conclusions of Ofcom's recent review of BT's cost of capital;
- Ofcom has used the £58.51 estimate of copper costs as set out in the *Valuing BT's copper access network* statement, which allows for an adjustment for Digital Access Carrier System ("DACS") (i.e. the use of Pair Gain equipment). However, as Ofcom has excluded the cost of Pair Gain equipment from the charge, Ofcom has also excluded the adjustment related to DACS;
- Ofcom is proposing to disallow some of BT's proposed increase in drop costs and excluded those drop costs which are already being recovered through residential retail prices, in order to ensure no double recovery; and
- Ofcom is proposing applying a cost volume elasticity (CVE) factor to BT's selling and general administration (S&GA) costs.

1.12 Ofcom is proposing not to set charge ceilings for business ISDN2 WLR. This is because from its review of the charges Ofcom considers that the current charges appear reasonable; and Ofcom has not set charges for business ISDN2 WLR in the past, and to do so now would be an extension of regulation. BT is required, however, to ensure that the charge for this service is reasonably derived from the costs of provision based on a forward looking long-run incremental cost approach.

1.13 On the basis of the approach set out above, Ofcom proposes setting the following charge ceilings. Table 1.1 sets out Ofcom's proposed charge ceilings for line rental, transfer and new line installations for residential and business analogue WLR. Table 1.2 compares the proposed rental charge ceilings with the WLR rental charges prior to 1 August 2005 (i.e. before BT's voluntary charge reduction). Table 1.3 compares BT's current equivalent rental prices with the proposed line rental charge ceilings for WLR. (All values are exclusive of VAT.)

Table 1.1 – proposed charge ceilings for analogue WLR services

	New line installation charge ceiling	Transfer charge ceiling	Line rental charge ceiling
Residential WLR	£90.00	£2.00 / line	£100.68 / line / year
Business WLR	£90.00	£2.00 / line	£110.00 / line / year

Table 1.2 – proposed charge ceilings and previous charges for analogue WLR

	Rental (prior to 1 August 2005)	Proposed line rental charge ceiling	Reduction
Residential WLR	£9.24 / month	£8.39 / month	£0.85
Business WLR	£9.95 / month	£9.17 / month	£0.78

Table 1.3 – current BT Retail prices and proposed charge ceilings for analogue WLR

	Equivalent BT Retail rental prices ⁷	Proposed WLR line rental charge ceiling	Difference
Residential	£8.94 / month	£8.39 / month	£0.85
Business	£13.71 / month	£9.17 / month	£4.54

Next steps

- 1.14 Ofcom is consulting on these proposals until 12 December 2005. When Ofcom has considered responses to this consultation, it will decide whether to give effect to its proposals, with or without modifications, by publishing a final statement.

⁷ Equivalent BT Retail services for residential is BT Together Option 1 (when paid by direct debit) and for business is Business Phone Line.

Section 2

Background and introduction

WLR prior to the 2003 Market Reviews

- 2.1 Wholesale Line Rental (WLR) allows alternative suppliers to rent access lines on wholesale terms from BT, and resell the lines to customers, providing a single bill that covers both line rental and telephone calls. Its introduction has been a significant stage in the development of competition in retail markets in the UK. A fully effective WLR product will bring major benefits to consumers in terms of increased choice, innovation and lower prices. Consumers in all parts of the country will have the opportunity to choose alternative suppliers who provide combined access and call services.
- 2.2 In August 2002, Oftel modified BT's licence in accordance with the conclusions of the Director General of Telecommunications' (the "DGT") Review of the fixed telephony market published in the document *Protecting consumers by promoting competition: Oftel's conclusions* (20 June 2002)⁸ to make the provision of a WLR product a regulatory obligation. The June 2002 document also set the starting charges for WLR.
- 2.3 BT launched a basic WLR product (WLR1) in September 2002. Oftel considered that this basic product needed enhancing in order for it to be an effective mass-market product that was commercially attractive to service providers and to end users. Therefore, Oftel published a consultation document *Wholesale Line Rental* (14 November 2002)⁹ setting out proposals on the nature of the enhancements required and how related costs should be recovered. This consultation document was followed by a statement *Wholesale Line Rental: Oftel's conclusions* (11 March 2003)¹⁰. This statement set out Oftel's conclusions on (a) the requirements for WLR2, i.e. the enhanced automated WLR product, and (b) the cost recovery principles that should apply. BT launched WLR2 on 29 March 2004.

Regulatory framework

- 2.4 A new regulatory framework for electronic communications networks and services entered into force on 25 July 2003. The framework is designed to create harmonised regulation across Europe and is aimed at reducing entry barriers and fostering prospects for effective competition to the benefit of consumers. The basis for the new regulatory framework is five EU Communications Directives¹¹.

⁸ <http://www.ofcom.org.uk/static/archive/oftel/publications/pricing/2002/pcr0602.pdf>

⁹ http://www.ofcom.org.uk/static/archive/oftel/publications/whole_line/2002/wlr1102_1_4.htm

¹⁰ http://www.ofcom.org.uk/static/archive/oftel/publications/whole_line/2003/wlr_1_0303.htm

¹¹ Directive 2002/21/EC on a common regulatory framework for electronic communications networks and services

Directive 2002/19/EC on access to, and interconnection of, electronic communications networks and associated facilities

- 2.5 The new framework was implemented in the UK by the Communications Act 2003 (the “Act”).

Review of the fixed narrowband wholesale exchange line markets

- 2.6 The new framework requires national regulatory authorities (“NRAs”), such as Ofcom, to carry out reviews of competition in communications markets to ensure that regulation remains appropriate and proportionate in the light of changing market conditions.
- 2.7 Consequently, prior to 29 December 2003, the DGT carried out various reviews including the *Review of the fixed narrowband wholesale exchange line, call origination, conveyance and transit markets* (28 November 2003) (the “Call Origination Market Review statement”) ¹², which covered the markets relevant to the provision of WLR. This included his findings that BT has significant market power (“SMP”) (as defined in the Act) in certain services markets.
- 2.8 In the Call Origination Market Review statement, the DGT determined that BT has SMP in, among others, the markets for wholesale residential analogue exchange line services, wholesale business analogue exchange line services, wholesale business ISDN2 exchange line services and wholesale ISDN30 exchange line services in the UK excluding the Hull Area. The DGT also determined that Kingston has SMP in *inter alia* the markets for wholesale residential analogue exchange line services, wholesale business analogue exchange line services, wholesale business ISDN2 exchange line services and wholesale ISDN30 exchange line services in the Hull Area. The DGT imposed certain SMP services conditions on BT in those markets, including the obligation to provide WLR. The DGT did not require Kingston to provide WLR.
- 2.9 The Call Origination Market Review defined the WLR service as follows:
- “7.1 Wholesale line rental (“WLR”) is a service whereby competing providers effectively lease an exchange line and decide how best to route the customer’s calls. Providers therefore take on the full retail relationship with the customer and offer a “single bill” to end-users for all basic communications services.”

Relevant SMP services condition

- 2.10 The following SMP services conditions, among others, have been imposed on BT in the relevant exchange line services markets:
- Charge control (AA4) – which included an RPI-2% control on WLR services; and

Directive 2002/20/EC on the authorisation of electronic communications networks and services;
Directive 2002/22/EC on universal service and users' rights relating to electronic communications networks and services

Directive 2002/58/EC concerning the processing of personal data and the protection of privacy in the electronic communications sector

¹² http://www.ofcom.org.uk/consult/condocs/narrowband_mkt_rvw/nwe/

- Requirement to offer WLR (AA10) – which extended the obligation to BT also being required to offer WLR products for ISDN2 and ISDN30.
- 2.11 In addition, the Call Origination Market Review set out the functional specification for Wholesale ISDN Line Rental (in relation to ISDN 2 line rental and ISDN 30 line rental) (“WLR functional specification”).

Historic pricing of WLR products

- 2.12 On 20 June 2002, in the statement *Protecting consumers by promoting competition: Oftel’s conclusions*, the Director set starting charges for WLR as shown in table 2.1 below.

Table 2.1 – starting charges for analogue WLR services

	New line installation	Transfer	Line rental
Residential WLR	£92.89	£1.41 per transaction or multiples thereof	£28.00 per line per quarter, i.e. £112.00 pa
Business WLR	£92.89	£1.41 per transaction or multiples thereof	£29.87 per line per quarter, i.e. £119.48 pa

- 2.13 As noted above, these charges were covered by a charge control of RPI-2%, which will have acted on these charges.
- 2.14 On 19 December 2003, Oftel decided to undertake an own-initiative investigation into the price charged by BT for its wholesale business ISDN2 exchange line services (i.e. business ISDN2 WLR). At this time the quarterly charge for business ISDN2 WLR was £71.88 per quarter, i.e. £287.52 per year.
- 2.15 On 17 June 2004, BT announced that it was reducing the price of its Wholesale Business ISDN2 Line Rental to £55.00 per quarter, i.e. £220.00 per year. At this time Ofcom announced that there were two issues that may have an effect on whether this new charge was correct. These were (a) the cost of the copper loop and (b) the actual take-up of wholesale ISDN2 by service providers. As Ofcom was reviewing the cost of the copper loop and had no substantial evidence regarding the take-up of business ISDN2 WLR, Ofcom decided to close its investigation with the intention of considering the charges once more information was available on issues (a) and (b).¹³
- 2.16 On 1 August 2005, BT reduced the residential analogue WLR line rental charge from £27.72 per quarter (i.e. £110.88 per year) to £26.23 per quarter (i.e. £104.92 per year).
- 2.17 Therefore, at the time of publication, the charges for the WLR services being reviewed in this document were as shown below in table 2.2.

¹³ http://www.ofcom.org.uk/bulletins/comp_bull_index/comp_bull_ccases/closed_all/investigation_closed/#content

Table 2.2 – current charges for analogue and digital WLR services

	New line installation	Transfer	Line rental (£ / line / year)
Residential WLR	£91.99	£1.41 / transaction or multiples thereof	£104.92
Business WLR	£91.99	£1.41 / transaction or multiples thereof	£119.40
Business ISDN2 WLR	£232.98	£11.30 / line	£220.00

Reason for review

- 2.18 Charges for WLR products were last set by Of tel in August 2002. A charge control set at RPI-2% was also applied to WLR products.
- 2.19 On 18 August 2005, Ofcom published its statement entitled *Valuing BT's copper access network*¹⁴. Also on 18 August 2005, Ofcom published the statement *Ofcom's approach to risk in the assessment of the cost of capital*¹⁵. These documents are significant because a high proportion of the total cost of the WLR charges charge is determined by the cost of laying and maintaining the copper loop. As a result of these statements, Ofcom considers that the WLR charges – as set in August 2002 and changed in line with the charge control – do not adequately reflect BT's costs.
- 2.20 BT voluntarily reduced the residential analogue WLR charge on 1 August 2005 from £9.24 / month (£110.88) to £8.74 / month (£104.88). However, no changes were made to either business analogue WLR or business ISDN2 WLR charges.
- 2.21 Despite BT's charge reduction for residential WLR, Ofcom considers it appropriate to review the WLR charges for residential and business analogue WLR and business ISDN2 WLR to take these changes into account and to set charge ceilings where appropriate for these charges in order to ensure that BT's charges are both certain and transparent and that BT is not able to increase its charges to excessive levels.

Note on presentation of charges

- 2.22 In the BT Wholesale service provider price list¹⁶, WLR rental charges are priced on a quarterly basis, and to allow for easy comparisons to retail rental charges (which are typically advertised on a monthly basis), WLR rental charges are often referred to on a monthly basis. However, the analysis that Ofcom has carried out is based on annual financial information. Therefore, the analysis and proposed charge ceilings in the remainder of this document are presented on an annual basis. This is also consistent with the presentation of LLU charges.

¹⁴ <http://www.ofcom.org.uk/consult/condocs/copper/value2/statement/#content>

¹⁵ http://www.ofcom.org.uk/consult/condocs/cost_capital2/statement/#content

¹⁶ <http://www.btwholesale.com/sppl>

Section 3

Setting the wholesale line rental charge

Introduction

- 3.1 Determining charge ceilings for WLR line rental and transfer services constrains BT's ability to set excessive charges that could hinder the development of competition.
- 3.2 As noted in 2.19 to 2.21 above, Ofcom considers that in the interest of transparency and certainty within the industry, it is necessary to review the analogue and business ISDN2 WLR charges. In particular, this is necessary in order to ensure that the results of Ofcom's analysis of the cost of the copper access network and BT's cost of capital are appropriately applied to the charges for these products. In addition, BT's voluntary reduction (i.e. of the residential analogue WLR rental charge from £110.88 per year to £104.92 per year) on 1 August 2005 applied to the residential analogue WLR rental charge only.
- 3.3 Ofcom's proposes that it is appropriate to set charges for the analogue WLR services, in order to ensure that BT is not able to increase its charges to an excessive level. Ofcom considers that in this case it is preferable to set charge ceilings, rather than exact charges, as this gives BT scope to charge below the ceiling should it so wish, which would not be permitted if Ofcom set exact charges. In calculating the proposed ceiling, Ofcom has made a number of assumptions, which are set out below. A charge ceiling provides BT with the flexibility to charge below the proposed ceiling in the event that its own assumptions are different to those Ofcom has applied and if costs move over the period in which the ceiling is in place. For example, an outcome of the *Strategic Review of Telecommunications* has been Ofcom's acceptance of BT's undertakings in lieu of a reference under Part 4 of the Enterprise Act 2002, means the implementation of 'equivalence of inputs' for WLR¹⁷. There may be cost reductions as a result of this and if Ofcom were to determine the precise level of a charge, this would reduce BT's flexibility to reduce its charges. Ofcom considers that setting these charge ceilings will thus provide benefits to industry whilst not imposing an undue burden on BT.

Question 1: Do you agree that Ofcom should set ceilings for the WLR rental and transfer charges?

¹⁷ "Equivalence of Inputs" or "EOI" means that BT provides, in respect of a particular product or service, the same product or service to all Communications Providers (including BT) on the same timescales, terms and conditions (including price and service levels) by means of the same systems and processes, and includes the provision to all Communications Providers (including BT) of the same Commercial Information about such products, services, systems and processes. In particular, it includes the use by BT of such systems and processes in the same way as other Communications Providers and with the same degree of reliability and performance as experienced by other Communications Providers.

Cost recovery

- 3.4 In the Call Origination Market Review statement, Ofcom set out its decision on cost recovery for WLR services:

7.15 The condition sets out provisions for cost recovery. Ofcom expects that each element of cost of WLR will fall into one of four categories: system set-up costs, per operator set-up costs, per operator ongoing costs, and per customer line set-up costs. Ofcom has considered how these costs should be recovered in the light of its six principles for cost recovery: cost causation; cost minimisation; distribution of benefits; effective competition; reciprocity; and practicability.

7.16 The Director considers that there are strong arguments, based on the principles of cost minimisation, distribution of benefits, effective competition and practicality, for system set-up costs to be recovered across all BT lines. The principle of cost causation does not point strongly either to recovery of system set-up costs from service providers alone or to recovery across all BT lines. Therefore, system set-up costs are to be recovered across all BT lines.

7.17 The Director considers that there are strong arguments, based on the principle of cost causation and distribution of benefits, for per provider set-up costs, per provider ongoing costs and per line set-up costs to be recovered from service providers alone. The principles of cost minimisation and practicality point towards the recovery of these costs across all BT lines, whilst the principle of effective competition is broadly neutral. Therefore, per provider set-up costs, per-provider ongoing costs and per line set-up costs are to be recovered from WLR service providers only.

- 3.5 Ofcom considers that the application of the principles of cost recovery to WLR costs are still appropriate, as set out above. Table 3.1 summarises how WLR costs should be recovered.

Table 3.1: Application of the principles of cost recovery to WLR per service and system set-up costs

	Suggested mechanism of recovery			
Principle	System set-up costs	Per provider set-up costs	Per provider ongoing costs	Per customer line set-up costs
Cost causation	Neutral	Per SP	Per SP	Per SP
Distribution of benefits	Across all BT lines	Per SP	Per SP	Per SP
Effective competition	Across all BT lines	Across all BT lines	Across all BT lines	Across all BT lines
Cost minimisation	Across all BT lines	Across all BT lines	Across all BT lines	Across all BT lines
Practicability	Across all BT lines	Across all BT lines	Across all BT lines	Across all BT lines
Reciprocity	Not relevant	Not relevant	Not relevant	Not relevant

LRIC+ methodology

- 3.6 The Call Origination Market Review statement imposed on BT a requirement to charge for the provision of Network Access in the wholesale residential analogue exchange line services, wholesale business analogue exchange line services and wholesale business ISDN2 exchange line services markets, among others, on the basis of long run incremental cost ("LRIC") plus an appropriate mark-up for common costs including an appropriate return on capital employed ("ROCE") (SMP condition AA3). An appropriate mark-up would cover a reasonable share of common costs consistent with the overall recovery of these costs given that a proportion of them are covered by LLU and the wholesale narrowband interconnection services covered by the network charge controls ("NCCs"). The ROCE should be equal to the cost of capital.

CCA FAC

- 3.7 Current cost accounting with fully allocated costs ("CCA FAC") and LRIC+ are two different ways of apportioning common costs. While LRIC+ has been preferred in the past, it has the disadvantage of involving a time consuming operation which BT carries out on an irregular basis. Ofcom has little visibility of how BT generates costs from its LRIC model, and this extra iteration by BT of its financial data is not subject to external audit scrutiny. Performance monitoring on a LRIC basis against BT's actual financial performance is not straightforward, as routinely prepared wholesale service profitability information is prepared on a CCA FAC basis. By contrast, CCA FAC uses data that can be reconciled to the regulatory financial statements, which have been audited and are in the public domain.

- 3.8 In setting the new NCCs¹⁸ and proposed LLU charges¹⁹, Ofcom used CCA FAC as the appropriate basis for setting charges (with the exception of certain copper costs). CCA FAC was preferred to LRIC+ because of the transparency benefits described above and because LRIC+ is not conceptually superior to CCA FAC as a cost basis for setting charges. Ofcom is proposing to set the WLR charge ceilings on a consistent basis with the LLU charge ceiling, particularly because many components are shared by LLU and WLR.

The regulatory asset valuation

- 3.9 In the *Valuing BT's copper access network* statement, Ofcom concluded that it was no longer appropriate to value BT's pre-1 August 1997 copper access network assets on the basis of CCA FAC (or LRIC+). This was because to do so would have allowed BT to over-recover the costs of those assets which, until 1 August 1997, had been valued under the historical cost accounting ("HCA") convention. In order to avoid the potential for such over-recovery, and given that it is unlikely that any operator will build a new nationwide access network in competition with BT in the near future, Ofcom decided to create a regulatory asset value, or RAV, to represent the remaining value of the pre-1997 copper access network assets rather than continuing to value those assets at their current cost. The value of the RAV is set to equal the closing historical cost accounting value for the pre 1 August 1997 assets for the 2004/5 financial year and its value will be increased each year by the Retail Price Index ("RPI") to ensure it is not eroded by inflation. Over time the RAV will gradually disappear as the pre-1997 assets are gradually replaced with new ones. Post-1 August 1997 assets which have been valued consistently on a CCA FAC basis throughout their lives will continue to be valued using the CCA convention.
- 3.10 Therefore, the part of the WLR charges which reflects recovery of the costs of the local loop will reflect an average of the costs associated with pre-1 August 1997 assets, based on the RAV, and the costs associated with post-1 August 1997 assets, calculated using CCA FAC as described above. The other components of the WLR rental charges are based on CCA FAC.

BT cost data

- 3.11 Ofcom has used BT's audited 2004/2005 regulatory accounting cost data for the proposed WLR charge ceilings.
- 3.12 Ofcom has assessed BT's cost data and made adjustments to ensure that:
- only relevant costs are included;
 - no double counting takes place; and
 - costs are based on efficiently incurred cost levels.

¹⁸ <http://www.ofcom.org.uk/consult/condocs/charge/statement/#content> Consistency with the NCCs is important to avoid over or under-recovery of costs in aggregate.

¹⁹ <http://www.ofcom.org.uk/consult/condocs/llu/>

Rate of return on capital employed

- 3.13 The appropriate rate of return that should be included in the charges for WLR services is the cost of capital BT is currently allowed on its regulated copper access activities. This cost of capital is equal to the weighted average cost of capital for the activities assessed using the capital asset pricing model.
- 3.14 Ofcom has recently conducted a review of BT's cost of capital. The statement entitled *Ofcom's approach to risk in the assessment of the cost of capital*²⁰ sets out the conclusions of this review. In particular, it concludes that the appropriate rate of return on capital employed for BT's access network is 10.0%. This percentage has been used in setting the WLR charge ceilings.

Charge control

- 3.15 In response to movements in costs, and hence charges, over time, Ofcom can either re-determine charges or set a charge control. Charges that are re-determined regularly have a number of positive properties, but provide the dominant provider with limited incentives towards cost minimisation and provide little predictability for competing providers. To ensure that charges better mimic those that could be expected in a competitive market, it may be appropriate to introduce a charge control. In general, a charge control constrains the movement of regulated charges so that they reflect any cost savings derived from expected volume increases, expected reductions in asset and input prices and expected efficiency improvements (assessed through a benchmarking exercise). At the same time, a charge control allows the retention of all gains from unanticipated efficiency improvements for the period of the control, thus providing the dominant provider with incentives towards cost-efficiency.
- 3.16 In the Call Origination Market Review statement, the DGT set a charge control that applied, among others, to residential analogue WLR and business analogue WLR services (SMP Condition AA4). With regard to WLR services the charge control was RPI-2%. This charge control is due to expire on 31 August 2006.
- 3.17 In proposing to set these new charge ceilings Ofcom has had to consider whether to (a) amend this charge control; (b) set a new charge control; or (c) amend SMP Condition AA4 to remove the obligation. Ofcom proposes that although demand for WLR services is growing, the take-up of WLR in the medium- to long-term is not sufficiently certain (especially given the changes to the charges) to set a sufficiently robust charge cap. The implementation of 'equivalence of inputs' will add further uncertainty to the costs, as this will require the development of entirely new systems which will be used by both WLR providers and BT's retail activities. This issue is discussed further in the impact assessment in Section 5.
- 3.18 As it would clearly be inappropriate to leave the current charge control in place and therefore acting upon the new charges, Ofcom proposes to make a direction disapplying the charge control in relation to WLR charges. Ofcom will review the issue of a charge control in the next review of these markets and the charge ceilings will remain in place until any such decision.

²⁰ http://www.ofcom.org.uk/consult/condocs/cost_capital2/statement/#content

Cost categories for the wholesale line rental charge

3.19 The following cost categories are included in the wholesale line rental charge:

- **E-side and D-side capital and maintenance** – the exchange side (E-side) and distribution side (D-side) infrastructure, which were considered in valuing BT's copper access network review;
- **MDF (main distribution frame) capital and maintenance** – the equipment where local loops terminate and cross connections to competing providers' equipment can be made;
- **Drop capital and maintenance** – the drop wire from the street to the customer premises;
- **Selling and general administration costs** – these costs are the administrative costs BT incurs in providing a wholesale line rental;
- **Line cards** – the electronic cards in the exchange that provide connectivity to the switch;
- **Line test costs** – the costs of the functionality required to test lines provided to WLR providers; and
- **Costs of transfers not recovered in the transfer charge** – in the interest of minimising barriers to switching Ofcom considers that some of the costs associated with transfers should be recovered in the line rental.

Assumptions applied to the cost categories

- 3.20 The assumptions used for each of the cost categories are set out below. In each case, BT has provided Ofcom with cost data for 04/05 from its regulatory accounts, unless stated otherwise.
- 3.21 Except where otherwise identified below, Ofcom considers that the cost data provided by BT includes only relevant costs, contains no double counting and is based on efficiently incurred cost levels.

Forecasting costs

- 3.22 Ofcom is proposing to follow the same approach as LLU with regard to forecasting, i.e. to base the charge on projected costs for 05/06. For those costs not covered by the copper cost review, Ofcom has applied an RPI of 2.5% has been applied to 04/05 operating costs submitted by BT to calculate 05/06 costs.
- 3.23 Given that this charge ceiling is likely to apply for a period of approximately two years, until the next market review which is likely to be in 2007, Ofcom has considered whether forecasting costs beyond 05/06 would be appropriate. However, this would result in a charge similar to that under a charge control. Given the uncertainties involved with forecasting the costs for the implementation of "equivalence of inputs" and likely efficiency savings, Ofcom is of the view that costs are not sufficiently stable for a charge control to be imposed. Therefore, Ofcom proposes to use a ceiling constraint base on costs forecast up to 05/06.
- 3.24 Further to this, as the ceiling constraint at present is non-binding, BT is able to set a cost oriented price at or below the ceiling without needing to revert to Ofcom. As

such BT has some flexibility to increase or decrease its prices in line with cost movements. In addition to this, if BT believes that it is no longer able to materially recover its relevant costs and charge below the ceiling, then it could make representations to Ofcom for consideration of whether a review of the ceiling is necessary in advance of the next review.

Question 2: Do you agree that Ofcom should use forecast costs for 05/06? If not, please explain why.

Question 3: If you agree that Ofcom should forecast the costs for 05/06, is an RPI of 2.5% the most appropriate methodology to use?

- 3.25 Ofcom has used the same efficiency factor for WLR as used for LLU, i.e. an annual rate of efficiency gain of 1.5%. This efficiency factor has been applied to 05/06 operating costs.
- 3.26 As explained in the LLU consultation document, BT has submitted that any efficiency factor should be close to 0%. BT has based this on an analysis of historical performance where costs have remained flat in real terms and on planned savings from BT's 'hands off access network' and 21CN programmes, where BT expects a saving of 1.7% in the access network over two years. BT asserts that recent experience has shown costs rising in real terms and therefore it considers that achieving its target of a 1.7% saving is likely to be challenging.
- 3.27 As also explained in the LLU consultation document, Ofcom's efficiency factor was based on the operating costs (excluding depreciation) of the access network between 01/02 and 03/04, excluding costs relating to LLU and connection components. Ofcom assumed BT will be able to achieve the same underlying rate of real unit cost reduction over the period to 05/06 as it has over the period 01/02 to 03/04. The average real unit cost reduction over the period was calculated after accounting for volume changes, excluding catch up of BT's inefficiency at the start of the period and including the expected catch up of BT's inefficiency over the next six years (04/05 to 09/10). The data for BT's past and current levels of inefficiency were provided by various studies conducted by NERA on behalf of Ofcom²¹. This was consistent with the calculations for the NCCs.
- 3.28 Ofcom's calculations suggested a range of -0.9% to -4.0% per annum, depending on the cost-volume elasticity, the extent of inefficiency assumed to exist in 2003/04 and the period over which this is assumed to be eliminated. As in setting the NCCs, Ofcom applied a degree of judgement to ensure that the value calculated is a reasonable target going forward. As a result of this Ofcom believed it was appropriate to adopt a figure in the lower half of the range and considered the annual rate of efficiency gain of 1.5% to be reasonable.

Question 4: Do you agree that Ofcom should apply an efficiency factor of 1.5%? Please provide any evidence to support your answer.

²¹ <http://www.ofcom.org.uk/consult/condocs/charge/main/nera.pdf>

- 3.29 BT has also submitted that its expected increase in non-domestic rates should be explicitly recognised in any forecast. Ofcom does not consider that specific changes in costs should be included without being able to review all the cost items to determine known decreases as well as known increases in costs.

Elements of the WLR rental charge ceiling

E-side and D-side capital and maintenance and Pair Gain

- 3.30 The *Valuing BT's copper access network* statement sets out the methodology that has been adopted in valuing the E-side and D-side costs of the access network. Taking into account the new weighted average cost of capital for BT's access network, as set out above, the statement concludes that a reasonable estimate of these costs for WLR is £58.51 per line for the financial year 2005/6.
- 3.31 BT has raised some issues with regard to these costs in its response to the LLU consultation. In particular, that the incidence of faults on broadband lines is higher than on narrowband lines. Ofcom is considering this issue with regard to the fully unbundled rental charge ceiling. It may also have a minor impact on the maintenance costs included in the WLR rental charge ceiling. Ofcom will consider this issue during the consultation period.
- 3.32 Pair gain technology is used to provide two PSTN lines over a single pair of copper wires. This is also referred to as Digital Access Carrier System (DACS) and is usually used to provide an additional line without laying additional copper wire. BT has provided data which suggests that a small proportion of lines are provided by Pair Gain / DACS. Therefore, BT's figures for the cost stack for WLR included costs for Pair Gain / DACS equipment and an adjustment reducing the copper costs in line with the proportion of the relevant lines being provided by DACS.
- 3.33 Ofcom considered that there were two possible approaches to addressing this issue:
- Including the costs of Pair Gain / DACS equipment in the WLR cost stack and an adjustment reducing the copper costs to account for DACS lower usage of copper (option 1); or
 - Excluding both the costs of Pair Gain / DACS equipment and the DACS adjustment from the cost stack (option 2).
- 3.34 When Ofcom analysed the impact on the WLR cost stack, the difference between the two options was found not to be material, although option 2 did result in very slightly lower costs. Ofcom is proposing to use option 2 in setting the WLR charge as it seems likely that any benefits arising from the higher cost option (option 1) accrue to BT. This suggests that WLR service providers should only be charged for option 2.

Question 5: Do you agree with Ofcom's approach to excluding both Pair Gain costs and the adjustment for DACS?

MDF capital and maintenance costs

- 3.35 The costs associated with MDF capital and maintenance have been spread over all loops which use the MDF to give a unit cost. For each specific product, BT has calculated costs using the unit cost multiplied by a usage factor. Those products that

use more of the MDF than others are allocated more of the costs. For example, on this basis, PSTN and WLR services take a smaller proportion of MDF costs compared to LLU services. Ofcom considers that BT's costs and approach appear reasonable.

Drop wire capital and maintenance costs

- 3.36 Drop wire is the name given to the part of BT's network linking the distribution point to the end-user's premises. The name is derived from the line that linked (formerly) telegraph poles (the distribution point) to the end-user's premises. More often than not, this is now delivered underground.
- 3.37 The approach which Ofcom proposes to take to the recovery of drop wire costs in WLR charges is consistent with that taken in the calculation of the proposed LLU charge ceiling. Unlike LLU, there are distinct charges for business and residential WLR lines and, as explained below, the difference in the business and residential charges reflects the different way in which the costs of business and residential drop wires are recovered in WLR charges. In terms of the physical delivery mechanism, there is no difference between a single residential and single business line.
- 3.38 In the main, the costs associated with a drop wire are incurred in one of two circumstances. These are: (a) the new installation of a drop wire (capital expenditure); and (b) the ongoing maintenance and replacement of a drop wire (operating expenditure). For drop wires installed prior to the financial year 2001/2, BT expensed them or, in other words, wrote them off within the year. Since then BT has chosen to write-off drop wire costs over their average life (i.e., 10 years). Ofcom considers, therefore, that any drop wire capital costs incurred prior to 2001/2 have already been recovered.
- 3.39 As explained in paragraph 3.34 of the consultation document *Local loop unbundling: setting the fully unbundled rental charge ceiling and minor amendment to SMP conditions FA6 and FB6* (published 7 September 2005)²², the current retail price control (which is due to end on 31 July 2006) was set at its current level (that is, RPI-RPI) on the basis that historic drop wire costs were expensed and that capital and operational costs for installing and maintaining drop wires for the period of the price control were also treated as expensed (in other words the cap was set to cover these costs in the year they were incurred). It is, therefore, not appropriate to include these costs in setting the charge ceiling for wholesale line rental as they are recovered elsewhere. The retail price control, however, does not cover business lines and, as a consequence, capital and operational expenditure on drop wire costs for business customers were not included in the cost base used to inform the setting of the retail price control.
- 3.40 The drop wire capital and operating expenditure costs for business customers were therefore incorporated in the charge ceiling for unbundled local loops on an averaged basis. For wholesale line rental, however, there are separate residential and business products. The essential difference between the two products relates to the associated service levels, with the latter receiving a higher quality of service, particularly in relation to the speed of fault repair, and a higher charge. Ofcom

²² <http://www.ofcom.org.uk/consult/condocs/llu/>

considers, therefore, that it is appropriate for the costs of business drop wires to be included in the charge ceiling for the analogue business wholesale line rental product. The different treatment of drop wire costs explains the difference between the proposed charge ceilings for retail and business analogue wholesale exchange line rental.

- 3.41 In addition, allowance was made in the LLU rental for the cost of new provide LLU drop wires, i.e. those which have never been BT retail lines. A similar allowance is appropriate for WLR lines. However, the proportion of WLR lines which are new line installations (i.e. new provides) is very much lower than that for LLU lines, even allowing for the expected reduction in the use of LLU for second lines. Given that BT Retail will also pay WLR charges, Ofcom believes that it is appropriate to use the share of new line installations in all BT Retail and WLR lines to calculate the allowance for the cost of new line installation drop wires in the WLR rental. This is approximately 6%. Ofcom has therefore included 6% of the depreciation and annual cost of capital associated with a new drop wire in the WLR charge ceiling.

Question 6: Do you think that the methodology put forward by Ofcom for the recovery of drop wire costs is appropriate?

Selling and general administration (S&GA) and ASD development costs

- 3.42 It is also appropriate to include the wholesale costs incurred by BT in providing WLR. These costs include relevant systems costs and costs for activities such as billing and customer support, all of which are required to support WLR.
- 3.43 BT has not provided regulatory accounting data for these S&GA costs but has estimated what these costs are likely to be following the implementation of equivalence of inputs. BT has based its estimates on two inputs:
- the current per line S&GA costs for BT's wholesale broadband services; and
 - the costs BT expects to incur in developing the new equivalence of input systems to be used spread across all PSTN lines over five years.
- 3.44 Ofcom considers that BT's approach to the development costs of equivalent systems is reasonable and considers that it is correct that these costs should be recovered across all lines.
- 3.45 However, Ofcom considers that greater economies of scale should be applied to the costs derived from the wholesale broadband costs. Therefore, Ofcom has applied a cost volume elasticity (CVE) factor of 0.45 to the S&GA costs, i.e. for each 1% increase in volume the S&GA costs for WLR will only increase by 0.45%.

Question 7: Do you think that Ofcom's approach in applying a CVE to S&GA costs is appropriate?

Line cards

- 3.46 The costs associated with line cards are only applicable to PSTN and WLR products. As such the costs of these have been pooled and spread over PSTN and WLR volumes to derive a unit cost.

- 3.47 BT has suggested that line cards do not form part of the access network, and should attract a rate of return on capital employed of 11.4%. Ofcom considers that line cards are standard network components necessary to offer the access service and that call volumes are not a cost driver for line cards (and hence the income elasticity of demand is relatively low). Additionally, Ofcom has always envisaged that all the components in the WLR cost stack (including line cards) would attract the copper access cost of capital, because a WLR provider is required to purchase all the components associated with the provision of WLR and this includes the line card. The product would be more akin to LLU if the WLR provider installed its own line card. Therefore, Ofcom has applied the 10% cost of capital to line cards.

TAM and line test costs

- 3.48 The costs of the LLU TAM and PSTN line test costs have been pooled together and spread over all lines. Ofcom considers that this is a reasonable approach.

Phonebooks

- 3.49 When Oftel set the WLR charges in June 2002 the cost of a phonebook being provided to each WLR customer was separately identified and included in the WLR cost stack, because at that time phonebook costs were included as part of BT's retail cost base. However, Ofcom understands that these costs are now recorded in BT's wholesale business as part of the PSTN Line Card costs, the treatment of which are discussed in 3.46 and 3.47 above.

Costs of transfers included in the line rental

- 3.50 Ofcom considers that if transfer charges were high they would act as a barrier to switching. Therefore, in the interest of minimising barriers to switching, Ofcom considers that some of the costs associated with transfers should be recovered, not in the transfer charge, but in the line rental. Therefore, Ofcom is proposing that £2.22 is added to the line rental in order to recover this part of the costs of transfer. The impact of this approach is discussed in detail below (see 3.52).

Approach to setting WLR transfer charge ceilings

- 3.51 Ofcom has used BT's residential PSTN takeover activity as a starting point from which to estimate the reasonable cost of analogue WLR transfers. Ofcom has made a number of adjustments to this cost stack. That is, Ofcom has removed sales and marketing costs and reduced general management and customer service costs. This is to reflect that only part of this work would be carried out by BT as part of a WLR transfer and the remainder of the work would be faced by the WLR provider. Ofcom considers that this is a reasonable approach.
- 3.52 However, even after these adjustments, the transfer costs are still significantly higher than the current £1.41 transfer charge which reflects the application of a similar approach to transfer costs in the original WLR charge-setting exercise. As noted above, Ofcom considers that high transfer charges would act as a barrier to switching. Therefore, in the interests of minimising barriers to switching and in line with the current rental charge, Ofcom considers that some of the transfer costs should be recovered over a longer period through the rental charge. However, the appropriate balance between recovery in the rental and through the transfer charge is not precisely defined. Ofcom believes that it would be reasonable for the transfer

charge to be increased slightly so that a larger proportion of the transfer costs than at present are recovered directly from the transfer charge.

- 3.53 Therefore, Ofcom is proposing that the transfer charge for residential and business WLR transfers is £2.00 / line transferred. In addition, £2.22 has been added to the annual analogue WLR line rentals to cover the remainder of the cost of transfers (taking into account inflation, efficiency gains, discounting and churn rates).

Approach to setting WLR connection charge ceilings

- 3.54 Ofcom has calculated the charge ceiling for business and residential analogue WLR connection charges using the costs and volumes for all analogue new line installations (i.e. BT's own new line installations and WLR new line installations). Ofcom considers that this is a reasonable approach as the work involved should be the same regardless of whether it is carried out for BT's downstream business or a WLR provider.

Business ISDN2 WLR

- 3.55 Ofcom considered whether it is necessary to set any charge ceilings for business ISDN2 WLR. Ofcom took into account a number of issues including whether the current charge appeared reasonable, existing regulation of ISDN2 prices, the impact of Ofcom's work on the cost of copper on ISDN2 and the characteristics of ISDN2 services.
- 3.56 Using the same approach as described above, Ofcom's review of the charges for business ISDN2 WLR suggests that the current charges (£220 / year / line) are reasonable, even taking into account Ofcom's work on the costs of copper and capital. Ofcom notes that copper costs represent a significantly smaller proportion of business ISDN2 WLR charges than of analogue WLR charges.
- 3.57 Ofcom also took into account that it had not in the past set charges or charge ceilings for business ISDN2 WLR and that to do so would be an extension of regulation.
- 3.58 Therefore, Ofcom proposes not to set charges or charge ceilings for any business ISDN2 WLR. However, Ofcom notes that BT is still under an obligation to ensure that any charges for business ISDN2 WLR are cost oriented.

Question 8: Do you agree with Ofcom's proposal to not set charges or charge ceilings for business ISDN2 WLR?

WLR rental, transfer and connection charge ceilings

- 3.59 On the basis of the proposed approach, set out above, Ofcom proposes setting charge ceilings as shown below in table 3.2.

Table 3.2 – proposed charge ceilings for analogue WLR services

	New line installation charge ceiling	Transfer charge ceiling	Line rental charge ceiling
Residential WLR	£90.00	£2.00 / line	£100.68 / line / year
Business WLR	£90.00	£2.00 / line	£110.00 / line / year

3.60 As set out above, for the purposes of calculating the charge ceiling, Ofcom considers it appropriate to base the value of BT's pre-1 August 1997 copper access network assets on the value of the RAV set out in the Valuing copper access network statement. The reasons for the adoption of the RAV are set out in full in that statement. Given that BT's pre-1 August 1997 copper access network assets account for a significant proportion of the costs that make up the proposed charge ceiling, the charge ceiling itself cannot be said to be 'based' on LRIC+. On the face of it, the charge ceiling is therefore not consistent with SMP Condition AA3, imposed on BT in November 2003, which requires BT to ensure that its charge for Network Access in the wholesale line rental services market are 'based' on LRIC+. For this reason, Ofcom has included specific wording in its proposed Direction setting the charge ceilings to make it clear that the obligation in SMP Condition AA3.1, to ensure that BT's charges are based on LRIC+, will not apply in respect of these charge ceilings.

The proposed rental charge ceilings in context

3.61 Table 3.3 compares the proposed rental charge ceilings with the WLR rental charges prior to 1 August 2005 (i.e. before BT's voluntary charge reduction). Table 3.4 compares BT's current equivalent rental prices with the proposed line rental charge ceilings for WLR. (All values are exclusive of VAT.)

Table 3.4 – proposed charge ceilings and previous charges for analogue WLR

	Rental (prior to 1 August 2005)	Proposed line rental charge ceiling	Reduction
Residential WLR	£9.24 / month	£8.39 / month	£0.85
Business WLR	£9.95 / month	£9.17 / month	£0.78

Table 3.4 – current BT Retail prices and proposed charge ceilings for analogue WLR

	Equivalent BT Retail rental prices ²³	Proposed WLR line rental charge ceiling	Difference
Residential	£8.94 / month	£8.39 / month	£0.55
Business	£13.71 / month	£9.17 / month	£4.54

²³ Equivalent BT Retail services for residential is BT Together Option 1 (when paid by direct debit) and for business is Business Phone Line.

Section 4

Proposed directions and consent: setting the charge ceilings and disapplying the WLR charge control

- 4.1 For the reasons set out in detail in Sections 2 and 3 above and discussed further in Section 5, Ofcom has reached the provisional conclusion that it is necessary to set charge ceilings for the rental, transfer and connection charges for residential and business WLR. In order to implement these charge ceilings, Ofcom is proposing to issue two directions and a consent.
- 4.2 The first proposed direction will set the charge ceilings (see 4.64 to 4.70). The second proposed direction will disapply the RPI-2% charge control that applies to wholesale line rental services and the proposed consent will allow the charge ceilings to apply sooner than 90 days. These are necessary in order to implement the first direction properly.

Draft direction to set WLR rental, transfer and connection charge ceilings

- 4.3 In the Call Origination Market Review statement, SMP service condition AA10 was imposed on BT, i.e. the requirement to offer WLR.
- 4.4 Among other things, this SMP service condition allows Ofcom to set charges for WLR products. That is, SMP service condition AA10(3)(f) states:

the Dominant Provider shall modify any of its charges for the provision of Wholesale Line Rental in the manner in which the Director may direct.

- 4.5 Therefore, on the basis of the approach set out above in Section 3, Ofcom proposes setting charge ceilings as shown below in table 4.1.

Table 4.1 – proposed charge ceilings for analogue WLR services

	New line installation charge ceiling	Transfer charge ceiling	Line rental charge ceiling
Residential WLR	£90.00	£2.00 / line	£100.68 / line / year
Business WLR	£90.00	£2.00 / line	£110.00 / line / year

Communications Act tests

- 4.6 Ofcom considers that the draft Direction (at Schedule 1, Annex 1) meets the tests set out in the Act.

- 4.7 Ofcom has considered its duties under section 3 and all the Community requirements set out in section 4 of the Act. In particular, the proposed Direction is aimed at promoting competition and securing efficient and sustainable competition for the maximum benefit of retail consumers by ensuring that charges for WLR services are at a level that enables providers purchasing those services to compete in downstream narrowband markets.
- 4.8 Section 49 of the Act requires directions to be objectively justifiable, non-discriminatory, proportionate and transparent.
- 4.9 Ofcom considers that the direction is:
- objectively justifiable as it ensures that BT is unable to exploit its market power and enables competing providers to purchase services at levels that enable them to compete in downstream markets to the benefit of consumers;
 - proportionate as it allows BT a fair rate of return that it would expect in competitive markets;
 - not unduly discriminatory to BT because there is no other provider with significant market power currently specifically required to provide WLR services; and
 - transparent in that the requirements on BT are clearly set out in this consultation document.

Draft direction disapplying the WLR charge control

- 4.10 In the Call Origination Market Review statement, the DGT set a charge control that applied, among others, to residential and business analogue WLR services (SMP Condition AA4). Charges for WLR services were capped at RPI-2%. This charge control is due to expire on 31 August 2006.
- 4.11 As noted above, Ofcom considers it would clearly be inappropriate to leave the current charge control in place. Therefore, Ofcom proposes to make a direction disapplying the charge control in relation to WLR charges.

Communications Act tests

- 4.12 Ofcom considers that the draft Direction (at Schedule 1, Annex 2) meets the tests set out in the Act.
- 4.13 Ofcom has considered its duties under section 3 and all the Community requirements set out in section 4 of the Act. In particular, the proposed Direction is aimed at promoting competition and securing efficient and sustainable competition for the maximum benefit of retail consumers by ensuring that charges for WLR services are at a level that enables providers purchasing those services to compete in downstream narrowband markets.
- 4.14 Section 49 of the Act requires directions to be objectively justifiable, non-discriminatory, proportionate and transparent.
- 4.15 Ofcom considers that the draft direction is:
- objectively justifiable as the charge control for WLR was originally set to apply to the starting charges set in June 2002 and these new charges are being set (a) on a

new basis following Ofcom's analysis on cost of copper and capital and (b) shortly before the charge control is due to expire in any event, i.e. 31 August 2006;

- proportionate as it does not increase the burden on BT beyond the setting of the charge ceilings;
- not unduly discriminatory to BT because there is no other provider with significant market power currently specifically required to provide WLR services; and
- transparent in that the requirements on BT are clearly set out in this consultation document.

Draft consent to disapply the notification period

- 4.16 In the Call Origination Market Review statement SMP service condition AA6(a) was imposed on BT, i.e. the requirement to notify charges and terms and conditions.
- 4.17 The requirement to notify charges and terms and conditions requires BT to notify changes to charges and terms and conditions for existing Network Access not less than 90 days before any such amendment comes into effect (SMP Condition AA6(a).2(a)).
- 4.18 As Ofcom intends for this proposed Consent and any consequent charge changes to take effect on 1 March 2006, Ofcom considers that the notification period set out at BT's SMP Condition AA6(a).2(a) could potentially delay the introduction of the proposed WLR charge ceilings, therefore Ofcom considers it should consent to disapply the notification period in respect of this proposed Consent.

Communications Act tests

- 4.19 Ofcom considers that the proposed Consent (at Schedule 1, Annex 3) meets the tests set out in the Act.
- 4.20 Ofcom has considered its duties under section 3 and all the Community requirements set out in section 4 of the Act. In particular, the proposed Consent is aimed at promoting competition and securing efficient and sustainable competition for the maximum benefit of retail consumers by ensuring that charges for WLR services are given proper effect.
- 4.21 Section 49 of the Act requires directions to be objectively justifiable, non-discriminatory, proportionate and transparent.
- 4.22 Ofcom considers that the proposed Consent is:
- objectively justifiable as it will ensure the timely implementation of the proposed WLR charges;
 - proportionate as it reduces the notification requirement on BT where it is not necessary and would not be of any benefit to other Communications Providers;
 - not unduly discriminatory to BT because there is no other provider with significant market power currently specifically required to provide WLR services; and
 - transparent in that the requirements on BT are clearly set out in this consultation document.

Section 5

Proposals and next steps

Proposals

- 5.1 Ofcom is proposing to give a direction setting charge ceilings relating to business and residential analogue WLR rentals, transfers and new line installations as set out in the table 5.1 below for the reasons given in Section 3 and the summary below. In order to implement these charge ceilings, Ofcom considers it necessary to also give a direction to disapply the charge control as it applies to WLR charges and give a consent that BT can make the price changes for 1 March 2006.

Table 5.1 – proposed charge ceilings for analogue WLR services

	New line installation charge ceiling	Transfer charge ceiling	Line rental charge ceiling
Residential WLR	£90.00	£2.00 / line	£100.68 / line / year
Business WLR	£90.00	£2.00 / line	£110.00 / line / year

Impact Assessment

- 5.2 The analysis presented in this consultation document, along with the summary set out below, represents an impact assessment, as defined by section 7 of the 2003 Act. The following is in accordance with the Ofcom's impact assessment guidelines²⁴:
- 5.3 Ofcom considers that it was necessary to review the charges for residential and business analogue WLR and business ISDN2 WLR services because:
- Charges for the analogue WLR products were last set by Oftel in August 2002, subject to a RPI-2% price cap;
 - When Ofcom closed its investigation into BT's charges for business ISDN2 WLR on 17 June 2004, Ofcom noted that it would be necessary to review these charges once Ofcom's review of the cost of the copper loop was completed and once there was more evidence on the take up of business ISDN2 WLR;
 - On 18 August 2005, Ofcom published two statements (*Valuing BT's copper access network*²⁵ and *Ofcom's approach to risk in the assessment of the cost of capital*²⁶).

²⁴ *Better Policy Making*, 21 July 2005, which can be found at http://www.ofcom.org.uk/consult/policy_making/guidelines.pdf

²⁵ <http://www.ofcom.org.uk/consult/condocs/copper/value2/statement/#content>

²⁶ http://www.ofcom.org.uk/consult/condocs/cost_capital2/statement/#content

As a result of the implications of these documents Ofcom considered that the WLR charges – as set in August 2002 and changed in line with the charge control – do not adequately reflect BT's costs; and

- Although BT reduced the rental charge for residential analogue WLR on 1 August 2005, it did not adjust any other charges.

5.4 Therefore, having reviewed the charges for residential and business analogue WLR and business ISDN2 WLR services, Ofcom is proposing:

- To set charge ceilings for business and residential analogue WLR rentals, transfers and new line installations; and
- Not to set charge ceilings for business ISDN2 WLR because from its review of the charges Ofcom considers the existing charges appear reasonable and Ofcom has not set charges for business ISDN2 WLR in the past, and to do so now would be an extension of regulation.

5.5 Ofcom's decision to propose setting charge ceilings for business and residential analogue WLR rentals, transfers and new line installations had two stages. First, Ofcom considered whether the charges for these services should be changed, i.e. whether to do nothing. Secondly, then Ofcom considered what the most appropriate way of changing these charges would be to meet its duties in section 3 and 4 of the Act.

5.6 Ofcom's view that it is necessary to change the charges for business and residential analogue WLR rentals, transfers and new line installations is based on Ofcom's analysis of the cost stacks for these services (described in Section 3) and the application of Ofcom's analysis of the cost of the copper access network and BT's cost of capital in that BT's current charges for these services are no longer cost reflective.

5.7 Ofcom considered three main options regarding how to make the appropriate changes to BT's charges, i.e. setting exact charges; setting exact charges and a charge control; and setting charge ceiling. Ofcom considers that in this case it is preferable to set charge ceilings as this gives BT scope to charge below the ceiling should it so wish, which would not be permitted if Ofcom set exact charges. In calculating the proposed ceiling, Ofcom has made a number of assumptions, which are set out below. A charge ceiling provides BT with the flexibility to charge below the proposed ceiling in the event that its own assumptions are different to those Ofcom has applied and if costs move over the period in which the ceiling is in place. Determining charge ceilings for WLR line rental, transfer and new line installation services constrains BT's ability to set excessive charges that could hinder the development of competition. Additionally, Ofcom is of the view that although demand for WLR services is growing, the take-up of WLR in the medium- to long-term is not sufficiently certain (especially given the changes to the charges) to set a sufficiently robust charge cap.

5.8 Subsidiary to the main proposal to set charge ceilings for business and residential analogue WLR rentals, transfers and new line installations (as discussed in detail above), Ofcom is also proposing to disapply the existing RPI-2% charge control with regards to WLR and to consent to charges to be changed more quickly than allowed for by the 90-day notification period. Ofcom is making these proposals solely in order to implement the main proposal.

- 5.9 You should send any comments on this impact assessment by the closing date for this consultation and we will consider all comments before deciding whether to implement our proposals.

Next steps

- 5.10 Ofcom is required to give interested parties an opportunity to comment on the proposals contained in this consultation document. Ofcom is also required to send its proposals to the European Commission, NRAs of every other Member State and the Secretary of State. Ofcom is consulting on these proposals until 12 December 2005.
- 5.11 When Ofcom has considered responses to this consultation, including any made by the European Commission, it will decide whether to give effect to its proposals, with or without modifications, by publishing a final statement.

Section 6

Responding to this consultation

How to respond

- 6.12 Ofcom invites written views and comments on the issues raised in this document, to be made by **5pm on 12 December 2005**.
- 6.13 Ofcom strongly prefers to receive responses as e-mail attachments, in Microsoft Word format, as this helps us to process the responses quickly and efficiently. We would also be grateful if you could assist us by completing a response cover sheet (see Annex 6), among other things to indicate whether or not there are confidentiality issues. The cover sheet can be downloaded from the 'Consultations' section of our website.
- 6.14 Please can you send your response to first chris.rowsell@ofcom.org.uk.
- 6.15 Responses may alternatively be posted or faxed to the address below, marked with the title of the consultation.

Chris Rowsell
Floor 4
Competition Group
Riverside House
2A Southwark Bridge Road
London SE1 9HA
Fax:020 7783 3133

- 6.16 Note that we do not need a hard copy in addition to an electronic version. Also note that Ofcom will not routinely acknowledge receipt of responses.
- 6.17 It would be helpful if your response could include direct answers to the questions asked in this document, which are listed together at Annex 6. It would also help if you can explain why you hold your views, and how Ofcom's proposals would impact on you.

Further information

- 6.18 If you have any want to discuss the issues and questions raised in this consultation, or need advice on the appropriate form of response, please contact Chris Rowsell on 020 7783 4176.

Confidentiality

- 6.19 Ofcom thinks it is important for everyone interested in an issue to see the views expressed by consultation respondents. We will therefore usually publish all responses on our website, www.ofcom.org.uk, ideally on receipt (when respondents confirm on their response cover sheer that this is acceptable).
- 6.20 All comments will be treated as non-confidential unless respondents specify that part or all of the response is confidential and should not be disclosed. Please place any

confidential parts of a response in a separate annex, so that non-confidential parts may be published along with the respondent's identity.

- 6.21 Ofcom reserves its power to disclose any information it receives where this is required to carry out its legal requirements. Ofcom will exercise due regard to the confidentiality of information supplied.
- 6.22 Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use, to meet its legal requirements. Ofcom's approach on intellectual property rights is explained further on its website, at www.ofcom.org.uk/about_ofcom/gov_accountability/disclaimer.

Next steps

- 6.23 Following the end of the consultation period, Ofcom intends to publish a statement in January 2006.
- 6.24 Please note that you can register to get automatic notifications of when Ofcom documents are published, at http://www.ofcom.org.uk/static/subscribe/select_list.htm.

Ofcom's consultation processes

- 6.25 Ofcom is keen to make responding to consultations easy, and has published some consultation principles (see Annex 5) which it seeks to follow, including on the length of consultations.
- 6.26 This consultation is shorter than Ofcom's standard 10 week period because Ofcom has already consulted on most of its approach to setting the WLR charge ceilings. The previous WLR statements have set out Ofcom's general approach to setting WLR charges, the *Ofcom's approach to risk in the assessment of the cost of capital* statement sets out the appropriate cost of capital for BT's access network, and the *Valuing BT's copper access network* statement sets out the appropriate copper costs for WLR. Therefore, Ofcom considers that a 5 week period is sufficient for consideration of the proposals contained in this consultation.
- 6.27 If you have any comments or suggestions on how Ofcom conducts its consultations, please call our consultation helpdesk on 020 7981 3003 or e-mail us at consult@ofcom.org.uk. We would particularly welcome thoughts on how Ofcom could more effectively seek the views of those groups or individuals, such as small businesses or particular types of residential consumers, whose views are less likely to be obtained in a formal consultation.
- 6.28 If you would like to discuss these issues, or Ofcom's consultation processes more generally, you can alternatively contact Vicki Nash, Director for Scotland, who is Ofcom's Consultation Champion:

Vicki Nash
Ofcom (Scotland)
Sutherland House
149 St. Vincent Street
Glasgow G2 5NW
Tel: 0141 229 7401

WLR: Reviewing and setting charge ceilings for WLR services

Fax: 0141 229 7433

E-mail: vicki.nash@ofcom.org.uk

Annex 1

Notification: Direction setting certain charge ceilings for wholesale line rental

NOTIFICATION OF A PROPOSAL UNDER SECTION 49 OF THE COMMUNICATIONS

ACT 2003

Proposal for giving a Direction under SMP Services Condition AA3.1, AA10.3(a)(ii), and AA10.3(f) imposed on BT as a result of the market power determinations made by OFCOM that BT has significant market power in the markets for wholesale residential analogue exchange line services and wholesale business analogue exchange line services in the United Kingdom, excluding the Hull Area

1. OFCOM hereby makes, in accordance with section 49(4) of the Act, the following proposal for a Direction to be given to BT under SMP Services Condition AA3.1, AA10.3(a)(ii) and AA10.3(f) as set out in Schedule 1 to the Notification at Annex A of the *Review of the fixed narrowband wholesale exchange line, call origination, conveyance and transit markets* review statement published on 28 November 2003.

2. The draft Direction is set out in the Schedule to this Notification.

3. The effect of the draft Direction, and the reasons for making the proposal, is set out in the accompanying explanatory statement.

4. In making the proposals set out in this Notification, OFCOM has considered and acted in accordance with its general duties in section 3 of the Act and the six Community requirements in section 4 of the Act.

5. Representations may be made to OFCOM about the proposed draft Direction by 12 December 2005.

6. In accordance with section 50 of the Act, copies of this Notification have been sent to the Secretary of State, the European Commission and to the regulatory authorities of every other Member State.

7. In this Notification (not including the Schedule) –

(a) “**Act**” means the Communications Act 2003 (c.21);

(b) “**BT**” means British Telecommunications plc, whose registered company number is 1800000, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 736 of the Companies Act 1985, as amended by the Companies Act 1989;

(c) “**Hull Area**” means the area defined as the ‘Licensed Area’ in the licence granted on 30 November 1987 by the Secretary of State under section 7 of the Telecommunications Act 1984 to Kingston upon Hull City Council and Kingston Communications (Hull) plc;

(d) “**OFCOM**” means the Office of Communications; and

(e) “**United Kingdom**” has the meaning given to it in the Interpretation Act 1978 (c.30).

Steve Unger

Director of Telecoms Technology

A person authorised under paragraph 18 of the Schedule to the Office of Communications Act 2002

9 November 2005

SCHEDULE

[Draft] Direction under section 49 of the Communications Act 2003 and SMP Services Condition AA3.1, AA10.3(a)(ii) and AA10.3(f) imposed on BT as a result of the market power determinations made by OFCOM that BT has significant market power in the markets for wholesale residential analogue exchange line services and wholesale business analogue exchange line services in the United Kingdom, excluding the Hull Area

WHEREAS:

A. As a result of a market analysis carried out by the Director General of Telecommunications (the '**Director**'), he proposed on 17 March 2003 and on 26 August 2003, in accordance with sections 48(2) and 80 of the Act that the Dominant Provider has significant market power in the markets for among others wholesale residential analogue exchange line services and wholesale business analogue exchange line services in the UK, excluding the Hull Area and the setting of certain SMP conditions;

B. The Director having considered every representation duly made, and thereafter on 28 November 2003 pursuant to sections 48(1) and 79 of the Act by way of publication of a Notification identified the relevant services markets, made market power determinations to the effect referred to in recital (A) above and set certain significant market power ('**SMP**') conditions on the Dominant Provider to take effect on 28 November 2003, unless otherwise is stated in Schedule 1 thereto; including SMP Services Condition AA3, which requires BT to secure that its charges are reasonably derived from the costs of provision on a forward looking long-run incremental cost approach and allowing an appropriate mark up for the recovery of common costs including an appropriate return on capital employed, and SMP Services Condition AA10, which requires BT to provide specific Wholesale Line Rental services on reasonable terms and modify its charges for the provision of Wholesale Line Rental in the manner in which OFCOM may direct;

C. This Direction concerns matters to which SMP Services Condition AA3 and AA10 relate;

D. For the reasons set out in Section [...] of the explanatory statement accompanying this Direction, in accordance with Section 49(2) of the Act, OFCOM is satisfied that this Direction is:

(a) objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;

(b) not such to discriminate unduly against particular persons or against a particular description of persons;

(c) proportionate to what it is intended to achieve; and

(d) in relation to what it is intended to achieve, transparent.

E. For the reasons set out in Section [...] of the explanatory statement accompanying this Direction, OFCOM is satisfied that it is acting in accordance with the relevant duties set out in Section 3 and 4 of the Act in giving this Direction;

F. On 9 November 2005, OFCOM published a Notification of a proposal to give this Direction in accordance with Section 49(4) of the Act and invited representations about the proposed Direction by 12 December 2005;

G. In accordance with Section 50 of the Act, a copy of the Notification was sent to the Secretary of State, the European Commission and the regulatory authorities of every of the Member State;

H. By virtue of section 49(9) of the Act, OFCOM may give effect to the proposal set out in the Notification, with or without modification, only if –

(a) they have considered every representation about the proposal that is made to them within the period specified in the notification; and

(b) they have had regard to every international obligation of the United Kingdom (if any) which has been notified to them for this purpose by the Secretary of State;

I. OFCOM has considered every representation about the proposed Direction duly made to it and the Secretary of State has not notified OFCOM of any international obligation of the United Kingdom for this purpose; and

NOW, THEREFORE, PURSUANT TO SECTION 49 OF THE ACT AND CONDITIONS AA3.1 AND AA10.3(f), OFCOM HEREBY GIVES THE FOLLOWING DIRECTION:

1. The Dominant Provider shall not charge more than:

(a) for the annual rental of a Wholesale Analogue Line Rental (residential quality of service), £100.68 (the charge for which shall be pro rated and levied on no less than a quarterly basis);

(b) for the annual rental of a Wholesale Analogue Line Rental (business quality of service), £110.00 (the charge for which shall be pro rated and levied on no less than a quarterly basis);

(c) for the Existing Line Transfer of a single analogue Exchange Line (residential quality of service), £2.00;

(d) for the Existing Line Transfer of a single analogue Exchange Line (business quality of service), £2.00;

(e) for the New Line Installation (analogue) (residential quality of service), £90.00; and

(f) for the New Line Installation (analogue) (business quality of service), £90.00.

2. The obligation on the Dominant Provider by virtue of AA3.1 to secure, and be able to demonstrate to the satisfaction of OFCOM, that each and every charge offered, payable or proposed for Network Access covered by Condition AA1(a) is based on a forward looking long-run incremental costs approach and allowing an appropriate mark up for the recovery of common costs including an appropriate return on capital employed, shall not apply in respect of the proposed charge ceiling set out in paragraph 1 above only;

3. For the purposes of interpreting this Direction, the following definitions shall apply:

- (a) “**Act**” means the Communications Act 2003;
- (b) “**Dominant Provider**” means British Telecommunications plc (BT), whose registered company number is 1800000, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 736 of the Companies Act 1985, as amended by the Companies Act 1989;
- (c) “**Ofcom**” means the Office of Communications;
- (d) “**The Notification**” means the Notification referred to in recital (B) as amended of this direction;
- (e) “**Transitional Provisions**” means sections 408 and 411 of the Act, Article 3(1) of the Communications Act 2003 (Commencement No. 1) Order 2003 and Article 3(2) of the Office of Communications 2002 (Commencement No. 3) and Communications Act 2003 (Commencement No. 2) Order 2003;

4. Except insofar as the context otherwise requires, words or expressions shall have the meaning assigned to them in paragraph 3 above and otherwise any word or expression shall have the same meaning as it has in The Notification or, if the context so permits, in Schedule 1 thereto, as appropriate, and otherwise any word or expression shall have the same meaning as it has in the Act.

5. For the purpose of interpreting this Direction:

- (a) the Interpretation Act 1978 shall apply as if this Direction were an Act of Parliament; and
- (b) headings and titles shall be disregarded.

6. This Direction shall take effect on [Date].

[Name]

[Title]

A person authorised under paragraph 18 of the Schedule to the Office of Communications Act 2002

[Date]

Annex 2

Notification: Direction disapplying the application of certain paragraphs of SMP service conditions AA4

NOTIFICATION OF A PROPOSAL UNDER SECTION 49 OF THE COMMUNICATIONS ACT 2003

Proposal for giving a Direction under SMP Services Condition AA4.11 imposed on BT as a result of the market power determinations made by OFCOM that BT has significant market power in the markets for wholesale residential analogue exchange line services and wholesale business analogue exchange line services in the United Kingdom, excluding the Hull Area

1. OFCOM hereby makes, in accordance with section 49(4) of the Act, the following proposal for a Direction to be given to BT under SMP Services Condition AA4.11 as set out in Schedule 1 to the Notification at Annex A of the *Review of the fixed narrowband wholesale exchange line, call origination, conveyance and transit markets review statement* published on 28 November 2003, as amended.

2. The draft Direction is set out in the Schedule to this Notification.

3. The effect of the draft Direction, and the reasons for making the proposal, is set out in the accompanying explanatory statement.

4. In making the proposals set out in this Notification, OFCOM has considered and acted in accordance with its general duties in section 3 of the Act and the six Community requirements in section 4 of the Act.

5. Representations may be made to OFCOM about the proposed draft Direction by 12 December 2005.

6. In accordance with section 50 of the Act, copies of this Notification have been sent to the Secretary of State, the European Commission and to the regulatory authorities of every other Member State.

7. In this Notification (not including the Schedule) –

(a) “**Act**” means the Communications Act 2003 (c.21);

(b) “**BT**” means British Telecommunications plc, whose registered company number is 1800000, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 736 of the Companies Act 1985, as amended by the Companies Act 1989;

(c) “**Hull Area**” means the area defined as the ‘Licensed Area’ in the licence granted on 30 November 1987 by the Secretary of State under section 7 of the Telecommunications Act 1984 to Kingston upon Hull City Council and Kingston Communications (Hull) plc;

(d) “**OFCOM**” means the Office of Communications; and

(e) “**United Kingdom**” has the meaning given to it in the Interpretation Act 1978 (c.30).

Steve Unger

Director of Telecoms Technology

A person authorised under paragraph 18 of the Schedule to the Office of Communications Act 2002

9 November 2005

SCHEDULE

[Draft] Direction under section 49 of the Communications Act 2003 and SMP Services Condition AA4.11 imposed on BT as a result of the market power determinations made by OFCOM that BT has significant market power in the markets for wholesale residential analogue exchange line services and wholesale business analogue exchange line services in the United Kingdom, excluding the Hull Area

WHEREAS:

A. As a result of a market analysis carried out by the Director General of Telecommunications (the '**Director**'), he proposed on 17 March 2003 and on 26 August 2003, in accordance with sections 48(2) and 80 of the Act that the Dominant Provider has significant market power in the markets for among others wholesale residential analogue exchange line services and wholesale business analogue exchange line services in the UK, excluding the Hull Area and the setting of certain SMP conditions;

B. The Director having considered every representation duly made, and thereafter on 28 November 2003 pursuant to sections 48(1) and 79 of the Act by way of publication of a Notification identified the relevant services markets, made market power determinations to the effect referred to in recital (A) above and set certain significant market power ('**SMP**') conditions on the Dominant Provider to take effect on 28 November 2003, unless otherwise is stated in Schedule 1 thereto;

C. On 10 February 2005, OFCOM published a notification under sections 48(1) and 86 of the Act at Annex 1 to the accompanying statement entitled 'Modifications to BT's SMP services conditions AA4' with the effect of:

(i) modifying SMP Condition AA4 as set out in Schedule 1 to the November 2003 Notification (as amended), in effect, substituting it for a new Condition AA4;

in relation to all the markets to which those respective SMP services conditions apply for which OFCOM were satisfied, in accordance with section 86 of the Act, that there had been no material change since the relevant market power determinations were made;

D. This Direction concerns matters to which SMP Services Condition AA4 as amended relate;

E. For the reasons set out in Section [...] of the explanatory statement accompanying this Direction, in accordance with Section 49(2) of the Act, OFCOM is satisfied that this Direction is:

(a) objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;

(b) not such to discriminate unduly against particular persons or against a particular description of persons;

(c) proportionate to what it is intended to achieve; and

(d) in relation to what it is intended to achieve, transparent.

F. For the reasons set out in Section [...] of the explanatory statement accompanying this Direction, OFCOM is satisfied that it is acting in accordance with the relevant duties set out in Section 3 and 4 of the Act in giving this Direction;

G. On 9 November 2005, OFCOM published a Notification of a proposal to give this Direction in accordance with Section 49(4) of the Act and invited representations about the proposed Direction by 12 December 2005;

H. In accordance with Section 50 of the Act, a copy of the Notification was sent to the Secretary of State, the European Commission and the regulatory authorities of every of the Member State;

I. By virtue of section 49(9) of the Act, OFCOM may give effect to the proposal set out in the Notification, with or without modification, only if –

(a) they have considered every representation about the proposal that is made to them within the period specified in the notification; and

(b) they have had regard to every international obligation of the United Kingdom (if any) which has been notified to them for this purpose by the Secretary of State;

J. OFCOM has considered every representation about the proposed Direction duly made to it and the Secretary of State has not notified OFCOM of any international obligation of the United Kingdom for this purpose; and

NOW, THEREFORE, PURSUANT TO SECTION 49 OF THE ACT AND SMP SERVICES CONDITION AA4.11 OFCOM HEREBY GIVES THE FOLLOWING DIRECTION THAT:

1. Paragraphs AA4.1 (a) and AA4.1 (e) do not apply to the provision of Wholesale Line Rental Services.

2. For the purposes of interpreting this Direction, the following definitions shall apply:

“**Act**” means the Communications Act 2003;

“**Dominant Provider**” means British Telecommunications plc (BT), whose registered company number is 1800000, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 736 of the Companies Act 1985, as amended by the Companies Act 1989;

“**Ofcom**” means the Office of Communications;

“**The Notification**” means the Notification referred to in recital (B) as amended of this direction;

“**Transitional Provisions**” means sections 408 and 411 of the Act, Article 3(1) of the Communications Act 2003 (Commencement No. 1) Order 2003 and Article 3(2) of the Office of Communications 2002 (Commencement No. 3) and Communications Act 2003 (Commencement No. 2) Order 2003;

3. Except insofar as the context otherwise requires, words or expressions shall have the meaning assigned to them in paragraph 2 above and otherwise any word or expression shall have the same meaning as it has in The Notification or, if the context so permits, in Schedule

1 thereto, as appropriate, and otherwise any word or expression shall have the same meaning as it has in the Act.

4. For the purpose of interpreting this Direction:

(a) the Interpretation Act 1978 shall apply as if this Direction were an Act of Parliament;

(b) headings and titles shall be disregarded.

5. This Direction shall take effect on [Date].

[Name]

[Title]

A person authorised under paragraph 18 of the Schedule to the Office of Communications Act 2002

[Date]

Annex 3

Legal notification for proposed consent

Notification of a proposal under section 49 of the Communications Act 2003

Proposals for giving a Consent under SMP Condition AA6(a).1 in Schedule 1 to the Notification at Annex A of the review of the fixed narrowband wholesale exchange line, call origination, conveyance and transit markets published on 28 November 2003 imposed on British Telecommunications plc as a result of the market power determination made by the Director that British Telecommunications plc has significant market power in the markets for markets for wholesale residential analogue exchange line services and wholesale business analogue exchange line services in the United Kingdom, excluding the Hull Area

1. OFCOM hereby make, in accordance with section 49(4) of the Act, the following proposal for a Consent to be given to BT under SMP Services Conditions AA6(a).1 in Schedule 1 to the Notification at Annex A of the *Review of the fixed narrowband wholesale exchange line, call origination conveyance and transit markets* published on 28 November 2003 to the accompanying explanatory statement.
2. The draft Consent is set out in the Schedule to this notification.
3. The effect of the draft Consent, and the reasons for making the proposal, is set out in Sections 1 to 4 and the annexes of the accompanying explanatory statement.
4. In making the proposals set out in this Notification, OFCOM have considered and acted in accordance with their general duties in section 3 of the Act and the six Community requirements in section 4 of the Act.
5. Representations may be made to Ofcom about the draft Consent by 12 December 2005. Representations shall be addressed to the person named in, and otherwise made in the manner set out in the accompanying explanatory statement and consultation document hereto.
6. In accordance with section 50 of the Act, copies of this notification have been sent to the Secretary of State, the European Commission and to the regulatory authorities of every other Member State.

Steve Unger

Director of Telecoms Technology

A person authorised under paragraph 18 of the Schedule to the Office of Communications Act 2002

9 November 2005

Schedule

[Draft] Consent under section 49 of the Communications Act 2003 and SMP Services Condition AA6(a).1 imposed on British Telecommunications plc as a result of the market power determinations made by the Director of Telecommunications that British Telecommunications plc has significant market power in markets for wholesale residential analogue exchange line services and wholesale business analogue exchange line services in the UK, excluding the Hull Area

WHEREAS:

(A) as a result of a market analysis carried out by the Director General of Telecommunications (the 'Director'), he proposed on 17 March 2003 and on 26 August 2003, in accordance with sections 48(2) and 80 of the Act that British Telecommunications PLC has significant market power in the markets for wholesale residential analogue exchange line services and wholesale business analogue exchange line services in the UK, excluding the Hull Area and the setting of certain SMP conditions;

(B) the Director having considered every representation duly made, and thereafter on 28 November 2003 pursuant to sections 48(1) and 79 of the Act by way of publication of a Notification identified the relevant services markets, made market power determinations to the effect referred to in recital (A) above and set certain SMP conditions on BT to take effect on 28 November 2003, unless otherwise is stated in Schedule 1 thereto;

(C) by virtue of the Transitional Provisions the Director was able to exercise the powers under the Act for an interim period. OFCOM has now assumed those powers as of 29 December 2003;

(D) this Consent concerns matters to which Condition AA6(a).2 relates;

(E) for the reasons set out in Sections [...] of the explanatory statement accompanying this Consent, OFCOM are satisfied that, in accordance with section 49(2) of the Act, this Direction is:

(i) objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;

(ii) not such as to discriminate unduly against particular persons or against a particular description of persons;

(iii) proportionate to what it is intended to achieve; and

(iv) in relation to what it is intended to achieve, transparent.

(F) for the reasons set out in Section [...] of the explanatory statement accompanying this Consent, OFCOM are satisfied that they have acted in accordance with the relevant duties set out in sections 3 and 4 of the Act;

(G) on 24 March 2005, OFCOM published a Notification of the proposed Consent and accompanying explanatory statement in accordance with section 49 of the Act and invited representations about any of the proposals therein by 28 April 2005;

(H) by virtue of section 49(9) of the Act, OFCOM may give effect to the proposal set out in the Notification, with or without modification, only if –

(a) they have considered every representation about the proposal that is made to them within the period specified in the notification; and

(b) they have had regard to every international obligation of the United Kingdom (if any) which has been notified to them for this purpose by the Secretary of State;

(I) OFCOM has considered every representation about the proposed Direction duly made to it and the Secretary of State has not notified OFCOM of any international obligation of the United Kingdom for this purpose; and

THEREFORE, PURSUANT TO SECTION 49 OF THE ACT AND CONDITIONS AA6 (A) IN SCHEDULE 1 TO THE NOTIFICATION, OFCOM GIVES THE FOLLOWING CONSENT:

1. The obligation on BT in SMP Condition AA6(a).2 to give prior notification of amendments to the charges for existing Network Access shall not apply to those charges set by Ofcom in the Accompanying Direction.

2. For the purpose of interpreting this Direction, the following definitions shall apply:

(a) '**Act**' means the Communications Act 2003;

(b) '**Accompanying Direction**' means the Direction published by Ofcom on the [...] directing BT's charges for the provision of wholesale residential analogue exchange line services, wholesale business analogue exchange line services, wholesale residential ISDN 2 exchange line services, and wholesale business ISDN 2 exchange line services within the United Kingdom, but not including the Hull Area;

(c) '**The Notification**' means the Notification referred to in recital (B) of this Direction as amended;

(d) '**Transitional Provisions**' means sections 408 and 411 of the Act, Article 3(1) of the Communications Act 2003 (Commencement No. 1) Order 2003 and Article 3(2) of the Office of Communications 2002 (Commencement No.3) and Communications Act 2003 (Commencement No. 2) Order 2003;

3. Except insofar as the context otherwise requires, words or expressions shall have the meaning assigned to them in paragraphs 2 above and otherwise any word or expression shall have the same meaning as it has in The Notification or, if the context so permits, in Schedule 1 thereto, as appropriate, and otherwise any word or expression shall have the same meaning as it has in the Act.

4. For the purpose of interpreting this Consent:

(a) headings and titles shall be disregarded; and

(b) the Interpretation Act 1978 shall apply as if this Consent were an Act of Parliament.

5. This Consent shall take effect on the day it is published.

[Name]

[Title]

A person authorised under paragraph 18 of the Schedule to the Office of

WLR: Reviewing and setting charge ceilings for WLR services

Communications Act 2002

[Date]

Annex 4

Ofcom's consultation principles

A4.1 Ofcom has published the following seven principles that it will follow for each public written consultation:

Before the consultation

A4.2 Where possible, we will hold informal talks with people and organisations before announcing a big consultation to find out whether we are thinking in the right direction. If we do not have enough time to do this, we will hold an open meeting to explain our proposals shortly after announcing the consultation.

During the consultation

A4.3 We will be clear about who we are consulting, why, on what questions and for how long.

A4.4 We will make the consultation document as short and simple as possible with a summary of no more than two pages. We will try to make it as easy as possible to give us a written response. If the consultation is complicated, we may provide a shortened version for smaller organisations or individuals who would otherwise not be able to spare the time to share their views.

A4.5 We will normally allow ten weeks for responses to consultations on issues of general interest.

A4.6 There will be a person within Ofcom who will be in charge of making sure we follow our own guidelines and reach out to the largest number of people and organisations interested in the outcome of our decisions. This individual (who we call the consultation champion) will also be the main person to contact with views on the way we run our consultations.

A4.7 If we are not able to follow one of these principles, we will explain why. This may be because a particular issue is urgent. If we need to reduce the amount of time we have set aside for a consultation, we will let those concerned know beforehand that this is a 'red flag consultation' which needs their urgent attention.

After the consultation

A4.8 We will look at each response carefully and with an open mind. We will give reasons for our decisions and will give an account of how the views of those concerned helped shape those decisions.

Annex 5

Consultation response cover sheet

- A5.1 In the interests of transparency, we will publish all consultation responses in full on our website, www.ofcom.org.uk, unless a respondent specifies that all or part of their response is confidential. We will also refer to the contents of a response when explaining our decision, without disclosing the specific information that you wish to remain confidential.
- A5.2 We have produced a cover sheet for responses (see below) and would be very grateful if you could send one with your response. This will speed up our processing of responses, and help to maintain confidentiality by allowing you to state very clearly what you don't want to be published. We will keep your completed cover sheets confidential.
- A5.3 The quality of consultation can be enhanced by publishing responses before the consultation period closes. In particular, this can help those individuals and organisations with limited resources or familiarity with the issues to respond in a more informed way. Therefore Ofcom would encourage respondents to complete their cover sheet in a way that allows Ofcom to publish their responses upon receipt, rather than waiting until the consultation period has ended.
- A5.4 We strongly prefer to receive responses in the form of a Microsoft Word attachment to an email. Our website therefore includes an electronic copy of this cover sheet, which you can download from the 'Consultations' section of our website.
- A5.5 Please put any confidential parts of your response in a separate annex to your response, so that they are clearly identified. This can include information such as your personal background and experience. If you want your name, address, other contact details, or job title to remain confidential, please provide them in your cover sheet only so that we do not have to edit your response.

Cover sheet for response to an Ofcom consultation

BASIC DETAILS

Consultation title: Wholesale Line Rental: Reviewing and setting charge ceilings for WLR services

To (Ofcom contact): Chris Rowsell

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

CONFIDENTIALITY

What do you want Ofcom to keep confidential?

Nothing

☐

Name/contact details/job title

☐

Whole response

☐

Organisation

☐

Part of the response

☐

If there is no separate annex, which parts?

If you want part of your response, your name or your organisation to be confidential, can Ofcom still publish a reference to the contents of your response (including, for any confidential parts, a general summary that does not disclose the specific information or enable you to be identified)?

DECLARATION

I confirm that the correspondence supplied with this cover sheet is a formal consultation response. It can be published in full on Ofcom's website, unless otherwise specified on this cover sheet, and I authorise Ofcom to make use of the information in this response to meet its legal requirements. If I have sent my response by email, Ofcom can disregard any standard e-mail text about not disclosing email contents and attachments.

Ofcom seeks to publish responses on receipt. If your response is non-confidential (in whole or in part), and you would prefer us to publish your response only once the consultation has ended, please tick here.

☐

Name

Signed (if hard copy)

Annex 6

Consultation questions

Question 1: Do you agree that Ofcom should set ceilings for the WLR rental and transfer charges?

Question 2: Do you agree that Ofcom should use forecast costs for 05/06? If not, please explain why.

Question 3: If you agree that Ofcom should forecast the costs for 05/06, is an RPI of 2.5% the most appropriate methodology to use?

Question 4: Do you agree that Ofcom should apply an efficiency factor of 1.5%? Please provide any evidence to support your answer.

Question 5: Do you agree with Ofcom's approach to excluding both Pair Gain costs and the adjustment for DACS?

Question 6: Do you think that the methodology put forward by Ofcom for the recovery of drop wire costs is appropriate?

Question 7: Do you think that Ofcom's approach in applying a CVE to S&GA costs is appropriate?

Question 8: Do you agree with Ofcom's proposal to not set charges or charge ceilings for business ISDN2 WLR?

Annex 7

Glossary

This glossary is without prejudice to the definitions used in the notifications set out in Annex 1, Annex 2 and Annex 3.

BT: British Telecommunications plc.

Communications provider: a person who provides an Electronic Communications Network or provides an Electronic Communications Service.

Hull Area: the area defined as the 'Licensed Area' in the licence granted on 30 November 1987 by the Secretary of State under section 7 of the Telecommunications Act 1984 to Kingston upon Hull City Council and Kingston Communications (Hull) plc.

ISDN: Integrated Services Digital Network. A Network based on the existing digital Public Telephone Network which provides digital links to Customers and end-to-end digital connectivity between them.

Kingston: Kingston Communications (Hull) PLC, communications provider which operates in the Hull Area.

Line card: the electronic cards in the exchange that provide connectivity to the switch.

Local loop: the access network connection between the customer's premises and the local serving exchange, usually comprised of two copper wires twisted together.

Local loop unbundling (LLU): a process by which a dominant provider's local loops are physically disconnected from its network and connected to competing provider's networks. This enables operators other than the incumbent to use the local loop to provide services directly to customers.

Main distribution frame (MDF): the equipment where local loops terminate.

Narrowband: a service or connection allowing only low data transfer speeds.

Pair gain: technology used to provide two PSTN lines over a single pair of copper wires. This is also referred to as Digital Access Carrier System (DACS) and is usually used to provide an additional line without laying additional copper wire.

PSTN: Public Switched Telephone Network.

SMP: The Significant Market Power test is set out in European Directives. It is used by National Regulatory Authorities (NRAs) such as Ofcom to identify those communications providers who must meet additional obligations under the relevant Directive.

Wholesale Line Rental (WLR): a service offered by BT Wholesale to other service providers allowing them to offer their own branded telephony service.