Markham Sivak
Competition Policy Manager
Competition Group
Riverside House
2A Southwark Bridge Road
London SE1 9HA

email markham.sivak@ofcom.org.uk

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Dear Markham

**A New Pricing Framework for Openreach**

This response has been prepared on behalf of the Fixed Service Providers group of the Federation of Communications Services, which represents more than 140 service providers and resellers of fixed telephony services including Wholesale Line Rental (WLR), calls packages and broadband. A list of our members can be found on the FCS website - www.fcs.org.uk

We broadly support the approach which is reflected in Ofcom's proposed changes. Pricing of these products should reflect the cost of provision and on this basis we agree with the move to adjust the differential between WLR and LLU.

We also note that the proposals continue to suggest a price differential between WLR business and residential lines, however we note that Openreach is currently undertaking a project on Service Harmonisation which may result in only one underlying line type existing with communications providers purchasing differing support levels to meet their end user's needs. We believe it would be prudent for Ofcom to assess whether the likely introduction of Service Harmonisation will affect the need to class Business WLR as separate to Residential WLR.

We would also like to reiterate the importance of the "total cost of ownership" which is one of the key issues which we flagged up in our response to the first phase of the consultation. We believe that the guiding principle in determining the new framework must be based on this concept i.e. the total cost over the life of the contract of providing service to the end user customer. There is little point in controlling the headline rental price if increases in ancillary services counter this or distort the balance between different product sets.

We believe a number of significant changes in the market have a bearing on this consultation and on the underlying assumptions which should influence the final outcome.

- BT Wholesale has announced that it has suspended development of next generation voice products (e.g. Wholesale Voice Connect) while it carries out a review of its policy in this area. Whatever the outcome of this review it now seems very unlikely that any next generation products which might serve as successor products to WLR3 will be delivered within the next 2-3 years. This will both prolong the life and increase the importance of WLR over this period. The implication is that we are not likely to see any significant migration away from WLR in this timeframe; this underlines the importance of investing in the current product.

- We believe that growth in LLU may be levelling out (during 2007 volume grew by over 200,000 per month whereas this slowed to under 150,000 per month in 2008) so that the forecasted reductions in WLR revenue due to migration to LLU may be overstated.

- There is ongoing pressure from some communications providers for delivery of an xMPF product which we understand to be a voice-only variant of MPF that would directly compete with WLR. It seems likely that this product would be offered more cheaply than WLR which would clearly have a significant impact on the market and on demand for WLR.

- Following recent discussions with industry, it seems likely that Openreach will be able to negotiate a variation to the Undertakings which will enable it to defer physical separation of its IT systems. While this may save Openreach cost in the short term, the prolonged use of redundant legacy systems will continue to have a detrimental effect on efficiency.

- The economic climate and the medium term outlook have deteriorated significantly and this will obviously impact the BT Group. While it is important that BT remains stable, viable and therefore profitable, it is important that Openreach is not allowed to become a "cash cow" for the rest of the group.

- There have also been significant cuts in the cost of Ethernet, which indicates a refocusing on this product set by Openreach with, we believe, some consequent diversion of resource (and cost) away from WLR.

As a final general point, we would like to restate the importance of a charging regime which does not represent a barrier to migrations. In our initial response we cited an example where the current price profile constitutes a clear disincentive for customers to move. The cost of a WLR to WLR transfer is currently £2 whereas the cost of an MPF to WLR transfer is £34.86.

Many services to end user customers are now provided via unbundled lines, a fact of which the end user will generally be unaware. When, subsequently, an end user customer consuming such a service wishes to move back to a WLR based product, the additional cost will become apparent; in these circumstances gaining providers or end users may not be able or willing to fund the additional cost of switching, which can lead to the end user customer being stranded and unable to move to the new supplier of choice.

We do understand the cost plus argument which is used to justify the price differential of, for example, MPF to WLR transfers, as additional jumpering work is required. However, this approach, where the cost based pricing is calculated for each product separately has led to a gross disproportion in the cost of WLR-WLR migrations compared to MPF-WLR migrations.

We believe that either the cost structure of the MPF and WLR products in relation to migration processes should be aligned more closely to support ease of switching in all scenarios or additional exchange based work should be considered as an overhead that is required to facilitate migration which is then absorbed as a general cost.

Our responses to the specific consultation questions are set out below:

**Question 2.1** *Do you agree with the stated scope of the review in the context of the proposed market reviews for Fixed Narrowband Market Review and Wholesale Line Access? If not please provide your reasons.*

As noted in our general comments above, we would like to see more focus on the "total cost of ownership" (including ancillary products and services). It is important that the pricing of such ancillary and service products does not distort the balance of the total cost of ownership between different products. This has been brought into focus by some of the discrepancies which exist between LLU and WLR as highlighted by the Service Harmonisation project.

**Question 2.2** *Do you agree with the proposed objectives for this review? If not please provide your reasons.*

We agree with the objectives which Ofcom has set. In addition to promoting competition, regulatory certainty is important for all in order to provide an environment which is conducive to investment. We also agree that, in addition to enabling Openreach to recover its costs, the pricing regime must offer incentives for it to invest in improving service and developing new products and services.

**Question 3.1** *What do you consider to be the key developments in access service competition and has your assessment changed since the First Consultation?*

We have set out what we consider to be the key developments above. In summary, these are:

- suspension of BT's proposed next generation voice products e.g. Wholesale Voice Connect
- proposals for development of xMPF as a voice only variant of MPF
- slowdown in the growth of MPF
- reduction in cost of Ethernet products
- deterioration in the economic outlook

**Question 3.2** *How should we take account of these developments and possible future developments when developing our final proposals?*

The key issue is to recognise the increased importance of WLR as the key product for delivery of competitive voice products in the medium term and its likely longer life as a consequence of market uncertainty about successor products

**Question 4.1** *To what extent should our assessment of Openreach's financial performance to date inform our final decisions for a new financial framework?*

We believe that the projected level of switching from WLR to MPF is overstated. We also note that the level of faults is being reduced by investment in and renewal of the network. There is not enough emphasis on the need for and benefit to be derived from efficiency gains. More weight needs to be attached to projected performance in this area.

**Question 5.1** *With reference to Annex 11, what are your expectations for future levels of demand for fixed lines and the mix of this demand between MPF and WLR?*

We expect demand for LLU to plateau as it is not generally suitable as a means of delivering business services (one factor in this is that businesses may more readily recognise the potential costs of migration back to WLR based services).

As previously noted, the life of WLR as the primary means of delivering voice services is likely to be extended since there are no suitable successor products in the pipeline. It must also be recognized that BT's downstream companies will also continue to use WLR as their primary means of delivering service.

Specifically, revenue projections which envisage a decline in WLR revenues may be unduly pessimistic.

**Question 5.2** *With reference to Annex 12, do you agree with our approach to estimating Openreach's cost of capital? If not, please provide evidence to support your view.*

No comment.

**Question 5.3** *With reference to Annex 14, do you agree with our approach to estimating Openreach's ability to deliver further efficiency gains in the future? If not, please provide evidence to support your view.*

In general we agree with the approach adopted. However, we think some of the potential gains from, for example, widespread adoption of WLR3 which is a much more highly automated product than WLR2 are not sufficiently recognised. We also feel that the retirement of some of the redundant legacy systems which sit behind EMP would provide significant gains in efficiency.

**Question 5.4** *Do you have any comments on the absolute levels of costs or cost trends projected in Section 5 and Annexes 9 and 10?*

We think that estimated energy costs appear overstated, as the cost of oil has fallen substantially from its 2008 peak and energy costs are now following this decline. The projection does not recognise the impact of reductions in the overall network fault rate and also the reduction in level of DOAs and ELFs now being experienced (which has benefited both industry and Openreach from an efficiency perspective). We also note that Depreciation has been included in Openreach's forecasts, however this is a non-cash item used for accountancy purposes and we would query it's usage in the context of future profit forecasts which may have a bearing on product pricing, as it appears to distort the underlying profit/loss trend. We also note that there are two measures of inflation, RPI and CPI, and trust that Ofcom has assessed which is the most appropriate for usage in this consultation.

**Question 5.5** *Please provide any comments and evidence you may have to inform our assessment of the cost projections and key assumptions set out in Section 5 and in Annex 10*

We do not understand the basis for the projected drop in WLR revenues starting in 2002/12 which are shown in the tables in section A10.116 of Annex 10. We have indicated that due to continuing uncertainty about the delivery of next generation successor products that we do not agree that the implied move away from WLR is likely.

**Question 6.1** *Do you agree with our assessment that on balance it is appropriate to rebalance the MPF charges towards CCA FAC? If not please set out your own views on the most appropriate approach.*

Yes we agree. Prices should reflect the relative cost of provision.

**Question 6.2** *Do you agree with our assessment that a glide path offers the best approach to the introduction of any new charges, subject to an assessment of starting points and the returns in a given year? If not please set out your own views on the most appropriate approach.*

We have a concern that multiple price changes which communications providers will need to accommodate may be disruptive for customer experience, however we do not disapprove of a stepped approach where the steps are clearly defined and are not too numerous and have suitable future visibility, such that communications providers can plan ahead with certainty.

We reiterate the need for the impact of Service Harmonisation to be considered, so that any glide path or stepped approach to price changes is not undermined by a redefinition of the nature of WLR pricing that may result from Service Harmonisation in future.

**Question 7.1** *Do you agree with the proposed basket treatment of the non core rental services subject to cost orientation? Do you agree with the principles for basket construction set out? If not please set out your preferred approach and why.*

We agree with the Ofcom approach, which proposes individual controls especially for transfers and migration related services which should not be included in any baskets. Overall we believe the basket approach to be appropriate, subject to the Total Cost of Ownership principle being incorporated – therefore the construction of the baskets needs to be considered carefully for WLR and a number of Service Products would need to be included.

**Question 7.2** *Do you have any comments on our proposed set of LLUcharges subject to specific or basket charge controls?*

No comment.

**Question 7.3** *Do you agree with the statements on cost orientation and the proposed baskets for the services set in Annex 7? Is the list comprehensive?*

Given the WLR focused nature of our response and the near total absence of WLR products in Annex 7, it is impossible for us to comment. In order to comment we would need to see a lot more detail, and look forward to receiving this from Ofcom before any irrevocable decisions are made in the context of this consultation process.

**Question 7.4** *Other than the core rental services and the MPF and SMPF services identified for a sub-basket cap do you believe there are other charges which require specific attention?*

We believe the following list of products/services requires individual attention from Ofcom:

- Transfers and MPF to WLR conversions – where the balance between the two needs to be considered, not as two separate cost-based charges.
- The following Service products:
    - Excess construction charges (ECCs) and ECC exemption levels
    - Time related charges and engineer visit charges
    - Fixed price extensions (currently work in progress by Openreach)

**Question 8.1** *Please set out your views on the proposals set out in Section 8, together with the potential implications of the those proposals for CPs and for consumers, and the factors you consider we should take into account when determining the final pricing regime.*

We support the principles underlying the proposed changes but would reiterate the importance of total cost of ownership and the potential impact of Service Harmonisation.

**Question 8.2** *Do you agree with our assessment that the proposed changes to conditions and directions meet the tests set out under the Act?*

No comment

**Question 8.3** *Please provide any other comments you may have in response to the proposals set out in this document.*

We have no further comments.

We trust that the above is helpful and our members would be happy to meet with Ofcom to discuss any of the issues raised in greater detail.

Yours sincerely

Michael Eagle

Michael Eagle
General Manager