Vodafone

September 2017

Response to Openreach's Consultation:
WLA Market Review
Consultation on pricing proposals for duct and pole access remedies

Executive Summary

Passive Infrastructure Access (PIA), or Duct and Pole Access (DPA) has been central to Ofcom's strategy to promote fibre investment for the last two years. To achieve a full fibre future, a Gigabit Society, a Digital Britain or even broadband speed that exceed 10Mb/s we have to unleash the investment and ambition of the telecommunications market as a whole. Effective DPA will enable CPs to take investment in their own hands and build fibre broadband networks.

We applaud Ofcom's tenacity in its efforts to deliver effective DPA. DPA is complex and very different to other regulatory remedies. It could enable the changes the market needs to allow investment to flourish. This consultation proposes a number of pricing proposals that would reduce the ongoing unit cost of some DPA charges and remove the requirement for CPs to bear entirely the cost of upfront network change works. For DPA to deliver the benefits it could provide for the UK economy and consumers the product must have an effective process that meets the needs of a scale network build and must be appropriately priced. Ofcom must ensure the avoidance of multiple build engagement hand offs that reduce operational efficiency, and multiple individual, unpredictable charges for ordinary run of the mill work, all of which will rack up costs and will result in the failure of FTTP deployment in the UK.

Vodafone has demonstrated its commitment to build FTTP networks across its operating territories: to date we cover over six million premises across Europe with further investment in Germany announced only last week. The FTTP networks have been achieved via a pragmatic mixture of commercial approaches, from an 'anchor tenant' arrangement to founding a wholesale-only joint venture, from self-build to commercial reciprocal arrangements.

Ofcom has set out its ambition for there to be three fibre networks covering 40% of the UK. The duct and pole access product proposals that Ofcom is presently consulting upon are an important element. In particular, Ofcom rightly identifies that costs associated with maintenance of BT's ducts to enable them to be ready and capable for use by 3rd parties should be borne by BT. This is an extremely positive proposal. For these proposals to have maximum efficacy, the work must be able to be undertaken by CPs, in order that operational efficiency is maintained.

Introduction

Over the coming market review period to mid 2021, Ofcom anticipates the take up of the DPA product will result in up to 1.5M homes being passed by fibre networks.

Providers wanting to invest in DPA will have sought to achieve a base of very high bandwidth broadband customers to migrate over to the new DPA-based networks. Consequently, market shares over the immediate term at the retail level (using Openreach wholesale inputs) of the very high bandwidth customers will be key to determining the speed of competing network rollout assuming those will sufficient customers will see the benefits of transitioning customers from Openreach wholesale services to their own networks.

In addition to the practicalities of securing a customer base to migrate to a new network there are further obstacles that need to be resolved for the UK to have the environment to support wide ranging investment. Effective Duct and Pole access is necessary but not sufficient to facilitate a business case, priority must also be given to:

- Ensuring that Openreach's separation from BT facilitates the desired independence. Regulation cannot force Openreach to treat customers appropriately, but we would hope that its new governance arrangements would help achieve this.
- Ensuring that Openreach's reaction to the new network build such as pricing and overbuild are appropriately regulated.
- Addressing BT's profits in regulated markets. The extremely high profitability in SMP markets continues and presently stands at £10.5Bn in the past 12 years.
- Ensuring customer switching processes allow consumers to exercise their choice in an efficient fashion. The current proposals for the WLA regulation of superfast broadband fail to do this.

However, these Duct and Pole Access proposals are a welcome step forward to enabling a fibre future.

The Proposed PIA Charge Control

Question 3.1 Do you agree with our proposals for setting the level of the cap on PIA rental charges? Please provide reasons and evidence in support of your views.

Vodafone agrees very strongly with Ofcom's view that without some form of price regulation there is a serious risk that BT would distort prices by maintaining its PIA pricing at excessively high levels. This would have serious consequences for the uptake of the PIA product and in turn for the communications industry. However, Vodafone considers that Ofcom's current pricing proposal is not robust and does not provide the required level of transparency. Put very simply, Ofcom has taken BT's existing historic PIA costing methodology created by BT and made high level adjustments without reviewing the granular cost stack, or the impact on total duct cost recovery.

Taking each element of the cost stack below we will provide comments on the adjustments Ofcom has made to BT's methodology for pricing duct access. However it is important to highlight Ofcom's summary statement from this consultation:[1]

"We explained that it is not currently practicable to apply a price cap based on BT's fully allocated costs (as we do in some other charge controls) as the necessary cost data is not reported to the required level of granularity in BT's accounting systems. We considered a number of approaches to providing more certainty about PIA pricing, and provisionally concluded that imposing a cap on rental charges based on the current methodology would be an appropriate approach in this review period. In particular, this would be an effective and pragmatic means of providing certainty to investors over the market review period and would result in PIA rental charges being at a level which should avoid undermining network investment."

Setting prices based on a methodology that has been constructed by the regulated organisation inherently includes risks. It is within BT's interest to maintain high rental charges in order to discourage the use of PIA, and BT's methodology will be constructed in order that the calculated charges are as high as reasonably possible, this is because BT is a commercial organisation that has a duty to its shareholders to maximize profits. Vodafone does agree that versus the counterfactual of not setting a price cap, setting a pricing cap does provide some level of certainty, but nevertheless the approach could still result in inflated price due to the methodological choices by the regulated entity.

[1] The consultation, paragraph 3.4

Vodafone does not support price regulation that has been based on a methodology that is constructed by the organisations that is being price regulated; our preferred approach is for Ofcom to base charges on a cost model that includes audited transparent data. Whilst Vodafone understands the difficulty in currently building such a model for PIA due to the paucity of data in the regulated accounts, considering PIA has been available for over 5 years as a regulated product we consider it unacceptable that there is little transparency and understanding of BT's product cost stack.

It is understood by Vodafone from the consultation[2] that the costs associated with producing the rental charge are largely driven by the asset component costs, because productisation costs are widely spread over all infrastructure users, and the network adjustment costs are spread over 40 years. With this in mind as mentioned above it is unfortunate that BT does not report in the regulated accounts to a level of detail that would enable transparent and clear methodological costing of the underlying PIA asset costs.

Due to the approach undertaken we consider that the proposed rental cap results in a service cap which is being set too high.

Asset costs

Vodafone understands that the main source of Ofcom's asset cost information for the PIA products is a regulatory financial reporting (RFS) sub-system. Presumably this sub-system then feeds the full costs of ducts into the regulatory accounting system and allocated the entirety of the duct asset costs to active products and services.

Therefore if PIA volumes grow, under the current methodology BT will over-recover their duct (or to put it another way, underlying PIA product) costs. Unless adjustments are made to the recovery of duct costs from active and other BT products. Historically duct costs have been completely recovered from all the active products within the RFS, we understand that Ofcom is proposing to make a temporary adjustment to the WLA charge control to deduct PIA revenues to avoid double counting but this is a 'work-around' that needs to be monitored and revised in the future. We will expand further on these issues in our answer to question 5.1.

We also understand that Ofcom has added additional costs into BT's costing methodology that BT did not see fit to add. Ofcom has added indirectly attributed overheads into BT's cost stack; Ofcom explain that this is because it is more consistent to do so and thus creates a level playing field between Openreach and other telecoms providers. Vodafone does not understand or agree with Ofcom's rational, Openreach themselves do not and will not consume PIA products on an equivalence of input basis, so Vodafone finds it contradictory

[2] The consultation figure 3.2

that Ofcom should make rental price increases to ensure consistency that will, even in the long term never exist.

Vodafone observes that the calculation of the rental price is also highly dependent on the assumption used for the available number of sub-ducts and the share of the regulatory asset base that PIA rental charges receive. These assumptions seem to be based on very little actual evidence. In the consultation[3] Ofcom provides an example of how the cost per metre is calculated, an assumption of 2.5 sub-ducts of 25mm are used to produce a cost per metre of £0.40. However, if the number of sub-ducts were increased by 1 then the asset costs per metre would reduce by 30%, likewise if the size of the sub-ducts was reduced by 50% then the asset cost per metre would reduce by 50%. When the calculated level of a pricing cap is highly dependent on input assumptions those input assumptions require to be detailed and evidence based.

Network adjustment

Ofcom has increased the network duct asset costs to take account of network adjustment work that BT may have to carry out to enable other telecoms providers to roll-out their network. Ofcom have estimated that the work BT is required to carry out for other operators will cost £134million and will enable them to pass 1.5 million premises. Although annually this does not increase the rental charge significantly as the costs are spread over 40 years, this is another costing assumption that is subject to a wide range of actual outcomes and as such should at least be closely monitored and reported on in the regulated accounts.

Productisation costs

Vodafone understands that one of the main changes Ofcom is proposing to BT's PIA costing methodology is that PIA productisation costs are recovered from all infrastructure users and not just users of PIA. Ofcom also proposes to ensure that these costs are not over recovered by netting out in the WLA charge control PIA revenues.

Vodafone agrees with this recovery of productisation costs, it ensures that the development costs are recovered in a way that will encourage the use of PIA, and by forecasting and also including PIA revenues in the WLA charge control will ensure no over-recovery of productisation costs.

[3] The consultation footnote 42

Question 4.1: Do you agree with our proposals for setting a financial limit for network adjustments? Please provide reasons and evidence in support of your views.

Question 4.2 Do you agree with our proposals for ancillary charges? Please provide reasons and evidence in support of your views.

Situation today

Openreach's current PIA price list requires CPs to pay for network enablement activities such as: the repair of Openreach's duct; the enlargement of Openreach's facilities; and the creation of new Openreach facilities. These works make Openreach's network properly usable or increase capacity in order for Openreach to rent the request space necessary for CP's the new network. The key points of this is that: the network is fully owned by Openreach; and should be appropriately maintained and repaired by Openreach; and that Openreach receives rental for the subsequent use of the network by a range of SMP and non SMP services.

The manner in which the costs of these "enablement" activities are passed onto CPs raises a number of issues.

Duct blockages and collapse repairs are duct maintenance activities

Presently, and we understand under the new proposals, CPs are required to pay for Openreach's duct maintenance as CPs bear the cost of clearing duct blockages and repairing duct collapses that are identified on the route of their network build. Today the CP is charged directly for these network repairs and in the future the proposal is for these costs to form a proportion of the inclusive amount for network adjustments a route may require per KM.

If CPs were not deploying network, Openreach itself would have to incur these costs as collapses become service effecting and blockages are revealed when Openreach installs new services of its own (its own NGA or other regulated and unregulated active services). The repair of duct is a necessary activity to maintain the passive network and ensuring that the quality of service of downstream service is protected at the passive layer by adequately maintaining and protecting the duct facilities. For example, more than 100 man days of work has been carried out on de-silting the duct serving the Farley exchange alone[4].

These costs are clearly relevant to all services provided from the Farley location.

We believe that these maintenance costs should be categorized as general network maintenance cost and recovered across all services reliant upon the duct facilities. In order to facilitate an efficient network rollout, we propose that CPs are able to remedy duct blockages and collapses when they are encountered and recharge Openreach for the works in line with the Openreach price list.

[4] http://www.ispreview.co.uk/index.php/2015/01/blocked-cable-ducts-frustrate-bt-fibre-optic-rollout-rural-wiltshire.html

Enlargement of facilities, creation of new facilities to support duct usage

CPs are required to pay Openreach when it is necessary to create additional network chambers and footway boxes to house cable and equipment. CPs additionally pay rental to utilise this space chamber and footway boxes. Presently the first CP that requires the chamber or footway box facility pays the full cost of it.

Ofcom proposes that these costs are covered within in an inclusive allowance per KM of build. We agree with this approach in general but it is not clear if again the first CP will be responsible for the recovery of the costs (even if they fall in the inclusive amount) in particular when it is likely the new / enlarged facility can be used by additional parties in the future. The allocation of the costs should be proportionate to the likely future usage.

As a general rule where they facilities are required within the local access network these costs should be included.

Build of new duct

Where there is insufficient duct to house the requesting party, new duct may need to be provided by the CP to overcome the impasse. We understand that Ofcom's policy proposal are that for short distances this is undertaken by Openreach or the CP but that costs are paid by Openreach. The exact circumstances are not fully defined.

We consider that Openreach should be responsible for the costs of all duct that can be reasonably reused by Openreach for other CPs and its own NGA rollout or other active services either regulated or unregulated.

We cannot identify locations (which should be serviced by underground cable) for which duct would be required within the local access network which do not already exist or are not likely to be of future use to Openreach.

Business case implications

Ofcom is right to identify that the current approach to upfront costs present serious issues for a network build business case. Today the upfront network rollout costs that might be incurred are entirely based upon luck and the timing of the build. This taken together with the lack detailed on the health of the network and evolving information concerning the occupancy status of duct routes creates substantial business case risk.

Vodafone has previously[5] indicated to Ofcom the impact of the variable assumption for upfront costs for a business case, whereby the proportion of duct/pole that can be reused has a significant impact on the scale of the total costs incurred. At present potential builders lack the detailed knowledge of how much they can

[5] Meeting between Vodafone and Ofcom 16th June 2016

rely on the availability of BT's ducts/poles to be used to build their network or the costs associated with readying BT's ducts/poles for use.

Using Vodafone modeling assumptions, CONFIDENTIAL.

It is our understanding that the proposals that Ofcom are making and intend to make remove the business case ambiguity around the capability and cost to use BT's duct/pole facilities in the local access area. The intention is that BT's duct/pole will be available in almost all required situations thereby propelling the business case assumption to include a more universal use of BT's existing duct and capacity enlarged duct (where it is required to augment a CP's existing network).

Ofcom proposals

Ofcom makes a number of important pricing proposals to improve the usability of the BT duct network and the related cost recovery for those works.

Providing BT with cost certainty

Ofcom seeks to assist BT with its budgeting of the cost of network changes required to make the duct/pole facilities fully enabled for CP/BT usage. During the setting of the cost base for the rental charges Ofcom calculates the network adjustment costs to be in the range of £73 to £105 per premise passed (with £89 being the mid-point average) of network adjustment costs which in the context of 1.5M homes passed results in £134M of costs. Once depreciated over a 40-year life Ofcom determines that £7M of costs should be recovered annually from all WLA infrastructure users. Notably £134M has been allocated for recovery across all WLA products. Ofcom then seeks to establish a rule base to confine CPs from requesting network enablement that in total results in costs in excess of £134M. This approach is in error as it includes the general network maintenance activity range (that should fall to all products not just WLA or regulated services) and because it reintroduces the luck lottery of network build costs.

We consider that a proportion of the network enablement activity that Ofcom includes is more appropriately handled under BT's general network maintenance budget. Where ducts are blocked or collapsed and where poles require stabilisation or repair to ensure they are safe to climb and maintain, these activities ensure the ability for BT to effectively manage its facilities and reduce repair time to service faults on these parts of the network. Ultimately BT would eventually have to attend to the deficiencies identified. The rollout of new CP infrastructure utilising these facilities do not create the network failures but simply identify them and require resolution earlier than BT itself may identify or seek to resolve them.

There is a second group of costs which does require additional investment by BT to increase chamber, footway and carriage way facilities. These new costs may be utilised by a number of parties and therefore the costs should be appropriately divided to ensure that the first party does not bear all of the costs. These new facilities will also be rented out providing another means of cost recovery. It is our view that in the local access network BT should be responsible for the costs of enabling its network to provide the facilities that its asset base is designed to provide and that BT will be subsequently receiving rent for.

Vodafone does not share Ofcom's concerns that efficient network planning cannot be agreed with Openreach which will only result in the necessary network augmentation. We recognize that costs incurred will ultimately be required to be recovered by service rental prices and this will ensure efficient decisions are made.

Review of the level of the charges

It is our understanding that Ofcom has not during this exercise ascertained whether the ancillary charges themselves are set at an appropriate cost orientated level. It is necessary to undertake that task.

Categorization of existing ancillary charges

Ofcom has transferred the following BT ancillary charges to the category of pre ordering costs which instead of being recovered upfront per user are recovered in the generality of the product costs under the rental charges. We agree with this approach.

Ancillary charge	Proposed per user upfront charge
Route plan provision	0
Technical survey (survey, approval, build) per hour	0
Overhead network data report for established PIA CPs	0
Network records admin	0
Join box breakthrough admin	0

Conclusions

Ofcom's pricing proposals for network enablement services are important to improving the effectiveness of the remedy and removing business case doubt. Our understanding is that duct and pole facilities can now be assumed to be available in almost 100% of cases where it is required with some £134m of the costs necessarily

incurred over the coming years to make more of BT's duct and pole network reusable being recovered by the PIA rental charges and WLA services rental charges.

We consider that the proportion of costs allocated to resolving duct blockages and collapses should in fact be allocated to network maintenance costs of a wider product set including PIA, WLA and other regulated and unregulated services. The development of the PIA remedy should not become a disincentive for BT to proactively maintain its duct facilities loading the cost and project time onto builders of NGA services.

We consider that Ofcom should abandon the inclusive allowance limits (which it does not believe would be generally breached) to remove the element of cost luck for network builders and ensure that first and subsequent builders are treated equally.

Question 5.1 Do you agree with our proposals for BT's regulatory financial reporting in relation to PIA services? Please provide reasons and evidence in support of your views.

Vodafone supports Ofcom's proposals in respect of the additional regulatory reporting that is necessary to ensure additional PIA costs that BT incur are accurately reported and recovered, however the largest element of the rental charge[6] is actually the underlying duct asset cost.

Using the 2017 regulated financial accounts[7] the total regulatory asset value for duct access is shown as £5.1bn, of which £3.7bn is allocated to fixed access markets. The payment of PIA rental charges by Vodafone and other telecoms providers will contribute to the recovery of depreciation relating to the underlying £5.1bn duct access asset. However, because at present no FAC information exists for PIA services how will Ofcom ensure transparency for the allocation of the regulatory duct access asset to products and services?

Due to the size and significance of the duct access asset BT should be required to produce an annex to the regulated accounts that clearly and transparently shows how duct costs are recovered across all of BT's products and services. This would show what percentage of total duct access costs are recovered from the PIA product and also ensure that BT does not over recover the asset across all of its regulated and non-regulated services.

[6] The consultation figure 3.4
[7] Annex 10.2.1 http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2017/index.htm