Openreach response to questions in Ofcom's consultation document

"Fixed access market reviews: Further consultation on notification periods, compliance with requirements on the VULA margin, and approach to pricing for TRCs and SFIs"

19 February 2014

Non Confidential VERSION
Redacted items shown as [✄]

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Foreword

On 3 July 2013, Ofcom published its proposals on the Fixed Access Market Reviews (FAMR). It subsequently published its consultation on 16 January 2014 (the "Consultation") asking for comments relating to notification periods, VULA margin compliance and TRCs/SFIs.

This document forms Openreach's response to Ofcom's proposals for TRCs/SFIs. It also notes Openreach's agreement to Ofcom's proposal to reduce the notification period for the WLR rental charge from 90 days to 28 days in respect of reductions to the WLR rental charge.

This response is in addition to our previous responses submitted on 30 September 2013 (Openreach response to service-related questions in Ofcom's consultation document "*Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30*" and Openreach response to questions in Ofcom's consultation document "*Fixed access market reviews: Approach to setting LLU and WLR Charge Controls*").

BT Group has responded separately to Ofcom's proposals on VULA margin compliance.

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1 Executive Summary – TRCs and SFIs

1. Ofcom's Consultation proposes charge controls for Time Related Charges (TRCs) and Special Fault Investigations (SFIs) provided by Openreach where they are "*reasonably necessary*" for LLU and WLR services. Ofcom proposes a one-off reduction, setting prices at FAC with no allowance for margin. In response to Ofcom's proposals, Openreach has a number of major concerns:

   - the majority of TRCs and SFIs are not "*reasonably necessary*" for the provision of WLR and LLU;

   - the grouping of TRCs and SFIs into the same regulatory group to apply a single form of regulation does not consider the different products and complexities within this group;

   - for 53% of TRCs and for all SFIs, the line has been tested by Openreach and found to meet the industry agreed SIN 349 standard;

   - 53% of TRCs and all SFIs are addressing complex customer issues not faults. In many cases these may turn out to be unnecessary engineering visits requested by the CP where the CP has failed to engage with customers to diagnose the problem nor invest in test and diagnostics systems and processes to identify their broadband service issues;

   - customers' expectations of, and reliance on, broadband are growing. Customers intolerance of issues impacting service are also growing[1] and there are new broadband issues such as Repetitive Electrical Impulse Noise ("REIN") which cause significant interference to broadband signals and this problem continues to grow;

   - Openreach has invested significantly in engineering training, processes, products and tools to resolve these complex customer issues;

   - Openreach deploys it's most trained and best equipped engineers to deal with these complex customer issues. SFI and CDTA engineers are additionally trained to deal with underground faults, are also further trained in testing and diagnostics and how to evaluate test results to identify a different number of potential issues on the line. This additional training allows these engineers to further utilise the latest testing units used within the engineering workforce to identify complex faults, such as REIN and high resistance problems on lines;

   - regulation should not remove, or reduce, Openreach's incentives to continue to invest and innovate in this area, in order to improve the customer experience in resolving these complex issues whilst; and

   - CPs should be encouraged to do more to improve their own diagnostic processes and reduce their reliance on both TRCs and SFIs.

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[1] As evidenced in Openreach's response of 18 February 2014 to Ofcom's consultation on Fixed access market reviews: Openreach quality of service and approach to setting LLU and WLR Charge Controls.

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2. Ofcom should also note the following:

    *   at least a quarter of TRCs and SFIs are wholly contestable and any regulation needs to allow for this;

    *   where they are contestable, CPs have (and exercise) a commercial choice about who they use to provide those services; and

    *   Openreach believes Ofcom has made an error in their calculation of the uplift, and should amend the 48% to 67% to correctly reflect the 2012/13 RFS costs.

3. Openreach's view is that further regulation is not warranted. However, in order to alleviate the more extreme effects of Ofcom's current proposals Ofcom should, at the very least, allow TRC and SFI charges to reflect a blended TRC rate based on FAC with the addition of a small margin. Ofcom's current proposals risk distorting the competitive market, removing incentives to innovate and reducing incentives for CPs to invest in their own processes. The minimum amount of acceptable margin should be at least 4%, based on the fact that [✂] represents a suitable EBIT margin on contestable services and that these contestable services account for at least a quarter of the TRC/SFI market. This would provide a commercial incentive for Openreach to maintain pricing parity and continue to provide these services in competitive markets and invest in further innovation.

Background

4. TRCs and SFIs are a portfolio of value added services, comprising a number of individual products that are designed to address very different purposes:

    *   TRCs are levied for an engineer's time to conduct repair work that is out of tariff. A proportion of TRCs will be levied because the CP requires Openreach to investigate a problem. TRCs are also levied where the repair work is on the end user network. This can be done by a non-Openreach engineer, such as Qube (or other), who can for example, replace end user wiring that the end user has accidentally cut through. In addition TRCs are levied to make good when the end user has damaged the Openreach network, for example, when a decorator has knocked the Network Termination Equipment ("NTE") off the wall. TRCs can also be raised as charges for the following engineering activities where there is no fault on the Openreach network (i.e. it has been tested by Openreach and found to meet the industry agreed SIN 349 standard):

        o   Conscious Decision to Appoint (CDTA), where the CP has the line test result and nevertheless makes a conscious decision for an engineer to visit the customer's premises <u>with</u> an appointed time; and

        o   Conscious Decision to Not Appoint (CDTnA), where the CP has the line test result and nevertheless makes a conscious decision for an engineer to visit the customer's premises, <u>without</u> an appointed time (for example, this happens where a CP chooses to rely completely on automated systems without engaging with their customer, rather than using call centre resource to confirm the appointment).

    *   TRCs can also be levied for provision work and pre-planned work. This includes end user wiring extensions in the course of an Openreach provision as well as pre-planned work on end user wiring and Volume Deals. Volume Deals are generally provided directly to third parties following a tendering process and include, for example, the provision of internal wiring on campus sites or multi-tenant buildings.

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- SFIs are an investigative product where the line is working to the industry agreed SIN 349 standard but the end user has an unresolved problem that affects their broadband service. There are six modules, each of which is ordered for a specific purpose. For example, a CP will order an End User Wiring module when undertaking work beyond the Openreach network or a Frames module in order to change a port in an exchange.

The majority of TRCs and SFIs are not "*reasonably necessary*" for the provision of WLR and LLU

5. 53% of TRCs and all SFIs are investigative products, where the line is already tested to be working to the industry agreed SIN 349 standard. Investigative products that examine issues where there is a positive line test require the highest engineering skills and the highest quality tools and engineering training. At least a quarter of TRCs and SFIs are wholly contestable

6. Ofcom needs to take into account that both TRCs and SFIs clearly contain contestable elements. Openreach conducted a study of SFI jobs, which showed that [✂] jobs, (c40%) could have been completed by someone else other than Openreach.

7. Openreach conducted a similar review which showed that work beyond the NTE (which is clearly contestable) accounts for [✂] and Volume Deals account for [✂] of all TRC revenues. Assuming at least half of Volume Deals are contestable, it could be reasoned that at least a quarter of TRC jobs are contestable.

Where services are contestable, CPs can exercise a commercial choice about who they use to provide those services

8. CPs themselves recognise certain activities are contestable given their different approaches when pre-authorising Openreach engineers to carry out both TRC and SFI tasks. Different CPs have different approaches to pre-authorisation and it is clear such CPs can limit work by Openreach engineers or presumably make alternative arrangements.

9. Far from it being "*unlikely to be economic for third party CPs to use non-Openreach engineers*"[2] it is clear that in a high proportion of cases the use of Openreach is a commercial choice for each individual CP. We understand that Ofcom is not explicitly seeking to regulate competitive services. However, the approach it proposes will inevitably embrace all TRC and SFI services, regardless of whether they are contestable or not.

Regulation should not remove or reduce Openreach's incentives to continue to innovate

10. Ofcom should take care that its proposals (to allow no margin in the TRC and SFI prices) do not result in a lack of incentives to supply these services (where the activities are contestable) or to innovate. Openreach is currently considering innovations which will benefit both CPs and consumers, such as [✂], Ofcom's proposals threaten to undermine the commercial case for these developments. Moreover, where work is contestable, and if there were an increase in demand (due to reduced price), Openreach would be more likely to consider a better use of its resources to be dealing with day to day demand for regulated products. Ironically the result of Ofcom's intervention would be to incentivise an outcome that Ofcom is trying to avoid.

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[2] Consultation, paragraph 5.5

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11. It is misleading for TTG to suggest that there has been little development of TRC and SFI products. There have been significant innovations and, in particular, Ofcom should note the following recent developments:

- the introduction of short form TRC Charge Description codes provided to CPs in invoice data and electronically via systems in individual KCI messages[3] – implemented in 2009;

- a simplified single charge for visit and first hour – implemented in 2010;

- a modular version of SFI (SFI2) launched in 2010/11 following requests from industry to give CPs more choice over the engineering activities they authorise;

- New Software – guiding engineers through tasks in real time, using new iPhone devices or Windows 8 for laptops – currently being rolled out in 2013/14; and

- a change to the Co-op Call module reducing the price to zero, notified in December 2013 (effective 1 April 2014) following a series of industry workshops.

12. In addition to this, Openreach is exploring a variety of potential developments, including [✂]. We consider it is industry best practice to drive innovation, and this should be encouraged, but the lack of incentives to innovate is an issue that Ofcom must address in its proposals.

CPs could do more to improve their own diagnostic processes and reduce their reliance on TRCs and SFIs

13. Some CPs could do more to improve their own diagnostic process efficiency, for example by resolving issues over the phone to check customer's equipment does not have a flat battery or that it is plugged in, both of which are common problems. For the largest proportion (nearly half) of cases there was no need for an engineer to be called out, this is currently driving unnecessary costs into the wider industry. Openreach believes a significant reduction of the TRC price, as proposed in the Consultation, would have the unintended consequence of reducing the commercial incentives for CPs to address these issues. The risk is that CPs bank the short term financial benefit of the proposed regulatory price changes rather than innovating or investing in their own fault handling processes. Such an outcome would not be in the interests of consumers and may actually allow consumer harm to persist.

Ofcom need to correct a potential error in their calculation of the uplift

14. Furthermore, as set out in this response, we believe Ofcom has made an error in their calculation of the uplift, and should amend the 48% to 67% to correctly reflect the Regulatory Financial Statements (RFS) for 2012/13 costs using 2011/12 methodologies.

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[3] [✂]

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2 Answers to Ofcom's questions

2.1 Notification periods

Question 3.1: Do you agree with our proposal to reduce from 90 days to 28 days the notification period that BT and KCOM are required to give in respect of reductions to the WLR rental charge? Please provide reasons in support of your views.

15. Openreach agrees with Ofcom's proposal to reduce from 90 days to 28 days the notification period that Openreach is required to give in respect of reductions to the WLR rental charge. This will align the notice period for price reductions on WLR and MPF.

2.2 VULA margin compliance

Question 4.1: Do you agree with our proposals for BT to provide information on the VULA margin every six months and on request? Please provide reasons in support of your views.

16. Please refer to the BT Group Response

2.3 Time Related Charges and Special Fault Investigations

Question 5.1: Do you agree with the charge control proposals for TRCs? Please provide reasons in support of your views.

17. Ofcom's 3 July 2013 consultation proposed a basis of charges obligation for TRCs and SFIs alongside a FAC+ approach where "any '+' would not be more than 5%"[4] in respect of TRCs and SFIs provided by Openreach that were "*reasonably necessary*" for LLU and WLR services.

18. The Consultation contains Ofcom's revised proposals for a one-off reduction to each and every TRC charge in the range of 12-40% (a base case reduction of 16%) with charges subsequently indexed to +0.2%[5].

19. Openreach does not agree with Ofcom's charge control proposals for TRCs. Ofcom needs to take account of a number of points detailed below and also consider additional evidence which Openreach believes support modification of Ofcom's proposals.

   - Some TRCs are contestable:

       o Volume Deals are contestable and should not be regulated;

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[4] Ofcom's 3 July 2013 Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30 consultation, paragraph, 12.77

[5] This is dependent on Ofcom's decision on Openreach's rate of efficiency for the purposes of the LLU/WLR Charge Control.

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- o Customer wiring work or any other work beyond the Network Termination Equipment (NTE) is contestable and is a commercial choice for each individual CP; and

- o Only [✂] of TRCs are raised when there is damage to the Openreach Network, which is not contestable

- Openreach should be incentivised to innovate and any new/value-add developments should not be subject to regulation.

- CPs could do more to improve their own diagnostic processes and reduce the need for TRCs.

Some TRCs are contestable

20. Ofcom recognises that some TRCs are contestable, as the proposals are limited to regulation of TRCs which are "*reasonably necessary*" for the provision of WLR and LLU. Ofcom should clarify that its pricing proposals do not apply to work carried out beyond the NTE at end users' premises. Openreach believes it should have commercial freedom to accept, prioritise and charge for this work in the wider context of its business priorities.

21. As Openreach stated in its September Response, TRCs cover a varied range of engineering tasks, some of which are contestable (that is that the work could be undertaken by a third party engineer) and some of which are non-contestable (that is the work involves action on the Openreach Network undertaken by an Openreach engineer). Ofcom states that there is a further category, which, although it does not involve engineering work on the Openreach network, is "*un-likely to be economic for third party CPs to use non-Openreach engineers.*"[6] Openreach summarises the approximate volumes of these TRC categories in Table 1 below.

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[6] Consultation, paragraph 5.5

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Table 1: Approximate volumes of TRC by category

Approximate % of Total TRC	Category	On or Off Openreach Network	Comment regarding contestability
Repair Journeys			
[✂]	Proving the issue is not on the Openreach network* – e.g. proving that the issue is a flat battery in the customer's phone	Off network	Openreach accepts Ofcom's finding that whilst theoretically contestable there are practical constraints. However, Openreach believes there is scope for CPs to avoid TRCs and use alternatives but this is currently understated.
[✂]	Proving the issue is on customer owned wiring and carrying out fix (as authorised)	Off network	Openreach believes is wholly contestable
[✂]	Fixing a fault on the Openreach network where the CP is responsible – e.g. because the customer has damaged the network	On network	Openreach believes is non-contestable
Provision Journeys or Pre-planned			
[✂]	Volume Deals and Events & Exhibitions - e.g. temporary engineers on standby at events like Wimbledon	Both off network & on network	Openreach believes that these projects contain both contestable and non-contestable elements
[✂]	Providing Customer wiring and extensions beyond the NTE on WLR & MPF provision jobs	Off network	Openreach believes is wholly contestable
[✂]	Other activities – e.g. NTE Shifts	On network	Openreach believes is non-contestable
100%	**Total**		

* N.B. CDTA and CDTnA jobs come under this category

Volume Deals are contestable and should not be regulated

22. None of the stakeholder responses to the July Consultation comment specifically on Volume Deals. This is unsurprising given that Volume Deals (along with Events and Exhibitions work i.e. campus wiring) are ordered and contracted directly with a third party, such as [✂], as part of larger scale pre-planned project work. While these projects do occasionally require work on the Openreach network (such as moving NTEs) they typically have a large off-network element. This off-network engineering work can be done by third parties. Indeed, due to the volume and advance planning of Volume Deal projects, customers frequently separate this work out for competitive tender. While Openreach wins some of this competitively tendered work, it does not win all of it. For example, Openreach has lost tenders [✂].

23. It is clear that Volume Deal TRCs cover both contestable and non-contestable work. Openreach also notes that the fact that work on third party or campus wiring (beyond the NTE) is competitive, is supported by TTG who states that, "*supply from competitors such as Qube … may be possible for some services (e.g. campus wiring.)*"[7]

24. In conclusion, off-network activity (beyond the NTE) as part of Volume Deals is not reasonably necessary for the provision of LLU and WLR, and hence Ofcom should recognise that this activity is outside the scope of its proposals.

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[7] Paragraph 1.9, LLU/WLR Charge Control Consultation: Talk Talk comments on BT's response, December 2013

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Customer wiring / work beyond the NTE is contestable and using or not using Openreach is a commercial choice for each individual CP

25. Openreach contends that all work carried out beyond the NTE is contestable even when the work is not pre-tendered.

26. CPs can select different levels of TRC banding which sets out how much engineering time they are prepared to authorise per job and thus their commercial exposure:

- Band 0 - no CP authority to the engineer to work beyond the NTE;

- Band 1 – CP authorises up to 2 man hours of engineering work beyond the NTE;

- Band 2 – CP authorises up to 4 man hours of engineering work beyond the NTE;

- Band 3 – CP authorises up to 6 man hours of engineering work beyond the NTE; and

- Band 4 – CP authorises as much engineering time as required to complete the work beyond the NTE.

27. Openreach has analysed the repair and provision jobs closed on 4 December 2013[8] for Sky and TTG and details the findings in Table 2 and Table 3 below. [✂]

28. [✂]

Table 2: MPF Repair Journeys

CP	Band 0	Band 1	Band 2	Band 3	Band 4	Total
TTG	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Sky	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Table 3: MPF Provision Journeys

CP	Band 0	Band 1	Band 2	Band 3	Band 4	Total
TTG	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Sky	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

29. This evidence demonstrates the extent to which authorising work and incurring TRCs for engineering activities beyond the NTE at the customer's premises is a commercial choice for each individual CP. Quite apart from the options available to CPs to meet customers' requirements for their own wiring and extension work at their premises, consumers also have a wide range of choice with any number of private contractors or electricians offering to undertake such work and self-install packs being readily available at most DIY outlets. Consequently, Openreach believes it is indisputable that all the TRCs incurred for work beyond the NTE are contestable.

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[8] This date was randomly selected the from most recent month for which data was available when the analysis was undertaken.

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Only of TRCs are raised when there is damage to the Openreach Network (which are not contestable)

30. Unlike faults, which are repaired in tariff, TRCs apply where damage has been caused to the Openreach Network (which could be deliberate, accidental or through neglect). Openreach accepts that only Openreach engineers can carry out this necessary repair work and these TRCs are not contestable.

31. However, as an overall percentage of TRCs this category is relatively small ([✂] of all TRCs). In addition, these TRCs are in response to damage to the Openreach network for which the CP is contractually liable (albeit it may be due to their end user). Openreach considers these costs as a 'cost of failure' for the whole industry and welcomes any measures to encourage CPs and their customers to avoid and protect against such damage. To this extent, Ofcom's proposals carry a risk of being counter-productive by reducing the incentive to do something to avoid these costs.

Openreach should be incentivised to innovate and any new/value-add developments should not be subject to regulation

32. Openreach welcomes Ofcom's comment in the Consultation that its proposals are not intended to "*undermine incentives to innovate for value-added type services as, to the extent they are not reasonably necessary for the provision of LLU- or WLR-based services, they are not covered by this regulation and as such could be charged for separately if there is a value to the CP.*"[9] For the avoidance of doubt Openreach requests that Ofcom clarifies that this would apply to any future value-add developments to the existing TRC and SFI products as well as any new services introduced to complement them during the period of the market review.

33. With such new services being beyond the scope of the proposed regulation Openreach should be able to set prices that the market will support. Openreach believes that such clarity would give it the reassurance it needs to make additional investment in developing value-add features, which may include activities such as:

   - [✂]

   - [✂]

   - [✂]

34. Openreach believes such future services and features, although they may be attractive to the market, go beyond the scope of the standard TRCs and SFIs that are charged.

35. Additional features for all existing standard products are likely to be over and above what is required for these services. For example, [✂]. In this case Openreach would expect to provide this feature at an unregulated price.

36. We note Ofcom references TTG's claim that "*innovation with respect to TRCs and SFIs has been minimal.*"[10] This is simply incorrect. The following significant developments have been made to the TRC product over the last five years:

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[9] Consultation, paragraph 5.120

[10] Consultation, paragraph 5.17

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- the introduction of short form TRC Charge Description codes provided to CPs in invoice data and electronically via systems in individual KCI messages[11] – implemented in 2009;

- the introduction of laptop logic which reduces scope for human error and does not allow TRCs to be raised with incomplete or inaccurate data fields – implemented in 2009;

- a simplified single charge for visit and first hour – implemented in 2010;

- amending the TRC charging policy to exclude older types of NTE from chargeable replacement – implemented in 2010; and

- New Software – guiding engineers through tasks in real time, using new iPhone devices or Windows 8 for laptops – currently being rolled out in 2013/14.

37. All of the changes have been implemented following suggestions from CPs and involved full collaboration with industry to deliver CPs additional benefit. Conversely Openreach observes that TTG's assessment that there has been "*minimal*" TRC innovation over the period could be interpreted as indicating that further development is not "*reasonably necessary*" to the provision of the service. Openreach believes that such an assessment reinforces its argument that there should be commercial incentives to any future product developments for TRCs.

CPs could do more to improve their own diagnostic processes and reduce the need for TRCs

38. The largest proportion (nearly half) of TRCs relate to repair visits requested by CPs where, on arrival, the engineer finds that there is no issue with the Openreach service and no further work is undertaken.

39. This category appears to be the focus of Ofcom's analysis of the competiveness of TRCs and subsequent assessment of the need for regulation. Ofcom states that, "*whether or not TRCs and SFIs are reasonably necessary should not just be based on whether the fault is on or off the Openreach network but whether (from the perspective of purchasing CPs) suppliers of other than BT (via Openreach) can supply equivalent economic TRC services … We have gathered further evidence to understand this, including information on the ordering and diagnostic steps and processes …*[12]"

40. Openreach accepts that CPs can experience difficulty identifying whether a reported issue is on-network or off-network at the point of ordering an engineering visit. In such instances Openreach recognises Ofcom's view there are practical and economic reasons why the CP may choose to order an Openreach engineering visit in preference to using a third party engineer.

41. However, Openreach has sought to reduce the uncertainty for CPs through diagnostic processes as well by giving advice and feedback to CPs, thereby enabling them to reduce their exposure to unnecessary engineering visit call outs and avoiding a TRC being raised altogether. On this basis, Ofcom must take into account the performance of individual CPs in this category of TRCs in order to evaluate the extent to which *repair* journey TRCs are being driven not by Openreach but by CP processes.

42. [✂]

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[11] [✂]

[12] Consultation, paragraph 5.26

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43. Openreach believes a significant reduction on the TRC price as proposed by Ofcom in the Consultation would have the unintended consequence of reducing the commercial incentives for CPs to address these issues. The risk is that CPs bank the short term financial benefit of the proposed regulatory price changes rather than innovating or investing in their own fault handling processes. Such an outcome would not be in the interests of consumers and may actually allow consumer harm to persist. For example if it was just a case of a flat battery then this could be diagnosed and resolved when the incident is first reported to a CP rather than requiring an engineering visit.

44. Figure 1 below shows the percentage of repair visits requested for the largest CPs where the engineer finds the line is right when tested on-site (resulting in a TRC) as a total number of the CP's requested repair visits. [✂]

Figure 1: Percentage of repair visits where the engineer finds the line is RWT on-site as a total number of the CP's requested repair visits

[✂]

45. Figure 2 below shows the percentage of repair visits that could have been resolved at the time the fault was reported by the end user. This is when a customer reports a problem with their line which, rather than being a fault with the Openreach circuit, results from an error in how they are operating their equipment (such as flat batteries). Such conditions can usually be identified by asking a few simple questions during the initial diagnostic process.

Figure 2: Percentage of repair visits that could have been resolved at the time the fault was reported by the end user

[✂]

46. Figure 3 below shows the number of unnecessary repeat call outs as a percentage of all the repeat jobs (within 28 days) and which result in a TRC being raised. [✂]

Figure 3: Number of unnecessary repeat call outs as a percentage of all the repeat jobs (within 28 days) on MPF lines

[✂]

47. [✂]

48. [✂]

Openreach's Proposals

49. Overall Openreach observes that TRCs are used to cover a combination of engineering scenarios where the work is contestable, non-contestable and a combination of both. Notwithstanding the competitive restraints Ofcom has identified on the operation of TRCs (which Openreach accepts arise in certain scenarios) Openreach believes that any regulatory measures Ofcom adopts should reflect the fact that the product is used in both competitive and non-competitive markets.

50. Openreach considers that the current proposals, by seeking to remove <u>all margin</u> above FAC and introducing a charge control are disproportionate. Moreover, there is a risk that the current proposals will have the *de facto* result of extending regulation into new areas and markets beyond the scope of what is "*reasonably necessary*" for the LLU and WLR services. Openreach does not believe that this

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is Ofcom's intention. Openreach suggests that Ofcom could easily remedy this by amending its proposals in one of two ways:

- **Option 1:** by introducing a blended TRC rate which is based on FAC, with the addition of an aggregated margin with future increases subject to charge control. This would provide a commercial incentive for Openreach to maintain pricing parity and continue to provide these services in competitive markets and invest in innovation; or

- **Option 2:** proceeding with the existing proposals for FAC without margin with future increases subject to charge control, but explicitly excluding (a) work beyond the NTE on other parties' wiring and networks, and (b) the development of future value-add services and features (i.e. which are not reasonably necessary), from the scope of the regulation, which would allow Openreach to price such services as the market supported.

51. With regard to Option 1, a simple approach would be to consider the proportion of work that is contestable and allow a margin for that work. For example, a competitive margin could be allowed on a quarter of TRCs. This would be made up of (as per Table 1 above), work beyond the NTE ([✂] of all TRC revenues) and contestable Volume Deals ([✂] of all TRC revenues [13]). Ofcom could assume that [✂] EBIT margin[14] is a reasonable margin in a competitive market. Ofcom should use these figures to calculate a margin of at least 4%. This is Openreach's preferred option, as it has advantages over Option 2, in particular, value added services will be available more widely and therefore more financially viable to launch. In addition there will be a single price for similar services regardless of their use.

Concluding comments

52. Amending the current proposals in line with the options above would mitigate the risks of unintended consequences of regulation. These include weakening incentives to invest in new technologies or systems and de-prioritising certain types of TRC work in the overall operational work stack. Openreach notes that Ofcom places little value in these arguments in paragraphs 5.115 to 5.120 of the Consultation, however Openreach maintains that these are significant risks. If the contractual and commercial drivers on Openreach gave significantly greater weight to non-TRC activities it would be difficult to justify an engineer staying longer at a particular premises to wire an extension socket at the request of the customer when they could have left site and be on their way to the next job. This could lead to end user inconvenience and dissatisfaction if an engineer did not have time to complete such requests. If Openreach were, as a result of regulation, to de-prioritise or withdraw from certain types of TRC work altogether (where the work is competitive) it would have the perverse outcome of reducing consumer choice by removing the option of using a known provider. Consequently Openreach believes that it is ultimately in consumers' interest that the regulatory outcome for TRCs reflects the flexibility suggested by Openreach.

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[13] This is based on an assumption that at least half of volume deals are contestable.

[14] Submitted to Ofcom in response to Ofcom's 11th Section 135 notice.

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> **Question 5.2**: Do you agree with the charge control proposals for SFIs? Please provide reasons in support of your views.

53. Ofcom's 3 July 2013 consultation proposed a basis of charges obligation for TRCs and SFIs alongside a FAC+ approach where "any '+' would not be more than 5%"[15] in respect of TRCs and SFIs provided by Openreach that were "*reasonably necessary*" for LLU and WLR services.

54. The Consultation sets out Ofcom's revised proposals for a charge control on SFIs, so that the hourly charge used to calculate SFI module prices should be aligned with the TRC "Additional Hour" charge, with charges subsequently indexed to +0.2%.

55. Openreach does not agree with Ofcom's charge control proposals for SFIs. Ofcom needs to take account of a number of points detailed below and also consider additional evidence which Openreach believes support modification of Ofcom's proposals.

   - Openreach should be incentivised to innovate and any new developments should not be subject to regulation;

   - Openreach agrees with Ofcom's proposal to align SFI pricing methodology with the TRC "Additional Hour" charge but the entire SFI portfolio could be regarded as a value add service; and

   - some SFI Modules are clearly contestable and CPs have – and exercise – choice in the combination of modules they select when booking an SFI job

Openreach should be incentivised to innovate and any new/value-add developments should not be subject to regulation

56. Openreach welcomes Ofcom's comment in the Consultation document that its proposals are not intended to "undermine incentives to innovate for value-added type services as, to the extent they are not reasonably necessary for the provision of LLU- or WLR-based services, they are not covered by this regulation and as such could be charged for separately if there is a value to the CP."[16] For the avoidance of doubt Openreach requests that Ofcom clarifies that this would apply to any future value-add developments to the existing TRC and SFI products as well as any new services introduced to complement them during the period of the market review.

57. With such new services being beyond the scope of the proposed regulation Openreach should be able to set prices that the market will support. Openreach believes that such clarity would give it the reassurance it needs to make additional investment in developing such value-add features which may include activities such as:

   - [✂]

   - [✂]

   - [✂]

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[15] Ofcom's 3 July 2013 Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30 consultation, paragraph, 12.77

[16] Consultation, paragraph 5.120

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58. Openreach believes such future services and features although they may be attractive to the market go beyond what is "*reasonably necessary*" to provide SFIs. This is because such services and features will not have formed part of the existing products over the last market review period nor were they identified as a "*reasonably necessary*" requirement in any of the stakeholder submissions to this review.

59. We note Ofcom references TTG's claim that "*innovation with respect to TRCs and SFIs has been minimal.*"[17] This is simply incorrect. The following significant developments have been made to the SFI product over the last five years:

   • a modular version of SFI (SFI2) was launched in 2010/11 following requests from industry in order to give them more choice over the engineering activities they authorise; and

   • a change to the Co-op Call module reducing the price to zero was notified in December 2013 (effective 1 April 2014) following a series of industry workshops.

60. These changes have been implemented following suggestions from CPs and involved full collaboration with industry. Conversely Openreach observes that the assessment that there has been minimal SFI innovation over the period can be interpreted as indicating that further development is not "*reasonably necessary*" to the provision of the service. Openreach believes that this reinforces its argument that there should be commercial incentives for any future product developments for SFIs.

Openreach agrees with Ofcom's proposal to align SFI pricing methodology with TRC "Additional Hour" charge but the entire SFI portfolio could be regarded as a value add service

61. Openreach supports Ofcom's comment that "given that the main input into an SFI module appears to be engineering resource, a key driver in SFI module costs would appear to be the time taken for each module to be completed."[18] TRC and SFI prices have historically been reviewed together under the umbrella of "field force products."[19] Accordingly Openreach recognises the logic of Ofcom's proposal to confirm the alignment of SFI module prices to the TRC "Additional Hour" charge notwithstanding the arguments Openreach makes regarding its preference for Ofcom to adopt either:

   • a blended TRC rate including an appropriate margin in recognition of the fact that TRCs are used to cover both contestable and non-contestable activities; or

   • excluding TRCs which cover engineering work beyond the NTE, new product developments and value-add services from the scope of regulation.

62. Openreach observes many of the same arguments also apply to the use of SFI, which can include engineering work both on and off the Openreach network. In addition, CPs can only order (and are only charged for) an SFI product when the line has met the industry agreed SIN 349 standard. To that extent Openreach believes that the entire SFI portfolio could be regarded as a value add service.

63. Openreach provides MPF circuits to the industry agreed SIN 349 standard.[20] SFI was specifically developed for scenarios where SIN 349 is met but where the end user was still experiencing issues with their CP-provided broadband service. SFI offers a per occasion engineering visit to work on any

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[17] Consultation, paragraph 5.17
[18] Consultation, paragraph 5.102
[19] Consultation, paragraph 5.103
[20] Where a line does not meet the SIN 349 standard, Openreach repairs this as an in-tariff fault.

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combination of: the end user's network and equipment, the Openreach network, or in conjunction with the CP to maximise the broadband service.

Some SFI Modules are clearly contestable and CPs have – and exercise – choice in the combination of modules they select when booking an SFI job

64. SFI is split into a series of individual modules covering a range of specified engineering tasks. CPs pre-order these combinations as required. The modules have been designed with input from CPs and the End User Visit SFI modules are listed below with brief descriptions for reference:

Table 4: Description of SFI modules[21]

Product	Description
Base module	This is the compulsory base module which involves the engineer visiting the end-user property to undertake an initial assessment of the cause of the broadband speed problems.
Network module	Involves the engineer investigating and if found, remedying the source of the broadband problems between the exchange and the end-user premise
Frame module	Involves the engineer investigating and if found, remedying the source of the broadband problems on CP equipment at the exchange.
End user wiring	Involves the engineer investigating, and if found, remedying the source of the broadband problem by renewing the internal wiring i.e. between the NTE and point of use only if found faulty.
End user equipment	Involves the engineer performing diagnostic checks on the end user's internal equipment which includes the modem/router.
Co-op module	This is a CP requested module if the engineer will need to liaise with the CP, for example, if re-jumpering is required on CP equipment in the exchange, then allows CP to specify the port to terminate the line. This module is compulsory for SDSL lines.

65. In the case of both the Network and Frames modules, we recognise only Openreach engineers can carry out the work. However, for End User Wiring and Equipment modules any third party engineer could complete the activity. Whilst the Base module includes many tasks that could be carried out by third party engineers, only Openreach engineers can replace the NTE or work on the Openreach network. To assess how often this activity was carried out as part of the Base module tasks Openreach carried out a sample of all the SFI jobs completed on 28 January 2014.[22] By assessing the engineers' checklists and notes for the [✂] jobs Openreach has been able to categorise them into those that required work on the Openreach network and those which did not. The results are shown in table 5 below.

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[21] A full copy of the current SFI2 Product Description with details of the product can be found at www.openreach.co.uk/sfi2productdescription

[22] This date was randomly selected from most recent month for which data was available when the analysis was undertaken.

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Table 5: Sample of SFI module tasks

Category	Combination of Modules	Volume of SFI Jobs	Estimated Revenue
On Network activities E.g. only Openreach engineers could complete these jobs	Base and Network	[✂]	[✂]
	Base and Frames	[✂]	[✂]
	Base, Network and End User Wiring or Equipment	[✂]	[✂]
	Base, Frames and End User Wiring or Equipment	[✂]	[✂]
	Base only (where the activities <u>included</u> work on the Openreach network)	[✂]	[✂]
	Base and End User Wiring or Equipment (where the activities <u>included</u> work on the Openreach network)	[✂]	[✂]
	Subtotal	[✂]	[✂]
Off Network activities E.g. Third party engineers could complete these jobs	Base only (where the activities <u>excluded</u> work on the Openreach network)	[✂]	[✂]
	Base and End User Wiring or Equipment (where the activities <u>excluded</u> work on the Openreach network)	[✂]	[✂]
	Subtotal	[✂]	[✂]
	Total SFI Jobs	[✂]	[✂]

* For End User Wiring and Equipment modules a blended average price has been used.

66. From this analysis Openreach found that around [✂] of the SFI jobs completed on this date could have been carried out by third party engineers. When multiplying the volumes by the module prices to ascertain the revenue value this equated to [✂]. Ofcom must take this evidence into account and revise its statement that "*up to 90% of … SFI revenue may occur on the Openreach network.*"[23]

67. This study also indicated that around half of the Base modules were on-net and half were off-network. Openreach believes that one way of increasing contestability with regard to SFIs could be to split the Base module into two new variants, which demarcate between work on the Openreach network and work that is not. This would do more to provide transparency and facilitate market entry than simply applying charge control regulation to this particular SFI module. [✂]

68. Openreach has also carried out an analysis of the SFI orders received during the week ending 22 November 2013, showing the combinations of modules authorised by each of the major CPs (note that the BT Wholesale data reflects the commercial decisions of a range of downstream CPs). The details are provided in Table 6 below.

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[23] Consultation, paragraph 5.29

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Table 6: Sample of SFI orders which show the Combination of Modules Authorised

CP	Total SFI2 Orders	Combination of Modules Authorised B = Base, N = Network, F = Frames, W = Wiring, E = Equipment			
		5 Modules = B, N, F, W & E	4 Modules = B, N, F, W or E	3 Modules = B, N, F only	2 or 1 Modules inc B & N or F
BT Wholesale	[✂]	[✂]	[✂]	[✂]	[✂]
Sky	[✂]	[✂]	[✂]	[✂]	[✂]
TTG	[✂]	[✂]	[✂]	[✂]	[✂]

69. [✂]

70. This suggests CPs have – and exercise – choice in the combination of modules they select when booking an SFI job. CPs can limit work by Openreach engineers or presumably make alternative arrangements. Openreach therefore concludes that the SFI End User Wiring and Equipment modules are wholly contestable.

Openreach's Proposals

71. Overall Openreach observes that SFIs are used to cover a combination of engineering scenarios where the work is contestable, non-contestable and a combination of both. Notwithstanding the competitive restraints Ofcom has identified on the operation of SFIs (which Openreach accepts arise in certain scenarios) Openreach believes that any regulatory measures Ofcom adopts should reflect the fact that the product is used in both competitive and non-competitive markets.

72. Openreach considers that the current proposals, by seeking to remove all margin above FAC and introducing a charge control are disproportionate. Moreover, there is a risk that the current proposals will have the *de facto* result of extending regulation into new areas and markets beyond the scope of what is "*reasonably necessary*" for the LLU services. Openreach does not believe that this is Ofcom's intention. Openreach suggests that Ofcom could easily remedy this by amending its proposals in one of two ways:

- **Option 1**: by aligning SFI module prices with a TRC "Additional Hour" charge based on a blended TRC rate which includes a small aggregated margin above FAC with future increases subject to charge control; or

- **Option 2:** proceeding with the existing proposals to align SFI module prices with a TRC "Hourly Charge" that is based on FAC without a margin element with future price increases subject to charge control but, in addition to (a) require Openreach to reconfigure the Base module in order to separate out activities which are clearly not Openreach related and could be done by third party engineers into a new on-premises engineering module, (b) exclude the End User Wiring, Equipment and new on-premises engineering modules from the scope of regulation, and (c) exclude the development of future services and features from the scope of the regulation which would allow Openreach to price such services as the market supported.

Concluding comments

73. Amending the current proposals in line with the options above would mitigate the risks of unintended consequences of regulation. These include weakening the incentives to invest in new technologies or systems and de-prioritising certain types of SFI in the overall operational work stack. Openreach

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notes that Ofcom places little value in these arguments in paragraphs 5.115 to 5.120 of the Consultation, however Openreach maintains that these are significant risks. As SFIs have no associated service level agreements and are ordered on lines that already meet the industry agreed SIN 349 standard, the contractual and commercial drivers on Openreach would warrant de-prioritising certain SFIs in favour of other job types. This would have the consequence of leading to longer lead times which could cause customer dissatisfaction. Similarly recognising that the SFI portfolio was itself developed to meet new technology and emerging usage trends (i.e. the increasing use of copper lines to support broadband rather than voice only services) Openreach believes that a restrictive regulatory regime that does not sufficiently incentivise innovation could quickly lead to moribund products. This would be to the detriment of the market which is fast moving, not least in terms of customer expectation. Consequently Openreach believes that it is ultimately in consumers' interest that the regulatory outcome for SFIs reflects the flexibility suggested by Openreach.

Question 5.3: Do you agree with our proposed approach to cost accounting for TRCs and SFIs? Please provide reasons in support of your views.

74. Openreach agrees that revenue reporting for compliance purposes may be required but disagrees that detailed cost reporting is required or proportionate. In the Consultation, Ofcom makes two proposals covering the management accounts and the RFS. In the event that Ofcom insists upon this level of reporting, Openreach requests further clarification regarding what information is required from management accounts and what information is required from the RFS.

Ofcom's Proposal for using Management accounts

75. Regarding using Management accounts, Ofcom proposes the following:

> *"the proposed charge controls for TRCs have been set on the basis of a range of estimates of cost (relative to prices), including Direct Labour Costs uplifted by an estimated percentage for indirect costs, with indexation for the review period. The prices for SFIs, as also set out above, are proposed to be aligned with TRC charges, e.g. based on the hourly TRC charge applied to the estimated time taken to complete an average module. For the purposes of monitoring the effectiveness of our remedy, we propose that BT must continue to provide to us the direct and indirect volume, revenue and cost information requested by us and supplied to us in the course of this consultation as set out in Annex 6 under the "Management Accounts information" tab. A subset of this information will be published in order to provide stakeholders with reassurance about compliance with our proposed charge control proposals for TRCs and SFIs and information to make better informed contributions to the development of the regulatory framework."[24]*

76. By this, we understand that Ofcom requires from BT's management accounts:

- TRC Reporting

    o Split of TRC hours into Normal, Other and Sunday hours.

    o A categorisation of BT's direct labour costs on a per hour basis.

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[24] Consultation, paragraph 5.137

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- SFI Reporting

    o Details of volumes, hours (on job and travel) and cost per module.

- Overheads

    o Overheads associated with SFI and TRCs.

77. Openreach understands that for compliance reporting, we need to provide Ofcom with price, volume and revenue schedules that demonstrate our compliance with the basket control. It is not immediately clear to Openreach that the schedules provided in Annex 6 of the Consultation are in a format that clearly demonstrates compliance. Openreach would welcome dialogue with Ofcom to enable it to develop a simpler set of schedules that would demonstrate basket compliance effectively.

78. It is unclear why Ofcom needs ongoing cost reporting at a granular level for the purposes of "monitoring the effectiveness of our remedy". Ofcom has proposed a remedy of price controls. Openreach will demonstrate compliance with the price control, however, it is not clear why Ofcom need the cost schedules, nor what Ofcom would do with such schedules. The charge controls will not be re-set annually, so, Openreach proposes that the cost schedules are not required.

79. Should Ofcom insist that such schedules are produced, Ofcom should note that the overhead cost will be produced almost entirely from the RFS and not from the management accounts as proposed by Ofcom. This is because the relevant information is sourced from RFS (as noted by Ofcom in row 24).

Ofcom's Proposal for using the RFS

80. Regarding using the RFS, Ofcom proposes the following:

> *"As we have not been able to set TRC and SFI charges on the explicit basis of actual FAC, due to the data concerns and lack of information available to us in the required timescale, we therefore propose that BT should provide us with the information set out in Annex 6 under the "FAC RFS information" tab. This information will not be published in the context of Regulatory Financial Reporting."*[25]

81. By this Openreach understands that Ofcom needs Openreach to produce as part of the RFS process, but not to publish:

- TRC reporting:

    o Billed and Worked hours

    o Total Revenues, splitting out stores

    o FAC costs split into labour, overheads, depreciation, ROCE and showing mean capital employed.

- SFI Reporting

    o Billed and worked volumes (we understand that this would be hours)

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[25] Consultation, paragraph 5.138.

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- o Revenues split by module

- o FAC costs split into labour, overheads, depreciation, ROCE and showing mean capital employed.

- o Total FAC costs split by module

82. As noted above, Openreach does not see the need for these cost schedules to be produced. It is not clear as to why Ofcom needs these schedules nor to what use Ofcom will put them. In the event that Ofcom considers these schedules are required, we set below our interpretation of their requirements:

- The TRC hours and revenues exclude volume deals.

- The overhead cost would be calculated as the overhead "uplift" rate calculated in the "Overheads combined" tab multiplied by the total direct costs in the "TRC reporting" tab.

- Depreciation cost is embedded in the direct labour cost and overhead cost, therefore we would propose to not show this separately. Splitting this out would cause unnecessary complexity.

- The mean capital employed and ROCE would also be sourced from the RFS. Openreach proposes adding this to the "Overheads combined" tab.

- Openreach do not intend for the RFS to model each SFI module separately, but to use the hours information to attribute the total FAC cost by product.

- This is annual requirement.

83. We agree with Ofcom's proposal that the above information is not published. The details of the precise make-up of our SFI and TRC cost structure is commercially and competitively sensitive.

84. In summary, Ofcom should replace the requirement for detailed cost and revenue reporting with a schedule requiring only the information necessary to comply with the legal instrument as currently drafted. In the case that Ofcom still considers such reporting is required, then Ofcom should take on board Openreach's comments above.

Ofcom need to correct a potential error in their calculation of the uplift

85. Openreach notes that Ofcom has uplifted the hourly rates by 48% for overhead costs. This is too low and should be 67%.

86. The 48% uplift for overheads is less than the 51% overhead rate that Openreach provided based upon the 2012/13 RFS. Ofcom has stated that it intends to use the 2012/13 RFS costs but using 2011/12 methodologies, and has used a revised figure of 48% based upon its analysis using the "Report Requested by Ofcom on the year ended 31 March 2013". It is unclear how Ofcom has arrived at this figure.

87. Regardless of this, Openreach considers that the correct uplift for overhead costs is 67%. This has been calculated based on the regulatory costing system 'run' used to prepare the October Report, which presents the 2012/13 RFS costs using the 2011/12 cost allocation methodologies. Accordingly, the uplift of 67% would be consistent with the other cost data that Ofcom proposes to use for the purposes of the FAMR and LLU/WLR Charge Control.