



Vodafone

22nd May 2017

Response to Ofcom's Consultation: Non Domestic Rates and the price for regulated Dark Fibre
Non Confidential



Introduction

1. It is now only four months until the launch of the dark fibre product. It is essential that in this final period that there is clarity and certainty regarding the pricing of the product. We therefore seek a rapid conclusion to this pricing revision.
2. The consultation sets out to modify the product pricing as required by the CMA determination. We consider that a balance needs to be struck between achieving the correct price and concluding this consultation with adequate speed. Ofcom's proposal overall meets that challenge.
3. Ofcom has come to a provisional conclusion using a number of assumptions due to the lack of available factual evidence. When Ofcom comes to review this decision in the next BCMR we propose that Ofcom uses the new factual evidence that can be collected once the product is in use.



Consultation question

4. In its consultation, Ofcom has asked the following question:

Do you agree with our proposal for the adjustment of the price of dark fibre to take into account the NDRs paid by CPs and our assessment of its impact on the costs and benefits of dark fibre? If not please set out your reasoning, including supporting evidence and explain i) how Ofcom should approach making the adjustment to the price of dark fibre in a manner that takes into account the determination and ii) how that alternative approach would impact on costs and benefits of dark fibre.

5. As directed by the CMA, Ofcom proposes to calculate the new formula for the deduction of NDRs from the DFA pricing. That formula contains four key decisions which we comment on below. We do not expect Ofcom to change the current proposals extensively. We make these observations primarily to aid Ofcom in the next BCMR market review.

CP scale

6. The actual NDRs payable by individual CPs differ depending upon the level of infrastructure that each CP operates. Ofcom proposes to assume an average level of NDRs that apply to all CPs with reference to the NDRs payable by a CP operating an existing dark fibre network with a total contiguous length of 1,000km or more. Ofcom then sets the adjustment to prices for DFA LA and the main links per metre on this basis.
7. In its final determination, the CMA indicated that it was open to Ofcom to make a range of different NDR assumptions because NDRs vary according to the scale of a CP's infrastructure. Four alternative sets of assumptions were proposed during the CMA process. Ofcom selected the assumption that CPs have a contiguous network of 1,000km or more. This suggests that Ofcom considers that several potential users of the dark fibre services:
- a) already have fibre networks of over 1,000km, or
 - b) are currently purchasing large volumes of active products from BT that could be migrated to dark fibre in the future.

However, it is not clear from Ofcom's analysis:



- a) what the split is of CPs (1) that currently have dark fibre networks of over 1,000km and (2) that currently do not, but that may acquire a dark fibre network of over 1,000km by migrating their active products to dark fibre in the future,
 - b) the proportion of CPs falling into categories (1) and (2) respectively,
 - c) how Ofcom expects large purchasers of active products to become large purchasers of DFA while migration caps are in place to prevent this, and
 - d) the relationship between active purchasing and NDRs overall.
8. The very real risk raised by the Talk Talk appeal is that inadequate consideration by Ofcom of the actual NDRs payable by CPs will reduce the number of active services that can be substituted by DFA.
 9. Ofcom's choice of an NDR level will in turn impact on Ofcom's assumptions about the take up of DFA. In its final determination, the CMA estimates that an inappropriate choice by Ofcom could lead to as little as 50% of new circuits being contestable via DFA, as opposed to the 95% assumed by Ofcom after it resets NDRs to an average CP level.
 10. During the next BCMR process we would hope to participate in a full and transparent debate about these issues.

Ofcom uses the rating multiplier of England

11. The UK has differing rates multipliers, with the multiplier for England being 2 pence below Wales, and 1.3 pence below Scotland.
12. Ofcom then concludes that 88% of BT's rateable value is in England. This then sets the basis for the decision about other CPs purchase patterns.
13. It is not clear why an average is preferred to the lowest possible value.
14. We also consider the rate should be modified during the lifetime of the product as the UBR rates are updated.



Ofcom proposes to use an average circuit length of 1.9km to calculate a standard NDR rate for the retail minus pricing calculation for DFA.

15. Ofcom wishes to keep the pricing aligned between EAD LA and DFA LA. To achieve this Ofcom considers that a single constant differential is necessary as opposed to a differential that takes account of the exact NDR payable.
16. Ofcom should mandate Openreach to collect a dataset of fibre distances for all dark fibre circuits that it sells in order to inform the next BCMR.

Ofcom proposes to use 1.4 as the radial to actual route conversion factor.

17. During the course of the CMA proceedings a radial to route factor of 1.4 was used. It is not clear if this number was ever verified. The 1.4 factor should be scrutinised as part of the next BCMR.
18. Our review shows that 1.4 is significantly lower than the radial to route factors that Openreach quoted us for circuit installations in 2013. We include a confidential annex showing this data. Our data shows a wide variation with (1) short distances akin to DFA LA having route factors of up to x , with an average of x , and (2) longer distance routes such as circuits including main link beyond 15km having route factors from $1.x$ to $1.x$.
19. When a CP orders a dark fibre circuit, Openreach will inform the CP of the exact route and length of the circuit – so as to allow the CP to install the correct active equipment appropriate to the length of the fibre.
20. Ofcom does not propose to use a route factor for the main link distance as it is assumed that the route and radial distance will be straight. Vodafone disagrees with this approach. We consider that the route factor rate is relevant to the per metre charges for main links. Our findings show that a route factor of $1.x$ to $1.x$ is appropriate for longer length circuits which would attract main link charges.
21. In order to inform the next BCMR, Ofcom should mandate Openreach to collect a dataset of main links sold, specifying the actual route length in metres so that we can in future determine based on evidence the radial to route conversion that apply to DFA LA circuits and DFA non LA.

Recovery of the efficiently incurred cost



22. Vodafone understands that after the CMA's decision Ofcom considered whether it was appropriate to adjust the leased line charge control to account for the risk that their proposed adjustment to the calculation of dark fibre charges could pose on BT's ability to recover its efficiently incurred costs.
23. Vodafone considers it appropriate when considering BT's ability to recover its efficiently incurred costs to consider this issue in context and not in isolation. BT reported in its 2016 RFS¹ that it earned returns in the regulated business connectivity market in excess of 23%. In the current market review, Ofcom highlighted BT's excessive profits in business connectivity markets in the prior review period. In order to curtail BT's high profits, and for the first time, Ofcom sought to implement a starting adjustment.
24. Whilst Vodafone understands that Ofcom wish to propose a focussed and proportionate approach to any adjustment to the LLCC, we still consider it appropriate for Ofcom to consider the wider environment. Ofcom is proposing to make an adjustment due to the potential risk that BT will not recover £5 million of incurred costs. However, this represents less than 2% of the £303 million excessive profits (i.e. profits above the benchmark WACC) that BT made in 2016 in business connectivity markets.² In this context the LLCC change is unwarranted.

¹ BT 2016 regulated financial statements;

<http://btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2016/index.htm>

² Frontier Report: <https://mediacentre.vodafone.co.uk/pressrelease/planned-reforms-openreach-required-new-report-highlights-bt-excess-profits-increased/>