Verizon Enterprise Solutions response to Ofcom's Fixed Access MR: Approach to setting LLU & WLR Charge Controls consultation

1. Verizon Enterprise Solutions ("Verizon") welcomes the opportunity to respond to Ofcom's Fixed Access Market Review: Approach to setting LLU and WLR Charge Controls consultation.

2. Verizon is the global IT solutions partner to business and government. As part of Verizon Communications – a company with nearly $108 billion in annual revenue – Verizon serves 98 per cent of the Fortune 500. Verizon caters to large and medium business and government agencies and is connecting systems, machines, ideas and people around the world for altogether better outcomes.

3. Verizon is not an LLU player and therefore only focuses upon matters related to the WLR charge control. Accordingly, our approach to responding to this consultation has been to set out our overall position in relation to Ofcom's proposals for the WLR charge control in a summary, focusing mainly on those key issues where we have concerns with Ofcom's proposals as set out in the consultation document. We then move on to address the specific WLR related questions raised by Ofcom.

4. Please note the views expressed in this response are specific to the UK market environment and regulatory regime and should not be taken as expressing Verizon's views in other jurisdictions where the regulatory and market environments could differ from that in the UK.

Summary

5. In general, Verizon is in overall agreement with Ofcom's analysis of the markets under review and that a charge control is an appropriate remedy for WLR. Such a remedy is needed to ensure competitive conditions are maintained and constrain the SMP provider's ability to adversely distort prices to its benefit and the detriment of competition and consumers.
6. Verizon also supports Ofcom's proposal to index the charge controls to the Consumer Prices Index (CPI), rather than the Retail Prices Index (RPI) which was utilised previously. This is consistent with our view expressed in our response to the BCMR consultation in 2012, although on that occasion Ofcom decided against changing the indexing approach for that market.
7. However, Verizon has concerns with the level of the proposed charge controls as well as the proposal to implement a glide path to reduce prices, considering that a one off price change at the start of the charge control period would be more appropriate.

8. The remainder of this response addresses the specific questions posed by Ofcom in the consultation document. Again, Verizon only offers a response to those questions which relate in any way to WLR.

Economic and regulatory background to the setting of cost-based charges for LLU and WLR

Question 3.1: *Do you agree with our proposal to impose an inflation indexed price cap? Please provide reasons to support your views.*

9. Verizon does agree with Ofcom's proposal to set an inflation indexed price cap. As Ofcom' notes, such an approach is well understood by industry and does not suffer from the potential downside of alternatives such as retail minus, which given the market dynamics could result in prices being set above the competitive level. Ofcom's proposed approach is, accordingly, considered to be the most appropriate for this market.

Question 3.2: *Do you agree with Ofcom's proposal to use a CCA FAC methodology to establish the cost base for the next LLU and WLR charge controls? Please provide reasons to support your views.*

10. Verizon agrees that a CCA FAC approach is appropriate for determining the next WLR charge control. Nothing in this market has materially changed since the last review, or indeed is likely to change during the period covered by this charge control, and therefore the proposed methodology, which rolls forward the previous approach, seems sensible and logical.

Question 3.3: *Do you agree with our proposal that, for the purposes of these charge controls, BT's pre-1997 duct assets should continue to be valued on an indexed historic cost (RAV) basis? Please provide reasons to support your views.*

11. Verizon agrees with Ofcom's proposals on this matter. Continuing to value BT's pre 1997 duct assets on this basis is necessary to prevent BT from over-recovering its costs. Such an approach is fair to BT in that it can recover the sunk costs of duct but at the same time preventing over-recovery which would be detrimental to competition due to higher than appropriate costs.

Question 3.4: *Do you agree with our proposal that, for the purposes of these charge controls, BT's post-1997 duct assets should be valued on a CCA basis based on capital expenditure indexed by RPI? Please provide reasons to support your views.*

12. On balance, Verizon considers that Ofcom's proposal to value the post 1997 duct assets on a CCA basis on capital expenditure indexed by RPI to be acceptable. As Ofcom noted, alternative industry specific price indices have inherent disadvantages, such as volatility, and that sticking with the tried and tested RPI alleviates concerns over fluctuating duct valuations.

13. There is a further advantage in that RPI is a well-recognised index that is used by other regulators for indexed valuations and price regulation calculations and therefore brings a degree of continuity/certainty.

Question 3.5: *Do respondents agree with our proposal to apply the anchor pricing principle by means of a model of hypothetical all-copper network? Please provide reasons to support your views.*

14. Verizon agrees with Ofcom's proposal to apply the anchor pricing principle by means of a model of hypothetical all-copper network. In our view the adoption of such a model offers the greatest chance of arriving at a reliable outcome and is certainly preferred over the alternative MEA approach in the prevailing market situation.

Question 3.6: *Do respondents agree with our proposal that the contribution to common costs should be the same for each wholesale access line service by the end of this control period? Please provide reasons to support your views.*

15. In principle, Verizon holds the view that common costs should only be allocated, and at an appropriate proportion, to a service to which they actually apply. Therefore a blanket approach, generally, would not be supported.
16. However, given Ofcom's view that the common costs for MPF, WLR and GEA over FTTP are likely to be very similar and we have no reason to believe this will not be the case, Verizon agrees with Ofcom that it seems reasonable to use the same common cost allocation per line across all lines, irrespective of the wholesale access line service.

Question 3.7: *Do respondents agree that we should remove the TAMs price adjustment by the end of the charge control period? Please provide reasons to support your views.*

17. As a non LLU operator (i.e. SMPF has no relevance), Verizon offers no response to this question.

Question 3.8: *Do respondents agree that we should not make an adjustment to MPF charges to allow for shorter than average line length? Please provide reasons to support your views.*

18. Verizon does not utilise MPF so offers no response to this question.

Question 3.9: *Do you agree with our proposal to remove printed directory costs from WLR rental, and to do so immediately? Please provide reasons to support your views.*

19. Verizon does agree with Ofcom on this issue, both in terms of the action and the timing. As Ofcom notes, if subscribers require a printed phone book there remains the provision for one to be supplied. However the removal of printed directory costs from WLR charges ensures that only those subscribers who require a directory pay for it, removing inappropriate cross subsidy.

Question 3.10: *Do you agree with Ofcom's proposal to set charge controls for LLU and WLR to expire on 31 March 2017? Please explain your reasoning and propose an alternative approach with supporting information if applicable.*

20. Verizon does agree with Ofcom's proposal. Such an arrangement is fully in line with the EU Framework Directive and will assist in ensuring regulation remains relevant and more in tune with market developments, which would not be the case if the market review process were set for a longer period. Similarly, a shorter duration would have the disadvantage of being disruptive to the market and disproportionate to both Ofcom and industry given the time and effort involved in conducting a market review. A 3 year period represents a happy medium between incentives to innovate on one side and greater stability in terms of business plans on the other.

Question 3.11: *Do you agree with our proposal to use glide paths to align charges with costs for these charge controls? Please provide reasons to support your views.*

21. In general, Verizon's preference is that charges should be aligned with costs as soon as possible unless there are overriding reasons not to adopt such an approach.
22. We have considered Ofcom's reasoning for implementing a glide path approach and agree that by phasing in the adjustment over the course of the next review period there is some merit in terms of greater stability and predictability.
23. However, to achieve the best outcome in terms of allocative and productive efficiency, we agree that the difference in charges between the services should be equal to the difference in long run incremental cost (LRIC) as early as possible.
24. Therefore, overall Verizon considers that it would be more efficient to have a one off adjustment to the MPF, WLR and SMPF rental service charges rather than achieve this at the end of the charge control period via a glide path.

Question 3.12: *Do you agree that CPI and RPI are the main indices to consider for the LLU and WLR charge controls proposed in this consultation? Please provide reasons to support your views.*

25. Verizon would agree that these are the two inflation indices that Ofcom needs to consider when determining the charge control for LLU/WLR services. In terms of RPI it is well understood and has been the traditional index adopted by Ofcom when setting charge controls. CPI on the other hand is now the index adopted by the Government for measuring and reporting inflation and is therefore also worthy of consideration.

Question 3.13: *Do you consider that we should use CPI to index the LLU and WLR charge controls proposed in this consultation? If not please explain why using the factors identified above, or any others you consider important.*

26. Verizon does agree with Ofcom's proposal to use CPI to index the LLU and WLR charge controls as set out in this consultation.

27. RPI is recognised as more volatile than CPI and it is also a poorer indicator of trends. In terms of achieving a more accurate and representative measure of inflation, CPI appears far superior to RPI inflation indexation. This view aligns with the Office of National Statistics concerns and the removal of RPI designation as a National Statistic.
28. Furthermore, the Bank of England has used the CPI to assess the level of inflation within the UK since 2003, as it facilitates a better reflection of the "changes in consumer spending patterns relative to changes in prices of goods and services". It is therefore appropriate that the price controls should be linked to the most appropriate index and not to one which uses irrelevant factors such as the mortgage interest rates which contribute to its instability.

Charge control design

Question 4.1: *Do you agree that we should set separate line rental charge controls for (i) MPF rental, (ii) SMPF rental and (iii) WLR rental? Please provide reasons to support your views.*

29. Verizon accepts Ofcom's reasoning in this matter and agrees that such an approach maintains regulatory consistency.

Question 4.2: *Do you agree that the price differences between MPF and WLR/WLR+SMPF new connections should be equal to the difference in LRIC in the last year of the new charge control (i.e., 2016/17)? Please provide reasons to support your views.*

30. Verizon does not fully support Ofcom's proposal. Rather, we consider that it would be preferable if the charges for MPF, WLR and SMPF rentals were adjusted by means of a one-off change to align them to the forecast LRIC differential, rather than achieve this via the use of a glide path to achieve this aim in 2016/17. However, Verizon does agree with Ofcom's overall intensions in this matter.

Question 4.3: *Do you agree with our proposed approach to estimating the costs of the simultaneous provision of WLR Conversion and SMPF New Provide? Please provide reasons to support your views.*

31. Verizon does agree with Ofcom's proposal. Such an approach ensures consistency of costs across the equivalent services, in line with technology neutral commitments. Such an approach represents a fair outcome and therefore should not distort competition.

Question 4.4: *Do you agree with our proposed approach to estimating the costs of provision of a WLR Conversion? Please provide reasons to support your views and if applicable please explain your preferred approach.*

32. Verizon does agree with Ofcom's proposed approach, agreeing with Ofcom that such an approach would not result in competitive distortions.

Question 4.5: *Do you agree that we should control WLR Conversion and its simultaneous provision with SMPF New Provide using an indexed type of control? Please provide reasons to support your views.*

33. Verizon agrees that the price for WLR Conversion should be lower when it is provided simultaneously with SMPF New Provide then when provided on its own. However, Verizon is not fully supportive of Ofcom's intension to ensure this by means of a charge control alone. We note Ofcom's concerns about the flexibility a cost orientation obligation would allow Openreach; however, when used in conjunction with a charge control, such scope is severely constrained. Accordingly, Verizon considers that this would offer the best outcome in this instance.
34. However, Verizon does agree with Ofcom that maintaining the status quo would not be appropriate.

Question 4.6: *Do you agree that we should charge control migration services at incremental cost? Please provide reasons to support your views.*

35. On balance, Verizon accepts Ofcom's reasoning and therefore agrees with Ofcom's proposal. Verizon recognises Ofcom's intent in terms of consistency for migration charges across competing services and therefore accepts the proposal to align migration charges to incremental costs rather than to CCA FAC.

Question 4.7: *Do you agree that we should align all migration charges involving jumpering to a single target price ceiling from the beginning of the charge control period in 2014 and throughout the charge control period and set a separate target price ceiling for WLR Transfers to its incremental cost using glide paths? Please provide reasons to support your views.*

36. In general, Verizon considers that charges should be reflective of the cost of provision on a per service basis. As such, Verizon considers that Ofcom should set individual charge controls for each migration service reflecting the underlying (incremental) cost of that service.
37. In this regard we consider that Ofcom should align each charge to its respective forecast LRIC rather than the option currently preferred (i.e. option1 should be adopted).
38. Verizon does not find the reasoning for Ofcom favouring option 2 to be overly compelling, i.e. the simplification of the pricing regime (2 charges instead of 5) and spurious accuracy concerns. Although Ofcom states that their preferred option has disadvantages, it concludes that they are unlikely to materially distort efficient purchasing behaviour or competition. However unlikely Ofcom consider such issues are likely to occur, we consider any such concerns should have been sufficient to have pushed the decision in favour of option 1.

Question 4.8: *Do you agree that we should align MPF and SMPF Bulk Migration charges to a single target price based on the volume weighted average forecast LRIC by the end of the* *charge control period in 2016/17 using glide paths? Please provide reasons to support your views.*

39. As a non LLU player, Verizon offers no response to the remainder of the questions in this section (Q4.9 to Q4.20).

Quality of service review and fault rate effects

Question 5.1: *We would welcome the views of stakeholders on our proposed approach to estimating the cost of changes to service levels.*

40. Verizon considers that Ofcom has identified the key factors to take into consideration and so, at this stage, Verizon would be supportive of Ofcom's approach. However, as Ofcom recognises, a great reliance will need to be placed on Openreach's data, which is unproven and limited. As such further investigation and interrogation of the data will need to be conducted to ensure any cost projections are sufficiently robust.

Question 5.2: *We would welcome the views of stakeholders on our proposed approach to analysing fault rates. In particular do stakeholders believe that fault rates should differ between MPF, WLR and SMPF?*

41. Verizon does not consider that there are any obvious reasons why fault rates should vary significantly between MPF, WLR and SMPF. However, it is clear that, for whatever reason, MPF lines do appear to be more susceptible to faults, particularly early life faults. If this tendency is confirmed, then clearly Ofcom should factor this into their considerations to ensure that services bear the appropriate allocation of costs.

Charge control cost modelling

Question 6.1: *Do you agree with our proposals for forecasting operating costs using CVEs based on BT's LRIC model? Please provide reasons to support your views. If you do not agree, please propose alternative approaches with supporting information.*

42. Verizon is cautious in its responses to this section of the consultation given the complexity of the issues under consideration. Overall, Verizon has some reservations over adopting the modelling approach utilised in setting the 2013 leased line charge control given the fact that this control is subject to appeal relating to Ofcom's cost allocation approach, an issue of import in this consultation.
43. Verizon accepts that the prevailing market conditions in the Business Connectivity Market and Fixed Access market are significantly different, in particular in regard forecast volume reductions for some services but this only addresses certain elements of concern relating to scale. Ofcom's AVE/CVE based forecasting approach still requires a reallocation of common costs to retain consistency with the likely future common cost allocation under BT's usage method and this remains an issue.

44. Overall, Verizon does not see why Ofcom has decided to implement a different approach from the last LLU/WLR review, given that the cost forecasting approach used in setting the current LLU/WLR charge control also forecast changes in service volumes, as was the case in the BCMR, although the BCMR Statement adopted a simpler solution. Given the importance of the LLU/WLR charge control (being the market responsible for the greatest proportion of common costs) arguments for a simpler but potentially unreliable approach should not hold sway.

Question 6.2: *Do you agree with our proposals for forecasting capital costs? Please provide reasons to support your views. If you do not agree, please propose alternative approaches with supporting information.*

45. Noting the issues referenced in the response to question 6.1, Verizon does accept Ofcom's proposals for forecasting capital costs. Given the fact that the AVEs derived from the LRIC model are designed to estimate a percentage change in GRC for a given percentage change in volumes, which is Ofcom's aim with the Cost Model, then this methodology seems appropriate.
46. Further, given the assurance that Ofcom performed a cross-check of the capex forecast as a result of this approach against those forecast in the CF/CA models used for the March 2012 Statement and that the difference was not material, such an approach appears to be justifiable.

Question 6.3: *Do you agree with our proposed estimates of inflation for BT's pay, non-pay costs and asset price inflation? Do you consider that using a longer time series to analyse the correlation of input prices with general inflation indices would provide more robust estimates of input price inflation? Please provide reasons to support your views.*

47. Given the economic uncertainties for the UK, which have prevailed for the last few years and which are expected to continue, certainly for the period covered by this review, it is extremely difficult to forecast future trends for such matters as pay, costs and inflation with any degree of certainty. In the absence of anything which is likely to deliver a more robust outcome, Verizon considers that Ofcom's proposals are likely to prove as accurate as any alternative.
48. In light of the above, and given the downward pressures that are likely to apply, Verizon would urge Ofcom to err on the side of caution when determining such forecast figures for incorporation in the cost model.

Question 6.4: *(a) Do you consider that the broadband line testing unit cost figures for MPF and SMPF in BT's 2011/12 RFS are reasonable? (b) What should Ofcom assume for broadband line testing costs for 2016/17? Please give reasons to support your views.*

49. Verizon, as a non LLU player, offers no response to this question.

Question 6.5: *Do you agree with our proposed approach to estimating the LRIC for relevant services in 2016/17? Please provide reasons to support your views.*

50. Verizon agrees with Ofcom's proposed approach. Given the volatility of the component level LRIC figures, Verizon agrees these would not be appropriate for forecasting LRICs to 2016/17. Accordingly, and given the investigative work undertaken by Ofcom, Verizon agrees with Ofcom's proposal to utilise LRIC:FAC ratios to estimate the LRIC for the relevant services.

Efficiency

Question A7.1: *Do you agree with our proposed approach to modelling efficiency, both in general and in particular in applying a single efficiency target to both operating costs and capital expenditure? Please provide reasons to support your views.*

51. Verizon does agree with Ofcom's proposal to modelling efficiency and that a single efficiency target covering both operating and capital expenditure is appropriate. As Ofcom notes, such an approach achieves consistency between the efficiency target and the way it has been assessed.

Question A7.2: *Do you agree with our proposed net efficiency range of between 4% and 6% and base figure of 5%? Do you agree with the levels proposed? Please provide reasoning to support your views.*

52. Verizon does not agree with Ofcom's proposed efficiency/levels and considers they are balanced too much in BT's favour and that a higher efficiency gain should be set.
53. In particular, Verizon considers that Ofcom has not set sufficiently challenging targets in previous charge controls, which has effectively allowed BT to outperform the efficiency target without actually improving either its processes or services.
54. Clearly Ofcom is highly reliant on BT's data to determine the efficiency target and BT has a clear incentive to ensure such a target is set as low as possible. As a result, and given industries concerns in this regard, Ofcom should be more robust in determining the target and not err on the low side.

Verizon Enterprise Solutions
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