

**Local loop unbundling:
setting the fully unbundled rental
charge ceiling and minor
amendment to SMP conditions
FA6 and FB6**

Consultation document

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Section 1

Summary

Wholesale local access market review

1.1 In the Review of the wholesale local access market, 16 December 2004¹, (the “December statement”) Ofcom determined that BT has significant market power (“SMP”) in the market for wholesale local access in the UK excluding the Hull Area and Kingston has SMP in the wholesale local access market in the Hull Area. Ofcom imposed certain SMP services conditions on BT and Kingston in those markets and in respect of the provision of co-location. The wholesale local access market covers local loop unbundling (“LLU”) services.

1.2 LLU is a process by which the dominant provider’s local loops are physically disconnected from its network and connected to another communications provider’s network. This enables competing providers partly or wholly to lease a customer’s access line and provide voice and/or data services directly to end users.

1.3 The provision of LLU services is aimed at stimulating competition in the provision of broadband services. LLU services are important because they allow competing providers to innovate, differentiate their product offerings to a greater extent and provide higher bandwidth services, a better range of applications and improved service levels.

Delay setting the fully unbundled rental charge ceiling

1.4 Ofcom deferred setting the charge ceiling for the fully unbundled rental charge at the time of setting the other LLU charges in December 2004. This was because a high proportion of the total cost of this charge is determined by the cost of laying and maintaining the copper loop, the costs for which Ofcom was in the process of reviewing. Ofcom stated in the December statement that it would determine the fully unbundled rental charge ceiling on completion of the copper cost review. Ofcom published its statement entitled *Valuing BT’s copper access network* on 18 August 2005² and Ofcom is now able to set a ceiling for this charge.

1.5 BT voluntarily reduced the fully unbundled rental charge on 1 August 2005 from £105.09 to £80.00. Despite BT’s charge reduction, Ofcom still considers it appropriate to set a charge ceiling for this charge in order to ensure that BT’s charge is both certain and transparent and that BT is not able to increase its charge to an excessive level.

Approach to setting the fully unbundled charge ceiling

1.6 The following sets out Ofcom’s approach to setting the fully unbundled rental charge ceiling:

- Ofcom has used cost data for 04/05 from BT’s regulatory accounts. It is important to note that audited versions of BT’s 04/05 regulatory financial statements are not due to be published until early September. Therefore, although Ofcom believes that the

¹ <http://www.ofcom.org.uk/consult/condocs/rwlam/statement>

² <http://www.ofcom.org.uk/consult/condocs/copper/value2/statement/#content>

data provided is likely to be sufficiently robust to support the numbers presented, there may be further movement in costs between this consultation and the statement planned for October.

- As this charge ceiling is intended to apply from October 2005, Ofcom has projected costs for 2005/06 to ensure that the cost data is consistent with the period for which the charge is intended to apply.
- An efficiency factor of 1.5% has been applied to 05/06 operating costs.
- 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 capital³.
- Ofcom has used the £60.11 estimate of copper costs as set out in the *Valuing BT's copper access network* statement but applied a 16% reduction to D-side costs to reflect the fact that shorter lines are used to provide broadband services.
- The costs for new drop wire installation for fully unbundled loops are recovered in the rental charge in order to achieve consistency between LLU, wholesale line rental ("WLR") and BT's retail products.
- Ofcom has disallowed some of BT's proposed increase in drop costs and excluded those drop costs which are already being recovered through residential retail charges, in order to ensure no double recovery.

1.7 On the basis of the approach set out above, Ofcom proposes setting the fully unbundled rental charge ceiling at £81.85.

Minor amendment to SMP services conditions FA6 and FB6

1.8 SMP services conditions FA6 and FB6, requirement to notify technical information, currently require BT and Kingston to provide 90 days notice of new technical information or before amending existing technical terms and conditions. The Network Interoperability Consultative Committee ("NICC") determines technical specifications with industry consensus and has its own processes for consulting on new, and changes to existing, technical specifications. It therefore appears unnecessary and inappropriate for BT or Kingston to separately provide 90 days notice for these particular specifications, which could cause unnecessary delay.

1.9 Therefore, Ofcom proposes to amend SMP services conditions FA6 and FB6 to carve out technical specifications as determined by NICC from the 90 day notification requirement.

Next steps

1.10 Ofcom is consulting on these proposals until 10 October 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.

³ Ofcom's approach to risk in the assessment of the cost of capital, 18 August 2005, which can be found at http://www.ofcom.org.uk/consult/condocs/cost_capital2/statement/#content

Section 2

Background and introduction

Regulatory framework

2.1 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 Directives⁴.

2.2 The new framework was implemented in the UK by the Communications Act 2003 (the "Act").

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2.3 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.

2.4 In the December statement, Ofcom determined that BT has SMP in the market for wholesale local access in the UK excluding the Hull Area and Kingston has SMP in the wholesale local access market in the Hull Area. Ofcom imposed certain SMP services conditions on BT and Kingston in those markets and in respect of the provision of co-location. The wholesale local access market covers LLU services.

2.5 LLU is a process by which the dominant provider's local loops are physically disconnected from its network and connected to another communications provider's network. This enables competing providers partly or wholly to lease a customer's access line and provide voice and/or data services directly to end users.

2.6 The provision of LLU services is aimed at stimulating competition in the provision of broadband services. LLU services are important because they allow competing providers to innovate, differentiate their product offerings to a greater extent and provide higher bandwidth services, a better range of applications and improved service levels.

Relevant SMP services condition

2.7 The following SMP services conditions, among others, have been imposed on BT in the wholesale local access market:

⁴ 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
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

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- requirement to provide Local Loop Unbundling Services;
- basis of charges (cost orientation); and
- requirement to notify technical information.

2.8 The following SMP services condition, among others, has been imposed on Kingston in the wholesale local access market:

- requirement to notify technical information.

2.9 The requirement to provide Local Loop Unbundling Services requires BT to provide LLU services as soon as reasonably practicable on fair and reasonable terms to all communications providers who reasonably request such services. The condition provides Ofcom with a specific power to issue directions and requires BT to comply with any such directions.

2.10 The requirement to notify technical information requires BT and Kingston to notify new and amended technical information within a reasonable time period but no less than 90 days in advance.

Delay setting the fully unbundled rental charge ceiling

2.11 Ofcom deferred setting the charge ceiling for the fully unbundled rental charge at the time of setting the other LLU charges in December 2004. This was because a high proportion of the total cost of this charge is determined by the cost of laying and maintaining the copper loop, the costs for which Ofcom was in the process of reviewing. Ofcom stated in the December statement that it would determine the fully unbundled rental charge ceiling on completion of the copper cost review. Ofcom published its statement entitled *Valuing BT's copper access network* on 18 August 2005 and Ofcom is now able to set a ceiling for this charge.

Section 3

Setting the fully unbundled rental charge

Introduction

3.1 Determining charge ceilings for specific LLU services constrains BT's ability to set excessive charges that could hinder the development of competition.

3.2 BT voluntarily reduced the fully unbundled rental charge on 1 August 2005 from £105.09 to £80.00. Therefore, Ofcom has considered the option of not setting a charge ceiling for this charge. However, Ofcom believes that it is still appropriate to set a charge ceiling, in order to ensure that BT's charge is both certain and transparent and that BT is not able to increase its charge to an excessive level. Ofcom considers that setting this charge ceiling will thus provide benefits to industry whilst not imposing an undue burden on BT.

3.3 As set out in the December statement, Ofcom considers it preferable to set charge ceilings as opposed to exact charges. In calculating the proposed ceiling, Ofcom has made a number of assumptions, which are set out below. A charge ceiling, as opposed to an exact charge, 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 may be Ofcom's acceptance of BT's undertakings in lieu of a reference under Part 4 of the Enterprise Act 2002, which will mean the implementation of 'equivalence of inputs' for LLU⁵. 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.

Question 1: Do you agree that Ofcom should set a ceiling for the fully unbundled rental charge?

Cost recovery

3.4 The application of the principles of cost recovery to LLU costs broadly remains as set out in Section 8 of the December statement. Table 3.1 summarises how LLU per service and system set-up costs should be recovered.

⁵ 'Equivalence of inputs' means that BT will supply LLU on the same timescales, terms and conditions (including price) and by the same systems and processes to all communications providers (including its own downstream operations). Further, LLU will be sold out of a separate division of the BT group, referred to as the 'Access Services Division' or ASD.

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

Principle	Suggested mechanism of recovery	
	LLU per service costs	LLU system set up costs
Cost causation	Recovery over LLU lines	Unclear
Distribution of benefits	Recovery over LLU lines	Recovery over all broadband lines
Effective competition	Recovery over all DSL lines	Recovery over all DSL lines
Cost minimisation	Recovery over all DSL lines	Recovery over all DSL lines
Practicability	No suggestion	Recovery over all DSL lines
Reciprocity	No suggestion	No suggestion

Geographically averaged LLU charges

3.5 As stated in the December statement, regulated charges can be geographically averaged or vary across the geographic market to reflect differences in the costs of providing services in different areas.

3.6 De-averaged charges could more precisely reflect the costs incurred in providing LLU services in each area and can provide better signals for investment decision making. However, there are consumer affordability and significant practicality issues associated with de-averaging charges. Therefore, on balance, Ofcom considers currently that charges for LLU services should continue to be geographically averaged.

LRIC+ methodology

3.7 The December statement imposed on BT a requirement to charge for the provision of Network Access in the wholesale local access market on the basis of long run incremental cost ("LRIC") plus an appropriate mark-up for common costs including an appropriate return on capital employed (SMP condition FA3). An appropriate mark-up could be interpreted as that within a reasonable range determined by parameters such as the incremental cost floor and ceiling.

CCA FAC

3.8 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.

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3.9 Given that LRIC+ is not conceptually superior to CCA FAC as a cost basis for setting charges, but that CCA FAC has transparency benefits, Ofcom proposes using CCA FAC as the appropriate basis for setting the fully unbundled rental charge ceiling (with the exception of certain copper costs as outlined below). This is also the approach that has been adopted for the new network charge controls (“NCCs”)⁶ and Ofcom intends to consult on the adoption of the same approach for WLR charges later this year.

The regulatory asset valuation

3.10 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 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.

3.11 Therefore, the part of the LLU charge 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 fully unbundled rental charge are based on CCA FAC.

BT cost data

3.12 Regulatory accounting data was unavailable when the other LLU charge ceilings were set in December 2004, because at this time BT did not sufficiently disaggregate its accounting data into categories that would have enabled charge setting. Ofcom considers that it is more appropriate to use regulatory accounting data where available. BT has provided unaudited 04/05 regulatory accounting cost data for the fully unbundled rental charge. Using this data means that the rental charge ceiling will not be set on an entirely consistent basis to the other LLU charge ceilings, such as for the shared rental charge and connection charges⁷. However, given that it is generally more appropriate to use this data where available and Ofcom is likely to move all LLU charges to a regulatory accounting basis when they are next determined, Ofcom proposes to use this data to set the fully unbundled rental charge ceiling. It should be noted that the 04/05 financial data will not be finalised until early September and therefore there remains a possibility that the numbers could change between this consultation and the statement in October.

⁶ <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.

⁷ 04/05 regulatory accounting data was not used in the network charge control review because this data is already affected by PSTN rundown and replacement by next generation networks. This does not affect the access network and therefore there is not a consistency issue.

3.13 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.

Rate of return on capital employed

3.14 The appropriate rate of return that should be included in the charges for LLU services is the cost of capital BT is currently allowed on its regulated network activities. This cost of capital is equal to the weighted average cost of capital for the activities assessed using the capital asset pricing model.

3.15 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* 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 fully unbundled rental charge ceiling.

Charge control

3.16 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.

3.17 When LLU charges were first set, a charge control was not introduced because of the inevitable uncertainty surrounding the charging of services not yet in place. At the time of the December statement, Ofcom was of the view that current take-up of LLU services was too limited to allow an accurate enough assessment of LLU costs to set a sufficiently robust charge cap. Currently, the possible implementation of 'equivalence of inputs' adds further uncertainty to the costs. Therefore, Ofcom proposes to review the issue of a charge control in the next review of the wholesale local access market and the charge ceilings will remain in place until such time.

Cost categories for the fully unbundled rental charge

3.18 The following cost categories are included in the fully unbundled 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 the valuing BT's copper access network review;
- **MDF capital and maintenance** – the equipment where local loops terminate and cross connections to competing providers' equipment can be made;

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- **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 fully unbundled loop; and
- **Test access matrix (TAM) & line test costs** – the TAM provides a remotely-controllable facility for the temporary connection of a line to the line test system to facilitate fault investigation tests.

Assumptions applied to the cost categories

3.19 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. As mentioned above, the external audit of these figures is ongoing and audited versions of BT's regulatory financial statements are not due to be published until early September. Therefore, although Ofcom believes that the data provided is likely to be sufficiently robust to support the numbers presented there may be further movement in costs between this consultation and the statement planned for October.

3.20 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

3.21 As this charge ceiling is intended to apply from October 2005, Ofcom proposes to base the charge on projected costs for 05/06 to ensure that the cost data is consistent with the period for which the charge is intended to apply. For those costs not covered by the copper cost review, an RPI of 2.5% has been applied to 04/05 operating costs submitted by BT to calculate 05/06 costs. Given that this charge ceiling is likely to apply for a period of around two years, until the next market review which is likely to be in December 2007, it may be appropriate to base the charge on the average projected costs for 05/06 and 06/07. Alternatively, the ceiling could be indexed which would operate similarly to a charge control. Given the uncertainties involved with forecasting the costs for the implementation of 'equivalence of inputs' and likely efficiency savings, Ofcom proposes to only forecast costs for 05/06. If there was a material change in costs that would affect this charge significantly, Ofcom would consider whether it was necessary to re-determine the charge ceiling in advance of December 2007.

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?

3.22 An efficiency factor has been applied to 05/06 operating costs. 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.

3.23 Ofcom has based the calculation of its efficiency factor for LLU 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 has assumed that 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 is 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 are provided by various studies conducted by NERA on behalf of Ofcom⁸. This is consistent with the calculations for the NCCs.

3.24 Ofcom's calculations suggest 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 has applied a degree of judgement to ensure that the value calculated is a reasonable target going forward. As a result of this Ofcom believes it is appropriate to adopt a figure in the lower half of the range and believes an 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.

3.25 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.

E-side and D-side capital and maintenance

3.26 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 LLU is £60.11 per line for the financial year 2005/6.

3.27 For the purposes of determining E-side and D-side costs relevant to LLU, Ofcom proposes adjusting these costs on the basis of line length. BT has provided data which suggests that currently the average length of a copper loop that can be used to provide a 2Mbit/s broadband service is approximately 19% shorter than the average copper loop. This situation arises because DSL does not technically work over long line lengths and full LLU is mainly used to provide broadband, and broadband and voice services, but not voice only services. It is unlikely that line lengths constraining the provision of DSL will occur on the E-side and therefore Ofcom is only proposing to adjust the D-side costs to reflect shorter loop lengths for broadband services.

3.28 The choice of a line length reduction figure is difficult, as there is no precise data available. Therefore, Ofcom considers that it is appropriate to be cautious in this area and only apply a 16% reduction to D-side costs. This lower figure takes into account lower

⁸ <http://www.ofcom.org.uk/consult/condocs/charge/main/nera.pdf>

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bandwidth broadband services, for example a 512kbit/s broadband line will be able to use a longer line length, and technological advances that may mean higher bandwidth services are available over longer line lengths.

3.29 In the future, if fully unbundled loops are used to provide voice only services, then the rationale for using a shorter loop length may become less valid and this assumption may need to be revisited.

Question 5: Do you agree that a 16% reduction should be applied to D-side costs for LLU to reflect shorter line lengths used for broadband services?

MDF capital and maintenance costs

3.30 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 and therefore LLU takes a greater proportion of MDF costs compared to PSTN services. Ofcom considers that BT's costs and approach appear reasonable.

Drop wire capital and maintenance costs

3.31 The costs for drop wire installation for fully unbundled loops are currently recovered in the new provide connection charge. In order to achieve consistency between LLU, WLR and BT's retail products, Ofcom proposes that these costs are recovered in the fully unbundled rental charge. A consistent treatment of drop costs between these products will reduce incentives for arbitrage, such as currently where LLU providers may encourage customers to request a new line from BT and then immediately transfer the line to them. Consistency also reduces the risks of over-recovery where there is churn between products. For example, currently, a move from full LLU to WLR will mean drop costs are paid upfront in the LLU new provide connection charge and then again through the WLR rental charge.

3.32 To reflect this change, Ofcom expects BT to provide at least some rebate to LLU operators for existing new provide connections where drop wire costs have already been recovered. Ofcom also expects BT to revise its fully unbundled new provide connection charge to remove drop wire costs.

Question 6: Do you agree with the proposal to move the drop wire costs associated with a new provide connection into the fully unbundled rental charge?

3.33 BT has submitted that the LLU charge should contain an allowance for the capital costs of existing drop wires. The accounting data for 2004/05 only partly reflects these costs because the accounting treatment of drop wire costs was changed in 2000/01. Prior to this, drop wires were expensed (written off in the year incurred). Since 2000/2001 drop wires have been capitalised and written off over a ten year period. BT has proposed "normalisation" of the 04/05 data to include the full cost of drop wires and has assumed a 50% increase in capital costs in an attempt to reflect in LLU charges the position that the new accounting treatment of drop wires will show in 2010/11. Ofcom considers that this adjustment is inappropriate because the treatment of drop wire costs before 2000/2001 means that all capital expenditure on drop wires in this period has already been recovered. The normalisation adjustment proposed by BT would therefore result in the over recovery of the costs of pre 2000/2001 drops.

3.34 Moreover, to allow, in the charges, recovery of all the undepreciated portion of the costs of post 2000/2001 drop wires would also appear to result in over-recovery of these costs. This argument follows from treating drop wire costs as expensed in the modelling carried out in the 2001/2002 retail price control review which resulted in the setting of the current RPI-RPI retail price cap⁹. The level of retail prices controlled by the retail price cap allows for the recovery of the operating and capital costs of drops installed for BT retail residential customers during the price control period. Since the recovery of the capital costs of all existing residential drop wires has already been allowed for in retail prices, only the drop wire costs for business and new provide LLU connections and the future recurring operating costs for LLU residential drop wires should be included in the LLU rental charge for as long as the retail price control applies. Whether this approach remains appropriate beyond the retail price control period may depend on whether another retail control is put in place and, if so, the costs which are deemed to be recovered from retail customers for the purposes of setting it. Any subsequent charging regime should allow for the recovery of reasonable costs from retail, LLU and WLR customers in a consistent way and therefore it may be necessary to re-visit this charge ceiling if current circumstances materially change.

3.35 The capital cost of business LLU drop wires has been calculated on the basis that 5% of LLU transfers are business lines. BT and industry have provided Ofcom with data that suggests that 5% is a reasonable estimate of business transfers that will occur in 05/06. Ofcom has calculated 05/06 costs by adding a further year's worth of depreciation and return on capital employed to BT's 04/05 costs.

3.36 New provide LLU drop wires have been calculated on the basis that 15% of LLU connections are new provides. The current percentage of new provides is in the region of 35%. However, this is currently high as a result of a number of risk averse customers who are only prepared to take up services based on LLU with a second line¹⁰. Industry forecasts provided to Ofcom by current LLU operators purchasing fully unbundled loops, indicate that the number of new provides in 05/06 will reduce and be in the region of 15% of all LLU connections. BT has provided the depreciation and return on capital employed costs associated with a new drop wire. Ofcom has included 15% of these costs to reflect the number of LLU new provides that there are likely to be in a year.

3.37 Regarding the recurring operational costs and drop wire maintenance costs, BT has spread these costs across all drop wires to determine the unit cost.

Question 7: Do you think that the methodology put forward by Ofcom for the recovery of drop wire costs is appropriate?

Question 8: Do you think that the 15% figure currently used by Ofcom is a correct estimation of the number of LLU new provides as a percentage of all LLU connections? Please provide evidence in support of your response.

Question 9: Do you think that the 5% figure currently used by Ofcom is a correct estimation of the number of LLU business lines there are as a percentage of all LLU lines? Please provide evidence in support of your response.

⁹ http://www.ofcom.org.uk/static/archive/oftel/publications/whole_line/2002/pcr0602.htm

¹⁰ This may possibly be a reflection of current poor provisioning quality.

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Selling and general administration costs

3.38 It is also appropriate to include the wholesale costs incurred by BT in providing LLU. These costs include relevant systems costs and costs for activities such as billing and customer support, all of which are required to support LLU.

3.39 BT has not been able to provide regulatory accounting data for these selling and administrative costs but has estimated what these costs are likely to be following the implementation of equivalence of inputs. BT has based its estimates on the equivalent costs of its own broadband services and the costs it expects to incur in providing new systems. Ofcom considers that this is a reasonable approach to estimating costs going forward.

TAM and line test costs

3.40 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.

Fully unbundled rental charge ceiling

3.41 On the basis of the proposed approach, set out above, Ofcom proposes setting the fully unbundled rental charge ceiling at £81.85.

3.42 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 FA3.1, imposed on BT in December 2004, which requires BT to ensure that its charge for Network Access in the wholesale local access market are 'based' on LRIC+. For this reason, Ofcom has included specific wording in its proposed Direction setting the charge ceiling to make it clear that the obligation in SMP Condition FA3.1, to ensure that BT's charges are based on LRIC+, will not apply in respect of the charge ceiling.

Communications Act tests

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

3.44 Ofcom has considered its duties under section 3 and all the Community requirements set out in section 4 of the Act. In particular, the Direction is aimed at promoting competition and securing efficient and sustainable competition for the maximum benefit of retail consumers by ensuring that charges for LLU services are at a level that enables providers purchasing those services to compete in downstream narrowband and broadband markets.

3.45 Section 49 of the Act requires directions to be objectively justifiable, non-discriminatory, proportionate and transparent. Ofcom considers that the direction is an objectively justifiable and proportionate response to BT's market power, 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, whilst at the same time allowing BT a fair rate of return that it would expect in competitive markets. Although the direction is only made against BT, it does not unduly discriminate, as Kingston does not currently provide LLU services. Finally, it is transparent in

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that it is clear in its intention to ensure that BT provides LLU services at cost oriented charges.

Section 4

Minor amendment to SMP conditions FA6 and FB6: requirement to notify technical information

Introduction

4.1 Ofcom is using the opportunity of this document's publication to propose a change to SMP services conditions FA6 and FB6, requirement to notify technical information, which were imposed on BT and Kingston in December 2004 when the wholesale local access market review was completed.

4.2 These conditions require BT and Kingston to notify new technical information at least 90 days in advance of providing new wholesale services or amending existing technical terms and conditions to ensure that LLU operators are given sufficient time to prepare.

Technical changes determined by the Network Interoperability Consultative Committee (NICC)

4.3 NICC is a UK communications industry committee which acts as an industry consensus group in which specifications and technical issues associated with network competition can be discussed.

4.4 NICC deals with particular issues via its interest groups, which aim to represent particular sectors of the industry. They include representatives of network operators, public exchange manufacturers, terminal equipment suppliers and service providers. There is also a separate users' panel which works electronically to provide a user perspective on NICC activities.

4.5 NICC only determines technical specifications with industry consensus and has its own processes for consulting on new, and changes to existing, technical specifications.

Proposal

4.6 Given that industry is already involved in an appropriate consultative process for NICC technical specifications, it appears unnecessary and inappropriate for BT or Kingston to separately provide 90 days notice before introducing these new or amended technical specifications, which will add unnecessary delay. This delay that the 90 day notification period may cause is an issue that has been raised by stakeholders.

4.7 Therefore, Ofcom proposes to amend SMP services conditions FA6 and FB6, requirement to notify technical information, to carve out technical specifications as determined by NICC from the 90 day notification requirement. The proposed modifications are set out at Schedules 1 and 2 of Annex 2 of this consultation document. The SMP services condition, requirement to notify technical information, is set out at Annex 3.

Question 10: Do you agree that Ofcom should amend SMP services conditions FA6 and FB6 to exclude technical specifications determined by NICC from the 90 day notification requirement?

No material change to the relevant markets

4.8 Ofcom is empowered under section 86 of the 2003 Act to modify existing SMP services conditions without carrying out a market review. To do so, Ofcom must be satisfied that there has been no material change in the relevant markets since the condition was set or the SMP determinations were made in December 2004. Ofcom is satisfied that there has been no such material change and its analysis is set out in Annex 4.

Communications Act tests

4.9 Before amending an SMP services condition, Ofcom must satisfy the requirements set out in section 47(2) of the Act. In addition, Ofcom must consider and act in accordance with its general duties under section 3 of the Act and the six Community requirements in section 4 of the Act.

4.10 Section 47(2) requires modifications to be objectively justifiable, non-discriminatory, proportionate and transparent. The modifications are objectively justifiable, in that they remove notification requirements which would unnecessarily delay the introduction of new and amended technical specifications as determined by NICC. They are proportionate, as they remove the notification requirements on BT and Kingston where they are not necessary. They do not unduly discriminate as the same modification will apply to both BT and Kingston. Finally, they are transparent in that they are clear in their intention to ensure that BT and Kingston introduce new and amended technical specifications as determined by NICC without notifying them in advance.

4.11 Ofcom has considered its duties under section 3 and all the Community requirements set out in section 4 of the Act. In particular, the modifications are aimed at promoting competition and securing efficient and sustainable competition for the maximum benefits of consumers by ensuring that BT and Kingston introduce new and amended technical specifications as determined by NICC without any delay.

Section 5

Proposals and next steps

Proposals

5.1 Ofcom is proposing the following:

- to set the fully unbundled rental charge ceiling at £81.85; and
- to amend SMP services conditions FA6 and FB6 to exclude technical specifications determined by NICC from the 90 day notification requirement.

Impact Assessment

5.2 The analysis presented in Section 3 of this 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 guidelines¹¹:

- Stage 1 - Ofcom has considered whether LLU operators need certainty and transparency in relation to the fully unbundled rental charge.
- Stage 2 - The objective of setting a charge ceiling is to further the interests of consumers in voice and broadband markets by promoting competition based on LLU services.
- Stage 3 – Ofcom has the option of setting or not setting a charge ceiling.
- Stage 4 – If Ofcom does not set a charge ceiling, this could lead to uncertainty that BT will increase the fully unbundled rental charge from its current level. In setting a charge ceiling, Ofcom considers that this will provide benefits for industry in the form of certainty and transparency whilst not imposing an undue burden on BT (given its voluntary reduction to £80).
- Stage 5 – The certainty provided by a charge ceiling is more likely to encourage investment in LLU and increase competition.
- Stage 6 – The charge ceiling will not have a significant impact on BT, given the current level of its charge, and it will provide significant benefits for LLU operators. Therefore, Ofcom considers that setting a charge ceiling is proportionate and the most appropriate option.

5.3 Ofcom considers that the minor amendment to SMP conditions FA6 and FB6 is not an important proposal for the purposes of section 7 of the Act, as it does not involve a major change to Ofcom's activities, it does not have a significant impact on stakeholders and it does not have a significant impact on the general public in the UK. Therefore, Ofcom has not carried out an impact assessment for this proposal.

5.4 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.

¹¹ *Better Policy Making*, 21 July 2005, which can be found at http://www.ofcom.org.uk/consult/policy_making/guidelines.pdf

Next steps

5.5 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 10 October 2005.

5.6 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

6.1 Ofcom invites written views and comments on the issues raised in this document, to be made by **5pm on 10 October 2005**.

6.2 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.

6.3 Please can you send your response to first selina.chadha@ofcom.org.uk.

6.4 Responses may alternatively be posted or faxed to the address below, marked with the title of the consultation.

Selina Chadha
Floor 4
Competition and Markets
Riverside House
2A Southwark Bridge Road
London SE1 9HA

Fax:020 7783 3133

6.5 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.

6.6 It would be helpful if your response could include direct answers to the questions asked in this document, which are listed together at Annex 7. It would also help if you can explain why you hold your views, and how Ofcom's proposals would impact on you.

Further information

6.7 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 Selina Chadha on 020 7783 4147.

Confidentiality

6.8 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 sheet that this is acceptable).

6.9 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.

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6.10 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.

6.11 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

6.12 Following the end of the consultation period, Ofcom intends to publish a statement in October.

6.13 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

6.14 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.

6.15 This consultation is shorter than Ofcom's standard 10 week period because Ofcom has already consulted on most of its approach to setting the fully unbundled rental charge ceiling. The December statement sets out Ofcom's general approach to setting LLU 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 LLU. Therefore, Ofcom considers that a 5 week period is sufficient for consideration of the proposals contained in this consultation.

6.16 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.

6.17 If you would like to discuss these issues, or Ofcom's consultation processes more generally, you can alternatively contact Tony Stoller, Director, External Relations, who is Ofcom's consultation champion:

Tony Stoller
Ofcom
Riverside House
2A Southwark Bridge Road
London SE1 9HA
Tel: 020 7981 3550
Fax: 020 7981 3333
E-mail: tony.stoller@ofcom.org.uk

Annex 1

Notification: Direction setting the fully unbundled rental charge ceiling

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

Proposal for giving a Direction under SMP Services Condition FA9.2 imposed on BT as a result of a market power determination made by OFCOM that BT has significant market power in the market for wholesale local access services within the United Kingdom, but not including 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 FA9.2 as set out in Schedule 1 to the Notification at Annex 1 of the wholesale local access market review statement published on 16 December 2004.
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, are set out in Section 3 of 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 10 October 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

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

Andrew Heaney

Director of Competition Policy

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

7 September 2005

SCHEDULE 1

Draft Direction under section 49 of the Communications Act 2003 and SMP Services Conditions FA3.1 and FA9.2 imposed on BT as a result of the market power determination made by OFCOM that BT has significant market power in the market for wholesale local access services within the United Kingdom, but not including the Hull Area

WHEREAS:

- A. On 16 December 2004, in accordance with Section 79(4) of the Act, Ofcom published a Notification identifying the wholesale local access market in the UK excluding the Hull Area and making a market power determination that BT has significant market power in respect of that market;
- B. On 16 December 2004, in accordance with Section 48(1) of the Act, Ofcom published a Notification setting certain SMP conditions on BT to take effect on 16 December 2004, including SMP Condition FA3, which requires BT to secure that its charges are reasonably derived from the costs of provision based on a forward looking long run incremental cost approach and allowing an appropriate mark up for the recovery of common costs including an appropriate return on capital employed, and SMP Condition FA9, which requires BT to provide specific LLU services on fair and reasonable terms, conditions and charges as Ofcom may direct from time to time;
- C. This Direction concerns matters to which Conditions FA3 and FA9 relate;
- D. For the reasons set out Section 3 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 as 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 3 of the explanatory statement accompanying this Direction, Ofcom is satisfied that it is acting in accordance with the relevant duties set out in Sections 3 and 4 of the Act in giving this Direction;
- F. On 7 September 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 10 October 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 other EU Member State;
- H. Ofcom has considered every representation about the proposed Direction duly made to it;

NOW, THEREFORE, PURSUANT TO CONDITIONS FA3.1 AND FA9.2, OFCOM HEREBY DIRECTS THAT:

1. The Dominant Provider shall not charge more than £81.85 for the annual rental charge for access to Metallic Path Facilities.
2. The obligation on the Dominant Provider by virtue of Condition FA3.1 to secure, and to be able to demonstrate to the satisfaction of Ofcom, that each and every charge offered, payable or proposed for Network Access covered by Condition FA1 and/or Condition FA9 is based on a forward looking long run incremental cost approach and allowing an appropriate mark up for the recovery of common costs, including an appropriate return on capital employed, shall not apply in respect of the proposed charge ceiling set out in paragraph (1) above.
3. For the purposes of interpreting this Direction, the following definitions shall apply:
 - “**Act**” means the Communications Act 2003;
 - “**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;
 - “**Dominant Provider**” means BT;
 - “**Metallic Path Facilities**” means a circuit comprising a pair of twisted metal wires from an end user premises to a main distribution frame that employs electric, magnetic, electro-magnetic, electro-chemical or electro-mechanical energy to convey Signals when connected to an Electronic Communications Network; and
 - “**Ofcom**” means the Office of Communications;
4. Except where otherwise defined or in so far as the context otherwise requires, any word or expression shall have the same meaning as it has in the Act.
5. The Interpretation Act 1978 shall apply as if this Direction were an Act of Parliament.
6. Headings and titles shall be disregarded.
7. This Direction shall take effect on [XXX].

Andrew Heaney

Director of Competition Policy

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

[Date]

Annex 2

Notification: Amendment to SMP services conditions FA6 and FB6

NOTIFICATION UNDER SECTIONS 48(2) AND 86(4) OF THE COMMUNICATIONS ACT 2003

Proposed modification of SMP services conditions FA6 and FB6 as set out in Schedules 1 and 2 respectively to the Notification at Annex 1 to the wholesale local access market review statement published on 16 December 2004

1. OFCOM hereby makes in accordance with sections 48(2) and 86(4) of the Act the following proposals for the modification of SMP services conditions by reference to market power determinations made in relation to markets in which OFCOM is satisfied there has been no material change since those determinations were proposed or made.
2. The proposals contained in this Notification are further to the market power determinations made in the Notification under sections 48(1) and 79(4) of the Act by OFCOM on 16 December 2004 whereby BT was determined to have significant market power in the market for wholesale local access services within the United Kingdom, but not including the Hull Area, and Kingston was determined to have significant market power in the market for wholesale local access services within the Hull Area.
3. As a result of, amongst other things, the market power determinations referred to in paragraph 2 above, BT and Kingston have been subjected to a number of SMP services conditions, including SMP services condition FA6, in respect of BT, and SMP services condition FB6, in respect of Kingston. OFCOM is proposing to modify SMP services conditions FA6 and FB6 as set out in Schedules 1 and 2 respectively to this Notification.
4. The effect of, and OFCOM's reasons for making, the proposals referred to in paragraph 3 above are set out at Section 4 of the accompanying explanatory statement.
5. OFCOM considers that the proposals referred to in paragraph 3 above comply with the requirements of sections 45 to 50 and sections 78 to 92 of the Act, as appropriate and relevant to each of the proposals.
6. 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.
7. Representations may be made to OFCOM about the proposals set out in this Notification and the accompanying explanatory statement by 10 October 2005.
8. Copies of this Notification and the accompanying explanatory statement have been sent to the Secretary of State in accordance with section 50(1)(a), and to the European Commission and the regulatory authorities of every other Member State in accordance with section 50(3) of the Act.

9. In this Notification (not including the Schedules) -

(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) “**Kingston**” means Kingston Communications (Hull) plc, whose registered company number is 2150618, 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;

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

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

Andrew Heaney

Director of Competition Policy

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

7 September 2005

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SCHEDULE 1

Proposed modification to SMP services condition FA6 imposed on BT as a result of the market power determination made by OFCOM on 16 December 2004 that BT has significant market power in the market for wholesale local access services within the United Kingdom, but not including the Hull Area

The following sentence shall be inserted at the end of SMP services condition FA6.1:

“This obligation for prior notification will also not apply in relation to new or amended technical specifications determined by the Network Interoperability Consultative Committee”

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SCHEDULE 2

Proposed modification to SMP services condition FB6 imposed on Kingston as a result of the market power determination made by OFCOM on 16 December 2004 that Kingston has significant market power in the market for wholesale local access services within the Hull Area

The following sentence shall be inserted at the end of SMP services condition FB6.1:

“This obligation for prior notification will also not apply in relation to new or amended technical specifications determined by the Network Interoperability Consultative Committee”

Annex 3

SMP services condition: requirement to notify technical information

Condition FX6

Requirement to notify technical information

FX6.1 Save where Ofcom consents otherwise, where the Dominant Provider:

- (a) proposes to provide Network Access covered by Condition FX1 [and/or Condition FX9], the terms and conditions for which comprise new:
 - (i) technical characteristics (including information on network configuration where necessary to make effective use of the Network Access);
 - (ii) locations of the points of Network Access; or
 - (iii) technical standards (including any usage restrictions and other security issues), or
- (b) proposes to amend an existing Access Contract covered by Condition FX1 [and/or Condition FX9] by modifying the terms and conditions listed in paragraph FX6.1(a)(i) to (iii) on which the Network Access is provided,

the Dominant Provider shall publish a written notice (the “Notice”) of the new or amended terms and conditions within a reasonable time period, but not less than 90 days before either the Dominant Provider enters into an Access Contract to provide the new Network Access or the amended terms and conditions of the existing Access Contract come into effect. This obligation for prior notification will not apply where the new or amended charges or terms and conditions are directed or determined by Ofcom or are required by a notification or enforcement notification issued by Ofcom under sections 94 or 95 of the Act.

FX6.2 The Dominant Provider shall ensure that the Notice includes:

- (a) a description of the Network Access in question;
- (b) a reference to the location in the Dominant Provider’s Reference Offer of the relevant terms and conditions; and
- (c) the date on which or the period for which the Dominant Provider may enter into an Access Contract to provide the new Network Access or any amendments to the relevant terms and conditions will take effect (the “effective date”).

FX6.3 The Dominant Provider shall not enter into an Access Contract containing the terms and conditions identified in the Notice or apply any new relevant terms and conditions identified in the Notice before the effective date.

FX6.4 Publication referred to in paragraph FX6.1 shall be effected by:

- (a) placing a copy of the Notice on any relevant website operated or controlled by the Dominant Provider;
- (b) sending a copy of the Notice to Ofcom; and
- (c) sending a copy of the Notice to any person at that person's written request, and where the Notice identifies a modification to existing relevant terms and conditions, to every person with which the Dominant Provider has entered into an Access Contract covered by Condition FX1 [and/or Condition FX9]. The provision of such a copy of Notice may be subject to a reasonable charge.

Annex 4

The wholesale local access market – no material change

A4.1 Ofcom is empowered under section 86 of the 2003 Act to modify existing SMP services conditions without carrying out a market review. To do so, Ofcom must be satisfied that there has been no material change in the relevant markets since the conditions were set or the SMP determinations were made in December 2004. This annex sets out Ofcom's consideration of whether there has been a material change in any of the relevant markets.

Market definition

A4.2 Ofcom's definitions of the wholesale local access markets were included in the December statement. The market definition includes two parts: the product market definition and the geographic market definition. Product market definition is logically prior to geographic market definition.

Wholesale product market

A4.3 The December statement set out that the relevant wholesale local loop market included the provision of local access over twisted copper pairs as well as Siamese cable access. The December statement also set out that there are a number of potential candidate substitutes for wholesale local access and identified separate markets for:

- fibre;
- fixed wireless; and
- mobile.

A4.4 In modifying the relevant SMP conditions in this document, Ofcom has reviewed whether these market definitions still hold and could be expected to remain relevant for the remainder of the market review. Ofcom's conclusion of a single market including cable-based and loop-based access services to be effective substitutes, and as such in the same relevant market, was based on substitution between cable-based and loop-based retail products undermining the profitability of a price increase at the wholesale level (indirect substitution). There is nothing that has occurred over the last 8 months since December 2004 that would lead Ofcom to conclude otherwise. In any case, even if it was appropriate to define a narrow wholesale market for loop-based local access only (excluding cable-based access) this could only affect the SMP conclusions if BT was found not to hold a position of SMP in the broader market. Similar reasoning applies to Kingston within the Hull Area.

A4.5 For fibre-based access services, there have been insufficient changes in the costs and roll out of fibre infrastructure for it to constrain the pricing of loop-based and cable-based local access such that it would lead Ofcom to conclude a broader market definition than at the time of the December statement.

A4.6 For fixed wireless access, there have not been any significant changes in the roll out or take up in the last 8 months for this access service to be regarded as an effective substitute for loop-based or cable-based local access.

- A4.7 Mobile access was assessed not to be a sufficient substitute for it to be in the same market as fixed access primarily because mobile access was viewed to be an adjunct to fixed access. Because of the prevailing price differentials, it was unlikely that there would be effective demand side substitution in response to a SSNIP by a hypothetical monopolist in the provision of fixed access. There is no evidence to suggest that this has altered in the last 8 months.
- A4.8 Ofcom remains of the view that it is appropriate to define a single wholesale local access market for supply to both residential and business customers. In particular, Ofcom does not believe that the choice between a single and separate residential and business markets would affect the overall conclusions of its market analysis.
- A4.9 In summary, Ofcom considers that its definition of a wholesale product market for loop-based and cable-based local access, as defined in the December statement, remains appropriate.

Wholesale geographic market

- A4.10 Having defined the scope of the relevant product market it is possible to define the scope of the relevant geographic market. As with the definition of the product market, the geographic boundaries of the relevant market are defined by identifying all relevant competitive constraints.
- A4.11 The December statement sets out that since the provision of a local loop or cable connection to particular premises is an inherently local activity, there is little scope for direct demand-side substitution to loops offered elsewhere. By definition, a customer can only purchase a relevant loop or cable connection from a supplier who can provide a connection to that end user's premises. It follows too that the practical scope for supply-side substitution is likely to be limited to suppliers who have made infrastructure investments in the vicinity of the end user's premises.
- A4.12 Some overlap in the 'catchment' areas that can be served by the infrastructure at a given location may arise, with substitution then hypothetically possible for at least those consumers in the overlap between catchments. Where multiple overlaps of catchments arise in this way, chains of substitution may result in a single geographic market encompassing areas which are broader than indicated by direct substitution possibilities alone. Nevertheless, Ofcom concluded that this mechanism would be unlikely to result in an extensive broadening of the relevant market.
- A4.13 However, Ofcom stated that this narrow approach to market definition could fail to capture adequately the competitive constraints operating on supply in a particular geographic area. Specifically, this approach takes no account of the geographic pricing constraints faced by specific firms in reality.
- A4.14 Where firms choose, in practice, to adopt uniform pricing across local areas, local competitive pressures will have an impact only to the extent that they affect that single uniform price. Moreover, to the extent that local factors do influence that price, the effect will be transmitted beyond the particular area where the competitive pressure originally arose.
- A4.15 For some wholesale services, BT's charges are set by regulation at a level which does not vary with geography. In such cases, it cannot be automatically assumed that uniform pricing would continue in the absence of that regulation. Nevertheless, for

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other wholesale products, BT chooses to set uniform prices across its service area, even though it is not currently required to do so by regulation.

A4.16 On this basis there appear to be grounds for believing that BT would implement geographically uniform prices for local access even in the absence of regulatory constraints. In this context, Ofcom argued in the December statement that restricting attention to a narrowly defined geographic area is unlikely to identify all the sources of relevant competitive constraint affecting local access pricing in that particular area. Instead, a service-area wide perspective is appropriate.

A4.17 It is also relevant that a number of BT's and Kingston's retail tariffs are required to be set on a nationally uniform basis across their service areas as a result of their universal service obligations. It is significant, too, that even the cable operators, who are not themselves subject to regulatory constraints, have adopted uniform pricing throughout their service territories.

A4.18 Since BT does not operate a local access network in the Hull Area, the impact of its uniform pricing policy will not extend across to that area. Symmetrically, Kingston's uniform pricing constraint will not materially affect locations outside the Hull Area.

A4.19 Ofcom's conclusion in the December statement was that there are two distinct wholesale geographic markets relevant for the purposes of this review, namely:

- the UK excluding the Hull Area; and
- the Hull Area.

A4.20 Nevertheless, Ofcom recognised that the broad UK geographic market is characterised, to some extent, by local characteristics including some variation in the degrees of competitive pressure.

A4.21 Since the December statement, BT has introduced geographically localised IPStream and DataStream charges, in the form of a discount off nationally average charges, in areas served by 561 local exchanges. These discounts reflect the fact that alternative operators will be able to compete with BT using LLU inputs from BT in these downstream markets. This may indicate that there are more local geographic markets in the provision of these downstream products. However, Ofcom does not consider that this development undermines Ofcom's conclusion that the local access market is national. This is because Ofcom's understanding is that BT's geographically localised IPStream and DataStream charges are as a result of variations in competitive pressures resulting from alternative operators using wholesale local access products (i.e. LLU) rather than a change in competitive pressures in the provision of wholesale local access products. There have been no other developments in the last 8 months that suggest to Ofcom that the relevant geographic market is no longer national.

Market power assessment

A4.22 The local access network remains one of the least competitive segments of communications networks overall. BT's market share of the wholesale local access market in the UK excluding the Hull Area remains around 82%.

Table A3.1

Local access connection volume shares for the UK excluding the Hull Area

	All Operators	BT ¹	ntl & Telwest	Other	BT share
2003 Q4	24,081	19,920	4,002	159	82.7%
2004 Q1	24,064	19,865	4,040	159	82.6%
2004 Q2	24,137	19,748	4,232	157	81.8%
2004 Q3	23,920	19,663	4,101	156	82.2%
2004 Q4	23,842	19,602	4,083	156	82.2%

Source: Ofcom estimates from operator data

A4.23 Kingston continues to supply around 100% of the relevant local access connections within the Hull Area.

A4.24 As set out in the December statement a change in the competitive conditions would require:

- a radical increase in the competitive appeal of the services provided by the cable operators;
- the emergence of a credible new entrant in the supply of wholesale local access services; or
- a transformation in the buyer side of the market.

A4.25 These scenarios have not occurred over the last 8 months and therefore Ofcom does not consider that the findings of SMP in respect of BT or Kingston have changed.

Conclusion

A4.26 Ofcom considers that there has been no material change to the following markets:

- wholesale local access in the UK excluding the Hull Area; and
- wholesale local access in the Hull Area.

Annex 5

Ofcom's consultation principles

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

Before the consultation

A5.1 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

A5.2 We will be clear about who we are consulting, why, on what questions and for how long.

A5.3 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.

A5.4 We will normally allow ten weeks for responses to consultations on issues of general interest.

A5.5 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.

A5.6 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

A5.7 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 6

Consultation response cover sheet

- A6.1 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.
- A6.2 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.
- A6.3 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.
- A6.4 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.
- A6.5 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: Local loop unbundling: setting the fully unbundled rental charge ceiling and minor amendment to SMP conditions FA6 and FB6

To (Ofcom contact): Selina Chadha

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 7

Consultation questions

Question 1: Do you agree that Ofcom should set a ceiling for the fully unbundled rental charge?

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 that a 16% reduction should be applied to D-side costs for LLU to reflect shorter line lengths used for broadband services?

Question 6: Do you agree with the proposal to move the drop wire costs associated with a new provide connection into the fully unbundled rental charge?

Question 7: Do you think that the methodology put forward by Ofcom for the recovery of drop wire costs is appropriate?

Question 8: Do you think that the 15% figure currently used by Ofcom is a correct estimation of the number of LLU new provides as a percentage of all LLU connections? Please provide evidence in support of your response.

Question 9: Do you think that the 5% figure currently used by Ofcom is a correct estimation of the number of LLU business lines there are as a percentage of all LLU lines? Please provide evidence in support of your response.

Question 10: Do you agree that Ofcom should amend SMP services conditions FA6 and FB6 to exclude technical specifications determined by NICC from the 90 day notification requirement?

LLU: setting the fully unbundled rental charge ceiling and minor amendment

Annex 8

Glossary

This glossary is without prejudice to the definitions used in the notification set out in Annex 1.

Broadband: a service or connection which capable of supporting always-on services which provide the end-user with high data transfer speeds.

BT: British Telecommunications plc.

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

DSL (Digital Subscriber Line): a family of technologies generically referred to as DSL, or xDSL, capable of transforming ordinary local loops into high-speed digital lines, capable of supporting advanced services such as fast Internet access and video-on-demand. ADSL (Asymmetric Digital Subscriber Line), HDSL (High bit rate Digital Subscriber Line) and VDSL (Very high data rate Digital Subscriber Line) are all variants of xDSL.

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.

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

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 and cross connection to competing providers' equipment can be made by flexible jumpers.

Metallic Path Facilities: the provision of access to the copper wires from the customer premises to a BT MDF that covers the full available frequency range, including both narrowband and broadband channels, allowing a competing provider to provide the customer with both voice and/or data services over such copper wires.

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

PSTN: Public Switched Telephone Network

Shared metallic path facility (SMPF)/shared access: the provision of access to the copper wires from the customer's premises to a BT MDF that allows a competing provider to provide the customer with broadband services, while the dominant provider continues to provide the customer with conventional narrowband communications.

LLU: setting the fully unbundled rental charge ceiling and minor amendment

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.