INTRODUCTION

1. Prospect is an independent trade union representing over 120,000 managers, specialists and professionals in both the private and the public sectors in a range of industries and organisations from the communications, media and digital industry to aviation, agriculture, defence, energy, environment, heritage, industry, scientific research and children's services.

2. Our members working in the information and communications technology area work extremely hard, and with a strong degree of personal commitment as evidenced by extensive amounts of unpaid overtime working, for network operators and service suppliers to deliver timely and cost-effective network upgrades and repairs, as well as high-speed digital communications and entertainment services. It is clearly in their interest, in terms both of the health of the companies that they work for and the ability of such companies to deliver good jobs characterised by decent working conditions, that the regulation of their industries is fair and takes full account of the positions of the companies for which they work.

3. We are in the midst of extremely interesting times. The continuing communications revolution has the power to improve our lives both socially and economically as well as to change the way we interact with the world and the people around us. Nevertheless, it is important that we remind ourselves that these powerful changes are not taking place by themselves and that it is network investment by those who build, maintain and operate our communications networks that is facilitating our use and enjoyment of these developments. Without investment, progress would be slowed and the benefits lost, our use of technology made more frustrating and technological leads being taken elsewhere, by other companies.

4. It is easy to take our networks for granted – and, indeed, as private citizens we often do. But it not in our interests, as citizens and consumers, for investment to be held up by a regulatory model which is focused almost exclusively on the short-term as regards the prices that consumers pay. In contrast, we must, as policy makers, ensure that we get regulation right so as to ensure that network companies can deliver investment confident in their abilities to secure a return from it, thus allowing us all – right across the nations and regions of the UK – to get on with enjoying the advances in connectivity that modern communications can bring.

5. Prospect welcomes the opportunity to respond to this consultation. Our submission focuses on the general points which we consider to be important in motivating our response and then moves on to a brief consideration of the questions which Ofcom has posed.

6. Our submission, which has been discussed with the union's BT Committee, a body of representatives responsible for the interface between BT and Prospect, all of which have a variety of day jobs at different levels and in different parts of BT, argues the following main points:

   - Ofcom's relentless focus on price may be in the short-term interests of consumers, but it's unlikely to be in their long-term interests where it undermines the case for investment. We have argued before that Ofcom is failing to fulfil its statutory duty on the grounds that it has insufficient regard for the impact of its decisions on investment by prioritising short-term pricing considerations so absolutely; the same points are inescapable here given the direction of this consultation

- to exclude 21CN costs from the model risks sending absolutely the wrong signal as regards the importance of investment in remoter areas. We are not convinced that the incentives for investment that Ofcom believes to be present in its anchor pricing are actually there in practice, and that the risk is therefore that investment in remote areas is under-prioritised

- a cost proposal whose central case has BT's costs falling by inflation minus 12.3% – on top of an efficiency assumption which already assumes cost reductions of 5% – is simply unreasonable in market areas which competition has already rejected as being unworthwhile to serve. Ofcom has not paid due attention to the burdens that this will create for BT and, indeed, for its staff who have to bear the brunt of efficiency improvements and frequently do so via large amounts of unpaid overtime

- furthermore, Ofcom has not sufficiently demonstrated the thinking for its decision to diverge so sizably from the proposal for a charge control of inflation minus 4% on which it originally consulted last July. Clearly the rejection of 21CN costs in the final modelling plays a role but it is not clear how much and, as we say, we reject such an exclusion.

7. Essentially, we have two sets of interests that we are combining in our submission:

- Our members, in their working lives, where we have very great concerns about the potential impact of Ofcom's policies on the working lives of a group of people who are already, in some cases, under intolerable strain – see paragraphs 26-32 of our evidence. Here, we conclude that there needs to be a better balance between our members' interests and the policy objectives of Ofcom

- the interests of UK customers and society throughout the UK, including in areas where it is uneconomic for a private company, on its own, to create a utility service for the good of the nation as a whole at its own expense.

GENERAL POINTS

8. The first point to make is to note the necessarily narrow focus of the consultation: we are here focused on Market A areas (i.e. where there are no more than two principal operators), which account for less than 10% of UK premises and where – self-evidently – there will be a large degree of overlap with state-backed[1] fibre roll-out as a result of such areas not being envisaged as being viable for investment from private sources alone.

9. Consequently, it remains valid to articulate an approach which seeks to maximise the issue of investment. The winners of public sector contracts will not be investing their own resources – or, perhaps, so much of their own resources – where the investment climate is unsatisfactory. It is important to emphasise that, where the investment climate is not right, the burden of meeting social policy objectives in Market A areas will therefore fall more heavily on the state. Network roll-out is evidently far from complete, even in areas falling within the scope of BT's current investment programme, but evidence that just 6-9% of Market A exchanges, serving just 10-15% of premises,[2] have fibre-enabled cabinets is proof enough of the primacy of the attention which we need to

[1] It is important to note that those winning BDUK contracts are required to use state funding as a lever for their own resources, and that the supplier (i.e. BT) contribution varies between 5% (in the Highlands and Islands) to 51% (in Merseyside), at a median of 26.5%. Hence our use of 'state-backed' rather than 'state-funded', given that the latter implies the incorrect assumption that BDUK money is financing the whole of the programme.

[2] Para 3.15 of Ofcom consultation document.

continue to pay to investment, given the need also to maximise investment from private sources. The presence of an important and sizable component of private investment in state-backed projects, and which is variable between different ones, means that we cannot be as blasé about the impact of decisions on investment as the consultation document appears to conclude.[3]

10. We should also observe the knock-on effects of Market A exchanges being served from Market B ones – the 'inside out' model on which Ofcom consulted some years ago. The consultation document quotes that the:

    Large majority of fibre roll-out to cabinets in Market A areas is served from Market B exchanges.[4]

11. Consequently, it is possible that this may well change the economics for those service providers who currently see Market A areas as unprofitable, and several of whom may well be pulled into seeking to provide services on the strength of state-backed investment in Market A areas. We need to recognise that all service providers, not just BT, are liable to benefit from this state-backed investment. The extent to which this comes true is, as Ofcom recognises, uncertain[5] and we would agree that it is too early to seek a partial de-regulation of Market A areas.

12. Nevertheless, the potential for hitherto Market A areas to become competitive as a result clearly must play a major part in Ofcom's approach to the setting of regulated prices in Market A areas.[6] However, the notion that either there is regulation or there is no regulation, or either that there is protection of consumers or that there is over-regulation[7] or that there is under-regulation or over-regulation – all of which Ofcom posits – is an over-simplification. These are not either/or questions but, instead, ones of how much regulation is appropriate. Clearly Ofcom accepts that it cannot ignore the issue but, given the limitations of the available evidence in this area, and not least given that it expects the fibre conversion rate to be high,[8] we believe that Ofcom ought to adopt a less pessimistic approach to the setting of regulated prices in the context of such uncertainties, based on the potential impact on network investment (and thereafter on the calls made for state-support) of setting prices that are too low.

13. Consequently, we are slightly puzzled by Ofcom's reference to it not being appropriate to change its consultation proposals, despite BT providing information about roll-out plans in October 2013;[9] Ofcom has indeed changed its proposals – by tightening the X minus constraint – and quite considerably, too. If this evidence has an important impact on how Ofcom's proposals are shaped, then it ought to be given full weight in Ofcom's considerations.

14. We do not believe that it makes any sense for Ofcom to hold to an approach that says BT cannot recoup the costs of investment in new technology. Ofcom might believe that customers should not be made worse off as a result of changes to the technology over which a service is provided, but this is not the reality. In any situation, end prices to consumers reflect the full mix of costs and technologies which companies deploy to provide the service. Where there are savings, consumers may benefit in terms of lower

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[3] ibid. Paras 3.32-3.33.

[4] ibid. Para 3.13.

[5] ibid. Paras 3.16 and 3.21.

[6] Not one that might be dismissed in three short paragraphs, as Paras. 3.29-3.31 seek to do.

[7] ibid. Para 3.26.

[8] ibid. Para 3.19.

[9] ibid. Para 3.34.

prices but investment is made to secure returns and, consequently, the costs of this are reflected ordinarily in the prices that consumers pay from time to time and according to the company's judgment about what the market will bear. We do not believe, therefore, that the anchor pricing model effectively encapsulates the need to invest in technology, and the rewards of doing so, as would ordinarily be the case in a non-regulated market.

15. Consequently, Ofcom has not satisfactorily demonstrated the benefits of its belief in the incentive qualities of the model – particularly in the context of the EU Recommendation on costing methodologies in the broadband environment. We do not see that prices being anchored in old technology, regardless of whether they are actually delivered over new technology, provide network operators with any incentive in practice to invest in new technology. Neither does this provide any practical test of the extent to which consumers might be prepared to pay more for a product: it simply encourages a regard for low prices among customers and, potentially, the belief that any move to higher prices is simply the result of inefficiencies or excess profit-taking.[10]

16. Furthermore, as Ofcom notes,[11] the volume of IPstream business is likely to fall as a result of consumers in Market A being switched to fibre. Consequently, an approach which bases prices for continuing (and enhanced) services on a declining business is clearly facing difficulties in reflecting accurately the costs of providing those services not just now but right throughout the charge control period given that such volumes are dropping.

17. We do not think that such an approach is either credible or sustainable and would urge Ofcom to revisit it. We think that it should be perfectly possible to devise a glidepath from IP stream to fibre-based products which accurately reflects the investment made in transiting customers in regulated markets to the latter and which follows the timelines for doing so. We should bear in mind here that BT is also investing its own money alongside the resources committed by BDUK; a model ought to be perfectly capable of reflecting the balance of investment sources in this regard.

18. We note that the upshot of the several different adjustments which Ofcom is proposing in Section 4 to make to the charge control base for modelling purposes have the effect of increasing BT's operating costs, set against the basis of the October 2013 RFS Report, by some 8%.[12] This provides an important point of contrast with the sharp increase in the X minus charge control cap and, indeed, is thrown into sharp relief by it. Adjustments to the charge control proposals which reflect an acceptance of an increase in BT's costs make it very difficult to understand why the headline cap should have increased so sharply.

19. Clearly much of the difference is accounted for by the ejection of 21CN costs from the cost base since Ofcom undertook its original consultation, and in response to BT's publication of its Regulatory Financial Statements. Indeed, rather than an 8% increase in costs, the removal of 21CN costs sees them reduced by 30%.[13] We note the reasons for Ofcom's rejection of this in its Section 5, but we disagree.

20. Firstly, it may not be clear that all IPstream customers will migrate to 21CN. However – as was noted above – it is likely that many will. Ofcom itself seems also to have accepted the probability of a high rate of conversion. To deny that any customers will migrate –

[10] As we have said before, we regard low prices, and the regulatory drive for low prices as one of the problems besetting the industry, although that is not the point we are making here.

[11] Ofcom consultation document, Para 4.26.

[12] Table 4.4, p. 31.

[13] Table 5.3, p. 38.

which is essentially the outcome of a proposal to exclude all 21CN costs – is ridiculous in the context of the undoubted benefits of fibre. To argue that customers who do not use a service should not be required to contribute to its costs imposes an excessive granularity on the setting of prices in a social context,[14] or indeed for any product, while it seems to us that it is entirely appropriate that customers who are the beneficiaries of a service – and enhanced network access is clearly a service – should pay for the end-to-end costs of that.

21. Secondly, inconsistency with the anchor pricing approach is only a problem if anchor pricing is unarguably the best methodology. We cannot see that it is and the EC Recommendation does not endorse it. To turn the statement around, any inconsistency seems to us to be an argument for reconsidering the use of anchor pricing. Furthermore, it is perverse to 'Model[] BT's current network as though it were to continue to serve the whole of Market A throughout the period of the control'[15] when quite clearly it will not. A better, more informed approach is required.

22. BT may well benefit from better cost control if its investment turns out to be economically efficient – but it is odd to argue that it may well be able to benefit by the investment increasing revenue potential, should customers be willing to pay for greater functionality, since a charge control is self-evidently designed to limit its ability to increase revenues. We would also point out that investment in fibre has a long payback period – 15 years, in fact, and longer than most private companies might consider appropriate – which takes any assessment of whether investment has been efficient well beyond the scope of being encompassed within any particular charge control.

23. Thirdly, that Ofcom has modelled costs on the basis of 20CN technology, and would need to strip these out if it were to accept that 21CN costs should not be included, is not an argument for not including 21CN costs in the model. Furthermore, Ofcom has come nowhere near demonstrating that it is not efficient to include the costs of BT's investment in 21CN in the Market A charge control. We are all for regulatory simplicity in principle, but the concept of 'simplicity' itself does not appear in Ofcom's set of cost recovery principles, and it is surely more important that accuracy and the recovery of costs from beneficiaries – which does – are allowed to prevail when it comes to the setting of a charge control. Ofcom should think again on this point.

24. Finally, we can see that Ofcom has dramatically changed its proposal for the cost control via a fundamental re-appraisal in section 7 of 'calculating the value of X'. This extremely short section, which gives neither any detail behind the most important part of the consultation document nor any argumentation as to what is in Ofcom's thinking, embodies a change in the central case from CPI-4%, on which it originally consulted last summer, to one of CPI-12.3%. In both cases, this also encompasses a 5% cost efficiency target. The range within which X is located has shifted, from one of -7% to -1% to one of -15.2% to -8.7%. That is, the best case scenario in the original consultation now falls outside the worst case scenario. The central case assumption has, CPI being fixed, shifted by more than 200%.[16]

25. We do not understand – not least given the lack of supporting argumentation – what has changed to lead to such a radical departure in the costings which underpin the charge control. Indeed, it would be very useful were the consultation document to have contained a reconciliation of the changes in the assumptions about BT's costs between the original and this second consultation. Clearly, Ofcom's view of the desirability of the

[14] All citizens pay for public services, some of which they may never use, for example.

[15] Ofcom consultation document, Para 5.19.

[16] Of course, a time of falling inflation tightens the charge control even more.

exclusion of 21CN costs, with which we also disagree, has led it to some reduction in the costs which may be encompassed within the charge control, so we could anticipate some changes in this, but nothing like on this scale. We would remind Ofcom that Market A areas are, by definition, ones in which competition has shown little interest in serving, as well as being ones in which the costs of supply far outweigh the returns. Consequently – and remembering that private investment also features, and quite heavily, as a part of BDUK projects – we see no reason why the charge control should be so heavily reduced. We believe that, in an area marked by the high costs of the supply of services, Ofcom has been considerably over-optimistic about the cost reductions which it might expect to see.

26. The costs to BT of meeting this charge control – on top of the assumption of a 5% efficiency gain – will impose a considerable burden on Prospect members. We annually survey all our members in BT, in all parts of the company, and thus we have considerable evidence, both as a snapshot of how these issues look at a particular point in time but also as a collection of longitudinal data which demonstrates the changes over time. Our surveys show a workforce which is suffering the effects of unsatisfactory job loading, a poor work-life balance and a perception of having no control over the pace and intensity of their work. We will be happy to share this data with Ofcom on request.

27. To highlight some of the findings from the most recent survey (conducted in 2013):

- 17% of members in BT say they usually work more than 48 hours per week,[17] among which 7% have usual working weeks of 55 hours or more

- 39% say that they do not have a good work-life balance

- 59% say that workloads are becoming more, or much more, difficult

- 63% say that their jobs are not doable in their contractual hours

- 50% disagree, or strongly disagree, that they have control over the pace and intensity of their work.

28. Evidently, these figures are averages and tend, incidentally, to be poorer in the regulated parts of BT's business – so, therefore, we may observe that workload pressures are already most significant where resourcing challenges are also the most affected by pressures arising from the need to meet the cost efficiencies associated with the charge control. High workloads arising from jobs not being doable and becoming higher, combined with poor work-life balance and a feeling that the pace and intensity of work is out of individual workers' direct control, lead inevitably to workers feeling under intense pressure. Indeed, some 61% of respondents to our 2013 survey reported that they had suffered from a period of stress in the previous six months which they considered to have been work-related.

29. In such a situation, this very challenging charge control proposal will cause Prospect members considerable difficulties in delivering the service towards which they aspire. The prospect of the pressures that they are already under becoming much worse as a result of the impact on them of further demands for efficiencies and cost reductions, is

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[17] This is the statutory working time limit in the UK, reflecting the European Working Time Directive. In comparison, Prospect members in BT have a contractual working week of 36 hours. The average normal working week – across all full-time members – was a fraction over 44 hours in 2013, i.e. each one was putting in eight hours per week of unpaid overtime, adding over one-fifth of their ordinary working week.

not only unappealing in practical, day-to-day terms as well as in career development ones, but is likely to cause them considerable problems in their domestic lives, too.[18]

30. We might additionally observe here that working weeks which are regularly long are unlikely to be efficient: there comes a point at which productivity falls with additional hours.

31. Our members deserve to have their own interests considered by Ofcom and we would argue strongly for the need for a better balance to be struck between Ofcom's policy objectives and the impact that these have on Prospect members. It is neither fair nor sustainable to have Ofcom's objectives delivered at the cost of over-work for our members and through the resulting impact that this will have on their mental health at work.

32. Furthermore, such a draconian cost control approach will almost certainly lead to BT employing significantly fewer people than is optimal in the parts of the company that are most affected by the charge control. The very likely consequence of this, as we have argued just recently in the context of Ofcom's consultation on Openreach's quality of service, will be an undesirably short-term focus and an insufficient emphasis on things like – in this case – future product development and technology evaluation. Under-resourcing clearly creates immense problems for the market – but ones whose effects can be entirely anticipated; this needs to be properly acknowledged, and averted, if further regulatory action is to be avoided somewhere down the line.

33. Ofcom's relentless focus on price and cost reductions may be in the short-term interests of consumers in terms of the benefits they gain of price reductions, but it is unlikely to be in their long-term interests where it undermines the case for investment.[19] We have argued before that Ofcom is failing to fulfil its statutory duty by having insufficient regard to the impact of its decisions on investment and by prioritising short-term pricing considerations so absolutely, and we reiterate that view in response to this consultation. We believe that Ofcom must re-consider its approach and re-shape its proposals so as to strike a better balance between what it currently prioritises as the interest of consumers and citizens and the investment which is also in their interests. It is inescapable that focusing less on enforcing cost reductions frees resources for investment – a particularly important issue in areas which are already under-served by investment on the grounds of them being uneconomic.

[18] Our surveys demonstrate that workers who are under stress are much more likely to report difficulties with their personal and family relationships – evidently so, when many of them are spending considerable additional amounts of time at work.

[19] Remembering that BT employees are also broadband consumers, and continuing the theme of the paragraphs above, a drive for cost efficiencies that imposes intolerable working time burdens on them is clearly not in their interests, either in the short- or the long-term.

CONSULTATION QUESTIONS

Question 1 - Do you agree with Ofcom's proposal to use 2012/13 as the base year but to exclude all BT's new allocation methodologies set out in its 2013 RFS?

34. No, we do not. We believe that Ofcom should use the most recent costs data as the basis for the 2013/14 to 2016/17 charge control period. By the end of this period, use of the 2013 data, but on the basis of the 2012 methodology, is an approach that will be considerably out of date. BT is entitled to re-assess its approach to cost methodologies and whether this is or is not to BT's advantage ought to play little part in the decision as to which one to use, especially in the context of the presence of an independent[20] review of the revised methodology. Ofcom should re-consider its approach in the light of the Deloitte report, and use the 2013 methodology.

35. Furthermore, Ofcom might be consulting on adopting the same approach in the December 2013 LLU WLR Charge Control Consultation – but the fact of that consultation is not an argument for taking the same line here: the use of such a line of argument here simply prejudges that the outcome of the LLU WLR consultation will be to adopt this approach, and that is not yet known. So, this is not a valid argument, in our view.

Question 2 - Do you agree with Ofcom's proposal to make adjustments to SG&A Broadband and ATM Network Interface, Switching and Transmission costs presented in the October 2013 RFS Report?

Question 3 - Do you agree with Ofcom's proposal to update our one-off non recurring cost adjustments, our market size adjustment and our DSLAM cost adjustment?

36. We have no comments here.

Question 4 - Do you agree with Ofcom's proposal to update the HON adjustment in line with that made in the 2013 WBA Consultation but to adjust the asset lives?

Question 5 - Do you agree with Ofcom's proposal to exclude 21CN costs from the charge control?

37. We do not agree with the exclusion of 21CN costs from the charge control – and, consequently, we do not agree with the updating of the HON adjustment. We argued the reasons for our view in paras. 14-17 and 20-23 above but, in brief, the exclusion of 21CN costs in our view risks sending the wrong signals about the importance of investment, particularly in Market A areas; and also risks undermining what investment case does exist. Market A areas are, by definition, starved of investment, and excluding the costs of investment in the charge control does not attribute a proper value to investment. We would remind Ofcom that the BDUK-backed projects, possessing a significant level of overlap with Market A areas, still require a significant degree of private investment from operators which had already rejected investing in such areas as unworthwhile. Furthermore, it makes no sense in the context of Ofcom's principles of cost recovery.

Question 6 - Do you agree with Ofcom's proposed changes to the compliance formulae to reflect relevant EOI charges?

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[20] Deloitte is not BT's accountants.

Question 7 - Do you agree with Ofcom's proposal to include a carry-over provision within the legal instrument?

38. We have no comments here.

Question 8 - Do you agree with Ofcom's proposal to change the definition of cease charges that are to be set to £0?

39. No, we do not agree. The charges might be relatively small, but they do reflect that there are some costs to BT involved with customers switching providers and we do not think it is right that such costs go unrecognised. There is no evidence that such charges are a barrier to switching and, while it is perfectly permissible for a regulator to have a policy based around the notion that switching is a good idea, it is not within its remit to facilitate that further by preventing operators from making appropriate recovery of the legitimately-incurred costs. On the assumption that such charges would have been swallowed by service providers rather than passed on to consumers, such a switch benefits only BT's competitors and encourages them to believe that there is such a thing as a free lunch. The principle of causation in terms of cost recovery – i.e. costs should be recovered from those whose actions cause the costs to be incurred at the margin – ought to be allowed to prevail, we believe.

Question 9 - Do you agree with Ofcom's proposal in relation to migration and connection charges?

40. We do not disagree with such an approach.

Question 10 - Please provide any further relevant evidence you may have in relation to the appropriate efficiency improvement target for BT for WBA markets.

Question 11 - Please provide any comments you may have on the proposed range of X values of -15.2% to -8.7%.

41. We have included evidence above, at paras. 26-32, from our annual surveys of the likely impact of further demands for efficiencies and cost reductions on workers who are already extremely pushed in terms of the hours they commit to the company and the lack of control over pace and intensity of work caused by poor job loading. Such pressures can only increase where efficiency targets are stepped-up, or where a charge control results in a substantial squeeze on costs, and we fear that such pressures may end up in a serious impact on the mental health of BT's employees. It may also have the effect of driving resource out of BT, and that is the reverse of what needs to happen where existing pressures are so heavy.

42. We do not understand the reasons for the departure from the proposed range of X values on which Ofcom originally consulted, and this can only exacerbate the pressures on a group of employees who are already highly pressured in their jobs. In our view, Ofcom's movement is so substantial – the best case scenario for cost reductions then would not fit within the acceptable range, as revised – that it risks undermining the credibility of the original consultation. We think that Ofcom should re-consider its approach, in conjunction with a re-assessment of BT's 2013 RFS methodology and what we regard as the need to encompass 21CN costs within the charge control.

Question 12 - Do you have any other comments on the issues raised in this consultation?

43. We have no further comments.

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