Virgin Media's response to Ofcom's Consultation on the Approach to setting LLU and WLR Charge Controls

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Introduction

Virgin Media is pleased to respond to Ofcom's consultation on the charge controls imposed under the Fixed Access Market Review.

The level and structure of charge controls is a critical factor in the functioning and operation of the market.

In setting any control, the wider effects on the market, including the impact on other entities in that market, must be taken into account. It is important, therefore, that Ofcom strikes the right balance between providing a suitable remedy with respect to the effects of Significant Market Power, and ensuring that unintended consequences do not materialise being mindful of any indirect effects that the level and structure of any control has on competing, non-regulated entities operating in the same market.

Setting a charge control at too low a level or, indeed, setting efficiency targets for BT that are overly aggressive could have a chilling effect on competing investments, leading to a reduction in the level of competition and, ultimately, to a negative outcome for consumers.

It is widely recognised that infrastructure based competition delivers the best outcomes for consumers in terms of choice of provider, value for money and product innovation. Investment by other providers triggers cycles of investment and counter investment as players in the market seek to retain parity with or better their competitors. As discussed in response to the Fixed Access Market Review, investment by Virgin Media has been significant in the context of the wider market, and we look forward to continuing to make a significant and important contribution to driving forward technological advancement and consequent consumer benefit during the next market review period, provided that an appropriate regulatory framework remains in place to facilitate such investment and innovation.

Prior to setting out Virgin Media's responses to the consultation, it is important to highlight one issue that has arisen since publication. BT published its 12/13 RFS on 1 August 2013, which contained a restatement of its 11/12 data, including in the WFAEL and WLA markets. It is vital for Ofcom to maintain transparency of approach in this review, and all stakeholders need to know the extent to which BT's restatement may affect the proposals set out in this consultation. In particular, it will be vital for stakeholders to be offered an opportunity to comment on any material changes to proposals and to understand how Ofcom is treating the restatement in advance of any final decision being taken to set controls for the next three years. BT's decision to restate its accounts and alter the methodology applied to cost allocations at this crucial time, emphasises the need for a review of the way in which BT is obliged to undertake regulatory financial reporting, which Ofcom is currently undertaking with a prospective consultation being issued later this year.

Virgin Media's Responses to Consultation Questions

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

Virgin Media agrees with the proposed approach of maintaining price control based on an indexed price cap. This is the current approach adopted for these markets, and also represents the approach Ofcom takes in the majority of charge controls with respect to addressing the ability to excessively price. That said, any control proposed to control excessive pricing at the wholesale level must be able to take account of the need of competing efficient infrastructure providers, in order to ensure that competition at that level of the market is not adversely affected. Virgin Media believes that the current form of control does allow for this factor to be accommodated, provided the costs are appropriately modelled. Virgin Media addressed individual factors in the responses below.

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.*

Virgin Media agrees with the approach to use a CCA FAC methodology to establish the cost base, and agrees that it is preferable to using LRIC+EPMU. In particular, Virgin Media welcomes this statement from Ofcom notwithstanding the notably different approach proposed under the 2013 Narrowband Market Review, when a LRIC based cost base was used. Although specific reasons cited in the Narrowband Market Review for use of LRIC data meant that the approach taken in that consultation may be regarded as the exception to the rule (or at least established practice), it is reassuring to industry that Ofcom is proposing to adopt a consistent and sensible approach to the setting of controls within this review.

It is noted that Ofcom has had regard in this review to the EC Recommendation on non discrimination and costing methodologies (the 2013 EC Recommendation) (referred to in paragraphs 2.24 and in more detail at 3.192 onwards) and proposed a CCA FAC approach, notwithstanding the discussion of a BULRIC+ approach in the 2013 EC Recommendation. It is vitally important that Ofcom continues to ensure that the particular characteristics of the UK market are taken into account when proposing appropriate remedies within Market Reviews. These national characteristics underpin the entrenched regulatory practices that exist, as well as the particular physical deployment of UK networks. For example, BT has historically prepared its accounts on a CCA FAC basis, with LRIC based reporting being derived from FAC values which are not subject to same the level of regulatory scrutiny (for example not being included with the regulatory audit). This has resulted in LRIC data produced by BT as being less robust and, on occasions, wholly unreliable and inappropriate for the setting of regulatory remedies[1].

Virgin Media considers that Ofcom has, on other occasions, disregarded important factors that would objectively justify divergence in the UK from specifics set out in a Recommendation. For example, Virgin Media considers that Ofcom's approach in following the EC's Recommendation on Termination Rates in the Narrowband Market Review placed too much reliance on the Recommendation and went far beyond the need to take utmost account of it.

[1] See for example, paragraph 1.9 ISDN30 Charge Control Consultation December 2011, where Ofcom declined to rely on updated LRIC data due to a general lack of consistent data.

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.*

Virgin Media agrees that the RAV adjustment is sensible and its imposition in this review continues past practice to ensure consistency of approach (noting its application across charge controls, most recently in the Leased Lines Charge Control set earlier this year). Given that the level of the adjustment is reducing over time (to the extent that it will cease to be relevant when assets are fully depreciated), a sudden change in valuation methodology would appear to be unnecessary and disproportionate.

The RAV adjustment was an issue discussed in the context of the recent appeal of the current charge controls. In that regard, the Competition Commission's (CC) reviewed Ofcom's approach to duct asset valuation and did not oust Ofcom's decision.

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.*

Virgin Media broadly agrees with Ofcom's proposal to continue to regulate post-1997 duct assets on a consistent basis with the current control.

However, that both in relation to the application of the RAV adjustment and the indexation of post-1997 assets, Ofcom has proposed to use RPI as the appropriate inflation index. At paragraph A5.67, Ofcom sets out 6 key criteria as to why RPI remains the best index to use for this aspect of the control. Virgin Media does not disagree with Ofcom's proposal to use RPI, but is concerned that the proposed approach is then inconsistent with the provisional decision to use CPI in relation to the substantive control. In particular, Ofcom appears to assess the suitability of the inflation index for the substantive control against different key criteria, setting out 5 criteria at paragraph 3.170. The application of these different criteria lead to the unusual proposal for a control that is subject to both RPI and CPI in different contexts.

Virgin Media agrees that, given the application of the RAV adjustment to more than one charge control a consistent adjustment across the different controls should be used and RPI will also provide consistency with the outgoing control. Therefore, Virgin Media agrees with the proposed use of RPI in this context, but disagrees with Ofcom's proposal to use CPI elsewhere.

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.*

Virgin Media agrees with the proposed approach to model a hypothetical all-copper network.

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.*

Virgin Media agrees with Ofcom's proposals to recover common costs equally from each wholesale line access service. This is one input into a wider policy proposal to ensure that the differential between MPF and WLR+ SMPF be equal to LRIC. Virgin Media considers that this broader objective is appropriate in the circumstances to ensure a level playing field in what is now a fully mature market, as between CPs who chose to provide services via MPF and those who choose to provide via WLR. As Ofcom notes (albeit in relation to line length) at paragraph 3.104, making inappropriate adjustments could "risk distorting choices between MPF and WLR/WLR+SMPF at the margin, giving too strong an incentive to use MPF. This could mean that it might sometimes be cheaper for a CP to use MPF even though it would be more efficient to use WLR/WLR+SMPF." The advent of GEA as an overlay service in order to provide a retail fibre offering means that the differential will remain significant throughout this market review period, when there is likely to be considerable subscriber shift from ADSL to superfast broadband with competing providers using a mix of MPF and WLR inputs to compete for "superfast" customers.

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.*

Virgin Media considers that the proposal, which supports the overall policy objective of reducing the MPF / WLR+SMPF differential, is appropriate and justified. The magnitude of the adjustment, and the previously signalled intention of Ofcom in relation to phasing out the TAM adjustment, make the time right for its removal as part of this charge control period.

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.*

As discussed in our responses above, this proposal supports the move to a LRIC differential between MPF and WLR based services. Virgin Media supports this approach and therefore agrees that no line length adjustment should be made in this control.

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.*

Ofcom are proposing to remove directory costs from the WLR stack. In doing so, Ofcom have looked at three potential options:

- Maintain the status quo (costs recovered from WLR only);
- Not allow cost recovery; and
- Allow cost recovery across both MPF and WLR lines.

Ofcom proposes to choose option 2 as being appropriate for this control and, in reducing the WLR cost stack, it would be a contributing adjustment to achieve the overall reduction of the margin between MPF and WLR which, as a policy objective, we would support. However, there may well be significant consequences of removing directories from being recoverable costs and Ofcom needs to review this in more detail.

Virgin Media agrees with other stakeholders that recovery of directory costs from WLR lines, but not from MPF lines (Option 1), is not appropriate as WLR rental contributes to the cost of providing directories but the substitutable MPF service does not.

Option 2 may have significant consequences that could have a damaging impact on the sector. Currently, all CPs are required under GC8 to provide a hard copy of the local directory to their customers on request. Although a charge can be made, the only printed directory readily available is BT's Phone Book.

If, as a result of no longer being able to recover its costs from any regulated charge (which based on 6m external WLR lines at a per line cost of £2.30 would equate to a £13m loss of annual revenue), BT may review the basis upon which directories are provided and switch the responsibility to individual CPs (including BT Retail).

Given the obligation that sits in GC8 requiring all CPs to make available a hard copy directory on request, this would potentially have a significant impact on CPs if they were not able to source those directories from BT. If Ofcom did follow through on its proposal, it should fully investigate the consequences for directory supply.

Although a review of the General Conditions is not within the remit of a market review, there may, if BT changed its policy on directory publication / distribution, be a need to review the current obligations under GC8 which appear to gold plate the obligations under Article 5 of the Universal Service Directive (USD) (from where the obligation is derived). The USD only requires that "at least one comprehensive directory is available to end users….either printed or electronic or both". GC8 specifically requires a hard copy directory to be made available. Any switch in process by BT, that put the responsibility on individual CPs to provide a printed directory would be inefficient and inappropriate if a full directory was required to be supplied on request. Compliance with GC8 could be mitigated if, for example, the obligation was limited to the provision of an electronic directory, or a specific responsibility for compiling the comprehensive directory was placed on BT as the provider with USO obligations.

Option 3 would allow the costs of directories to be recovered by BT to the same extent that it can recover those costs today, but it would split those costs between MPF line and WLR lines. If the costs were split, then the differential would remain the same between both services, and the overall objective of reducing the differential to LRIC would not be affected.

Further, there would be no risk of any disruption to the market following a change of policy by BT to recoup / mitigate the loss of £13m revenue.

Ofcom notes that a reason for not choosing Option 3 is that there is no regulatory obligation for directory delivery to be included within MPF. Whilst that is correct at the wholesale level, there remains a clear regulatory obligation on CPs who take MPF lines to ensure that they comply with GC8. At present this compliance is met through BT's decision to uniformly provide directories to all households irrespective of the method of connection. Therefore, the underlying "retail level" obligation applies equally to MPF operators as it does to WLR operators. In that regard there seems little justification for citing a lack of regulatory obligation as a reason for not splitting the cost between MPF and WLR lines.

Ofcom also notes that it would not address a potential distortion between BT supplied services and cable supplied services. However, BT, as the SMP provider, does not supply cabled service, yet Virgin Media still remains under the obligation of GC8. Therefore, the potential distortion, suggested by Ofcom is not directly relevant, in that the inclusion of a directory cost (which BT is obliged to provide under GC8) is legitimate, and the cost of Virgin Media complying with GC8 remains a matter for Virgin Media to discharge.

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.*

Virgin Media agrees with the proposal to set a three year charge control, as this coincides with the forward looking period of the review and aligns all access controls (including ISDN30 and ISDN2) to a single date. It is of note that recent controls have been set in an ad hoc manner in terms of their duration and timing, with a number of "short" controls being used in order to align WLR, MPF and ISDN controls in a single review. Whilst it was understandable to use such transitional controls to move the review of the exchange line markets from the Narrowband review to be part of a Fixed Access Market Review along with the WLA market, it is important that there is stability in regulation going forward. These markets have been subject to considerable challenge through recent reviews, and whilst some certainty has been provided as a result of appellate decisions, it is important that any regulation imposed fully considers the need to provide certainty and confidence to industry as a whole.

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.*

Virgin Media agrees with the proposal to use glide paths rather than one off reductions. In particular, Virgin Media welcomes Ofcom's reassertion of its strong policy preference for glide paths rather than one-off adjustments (especially in light of the debate in the Narrowband consultation over the implementation of the charge control on termination and origination services). Virgin Media also agrees that use of a glide path will typically be the more proportionate approach over a one off adjustment.

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.*

Virgin Media considers that CPI and RPI are currently the main indices to consider in relation to the application of an inflation standard to charge control. Virgin Media agrees that RPIJ is currently not a suitable statistic given its current status as an "experimental" statistic suggests that its longer term status is still unclear. However, the issue of how statistics are calculated and how they may come to be calculated in the future remains live (for example, the inclusion of Owner Occupier Housing costs in HICP could mean a change to the way CPI is calculated in the future).

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.*

Virgin Media considers that the discussion on the potential change of inflation index is not sufficiently developed and, on balance, considers that the status quo should be maintained, retaining RPI as the relevant metric for this control.

Ofcom suggests that CPI is preferable to RPI as concerns over the index has led it to be no longer designated as a national statistic. It is of note that CPI runs about 0.5-1% lower than RPI and is likely to be less volatile than RPI. As Ofcom notes, CPI is also subject to a government target[2] so there is some assurance that it will meet a particular range, given that fiscal policy will be implemented to achieve this. Ofcom's assessment of the suitability of CPI is made against 5 criteria set out in paragraph 3.170. However, as mentioned in the response to Question 3.4 above, these 5 criteria appear to be different to the criteria applied to determine that RPI is the appropriate index to be applied to the RAV adjustment and duct asset valuation. It is undeniable that RPI is still a relevant statistic, used in many other contexts, some directly relevant to the setting of these controls and will certainly continue to be relevant for the forward look of this review. Additionally, other highly relevant controls are set using RPI, including the outgoing controls for these markets and controls in related markets (such as those for business connectivity products that may increasing overlap with access products as broadband speeds increase). As discussed above, the RAV adjustment / duct valuation is proposed to be indexed using RPI, so the full proposal as set out in the consultation relates to a control governed by both indices, which seems counterintuitive and unnecessarily complex.

Given that the future of inflation statistics remains unclear (in particular: the future of RPI; the relevance of RPIJ; and the effect of European regulation on CPI), Virgin Media considers that it is not the time to switch from the proven metric of RPI. An independent project could be run to consider the appropriate index for the next round of charge controls, given that all fixed telecom substantive reviews have recently been completed (BCMR / Narrowband), using RPI, and the next review is not due to be completed until April 2016 (BCMR). A review project would be more focussed than the discussion of this point within an overall market review, and would provide stakeholders with advance notice on the proposed approach to the 2016/7 round of reviews together with, for example, bringing a common approach to the treatment of adjustments that sit across controls (e.g. the RAV).

As Ofcom notes, the choice of a particular index is largely academic as final costs are estimated and the X is set adjusted to the level of the inflation index in order to meet that cost forecast. Although Ofcom suggests that this means that a change of index is likely to have a small effect, Virgin Media considers that, even aside from the arguments set out above, a lack of perceived impact demonstrates that there is no objective need to make a change in existing approach to setting these controls, especially in light of the need to have regard to regulatory consistency under section 3 of the Act.

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.*

[2] Although Ofcom states that the target is 2%, the actual target is expressed as 2%+/-1%, so allows for a target of between 1 and 3%.

Virgin Media agrees that the rental charges for the three services should be separately controlled, subject to the linkage between MPF and WLR+SMPF as discussed below.

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.*

Virgin Media agrees with the proposal to reduce the relevant price difference to LRIC by the end of the control. As discussed in the response to Question 3.6 above, it is vital that there is a level playing field for CPs purchasing either MPF or WLR inputs to provide voice and data services going forward.

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.*

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.*

<u>Virgin Media Response to Q4.3 and 4.4</u>

Virgin Media does not have any views on the proposed approach to estimating costs of WLR Conversion / SMPF New Provide (simultaneous provide or WLR Conversion only). Virgin Media notes the underlying rationale being to ensure that the competitive conditions between MPF and WLR remain neutral which, as discussed above, is a position that we support.

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.*

Although the imposition of a charge control represents, on the face of it, an increase in regulation of these charges, the underlying rationale again relates to the overall policy objective of Ofcom to ensure that there is a level competitive playing field as between MPF and WLR. Virgin Media agrees with this objective and agrees with the proposal that a charge control is the most effective and proportionate way of fulfilling the objective.

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

Virgin Media agrees that, consistent with the overall objective of ensuring competitive neutrality, it would not be appropriate to retain the status quo whereby migration services are regulated in different ways.

Virgin Media considers that, as a starting point, a service should recover the common costs associate with it, a view that would support a CCA FAC approach rather than the proposed use of LRIC. However, in this particular case, the interrelationship between MPF and WLR and the LRIC:FAC ratio is 0.93, which results in marginal difference between the FAC and LRIC values for each service. Given that the decision to use LRIC can be attributed to the particular policy objective and the lack of any material difference in value, Virgin Media does not object to the proposed approach on this occasion.

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

Virgin Media understands that an alignment to a single target price charge ceiling has benefits in providing a simplistic and transparent control on these charges. However, there is concern that Ofcom has proposed that any alignment should necessarily be achieved at the outset of the control by the application of one-off charge adjustments. Ofcom specifically asks, in Question 3.11, whether stakeholders agree with the proposal to use glide paths to align charges with cost, and confirm a "strong policy preference" for glide paths over one off adjustments. If however, the reduction to an average LRIC allows for the recovery of common costs previously allocated to these charges from the line rental cost, then there is less of a concern as overall cost recovery is maintained and it is merely a change of allocation, rather than a reduction of allowable cost. However, this should be fully explained by Ofcom in any final decision on the treatment of these charges.

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? Please provide reasons to support your views.*

Virgin Media refers to the response to Question 4.6 above which sets out concerns as to setting prices to LRIC as a starting point. However, whilst reservations still apply, Virgin Media accept that the consistent treatment of migrations is appropriate and therefore, if Ofcom were to adopt the approach suggested for single migrations, then it would be appropriate to adopt "option 2" in the case of Bulk Migrations.

Question 4.9: *Do you agree that the charge for MPF and SMPF cease should be zero and costs recovered from MPF and WLR rental charges on an equivalent per line basis? Please provide reasons to support your views.*

Virgin Media considers that retaining the status quo in terms of charging is appropriate in relation to cease services. Whilst, as discussed, the costs of a service should generally be recovered by that service, Virgin Media understands Ofcom's reasoning and consider that regulatory consistency in the treatment of these costs is appropriate in this exceptional case. Ofcom has proposed to adjust the basis of cost recovery for the provision of these services. However, as the proposal is consistent with the general approach being taken to the structure of the controls, Virgin Media has no specific comment on this proposed change.

Question 4.10: *The complete list of ancillary services considered in the MPF, SMPF and Co-Mingling baskets for the charge control period 2014/17 is included in the "Legal Instruments" Annex. Do you agree with our proposal to control three ancillary services baskets and with the proposed lists of ancillary services for the MPF, SMPF and Co-Mingling baskets? Please provide reasons to support your views.*

Virgin Media does not have any comment on the proposed lists of ancillary services.

Question 4.11: *Do you consider that X in CPI-X for the ancillary service baskets should be determined as: the same X for both SMPF and MPF ancillaries baskets based on the pooled costs and pooled revenues of SMPF Ceases, MPF Ceases and MPF New Provide; and X for Co-Mingling ancillaries basket based on the pooled costs and pooled revenues of Room Build, Hostel Rentals and Tie Cables? Please provide reasons to support your views. If you consider a different basis is more appropriate please set out what this approach would be and why.*

Virgin Media notes that the proposed approach differs from the discussed "efficiency based" option in the CFI, given the disparity between actual costs and proxy values. Virgin Media, in line with its comment in response to the CFI, agrees that, given that Ofcom has now considered the potential consequences of using an efficiency based approach, it would not appear appropriate to pursue that option. Virgin Media does not have any further comment on the cost-based approach proposed, save to note that the difference in methodology applied to the co-mingling basket needs to ensure that there is no distortion in the market given the separate and different "X" applied to that basket as opposed to the MPF and SMPF baskets.

Question 4.12: *Do you agree that sub-caps applied to the ancillary services baskets should be tighter than CPI-X+7.5%? Please give views on the appropriate level of sub-caps in the range 5% to 7.5%. Please provide reasons to support your views.*

Ofcom makes the statement that moving from an inertia clause to a sub-cap will have little practical impact despite the loss of minimum price protection for each service. The underlying logic that "a sub-cap on each charge is likely to prevent very rapid reductions in other charges in the basket if BT is to price up to the overall cap", appears sound, but Ofcom should ensure that this is tested for the baskets concerned before making a decision to change from inertia clauses to sub-caps.

Question 4.13: *Do you agree that the sub-cap on MPF Stopped Line Provide should now be set at the same level as the sub cap for other services in the MPF ancillaries basket? Please provide reasons to support your views.*

Question 4.14: *Do you consider that LLU Expedite charges should be based on Option 1 (maintain MPF Expedite and SMPF Expedite in the respective ancillary baskets) or Option 2 (remove MPF Expedite and SMPF Expedite services from the ancillary baskets and impose a safeguard cap on each Expedite service charge)? Please provide reasons to support your views. If you consider a different basis is more appropriate please set out what this approach would be and why.*

Question 4.15: *Do you consider that MPF/SMPF single/bulk jumper removal charges should be based on Option 1 (status quo) or Option 2 (separate charge controls for single/bulk jumper removals)? Please provide reasons to support your views. If you consider a different basis is more appropriate please set out what this approach would be and why.*

<u>Virgin Media Response to Q 4.13 – 4.15</u>

Whilst Virgin Media has no specific comment on the proposed approach to the proposed treatment of MPF Stopped Line Provide, LLU Expedite Charges or MPF/SMPF jumper removal, it is noted that the treatment is based on the need to ensure a level competitive paying field, which is considered to be the correct approach when price controlling ancillary services.

Question 4.16: *Do you agree that the existing obligation to align LLU Enhanced Care service charges with WLR Enhanced Care service charges should be retained? Please provide reasons to support your views.*

Virgin Media agrees that it would be disproportionate to subject this service to a charge control and the current regulatory approach should be maintained.

Question 4.17: *Do you agree with our view that it is not necessary to impose a separate charge control on Special Fault Investigations? Please provide reasons to support your views.*

Question 4.18: *Do you agree that the charges for special fault investigations should remain aligned between MPF and SMPF? Please provide reasons to support your views.*

Virgin Media Response to Q4.17 and 4.18

Virgin Media agrees with the approach proposed in relation to SFIs.

Question 4.19: *Do you agree that we should not align the SMPF and MPF services set out in Table 4.27? Please provide reasons to support your views.*

Virgin Media agrees that additional regulation (which would be difficult to achieve given uncertainty over costs) would appear to be inappropriate especially given the existing aligned pricing.

Question 4.20: *Do you agree that with basket controls coupled with sub-caps on individual services, a cost orientation obligation is unnecessary for the ancillary services? Please provide reasons to support your views.*

Virgin Media does not agree that sub-caps in themselves provide the same level of the protection as cost orientation and, as such, cost orientation would remain a useful complementary remedy to the charge control covering the gaps identified in our CFI response. This issue is part of Ofcom's broader policy change in relation to the use of cost orientation in that there has been an apparent wholesale abandonment of the previously used LRIC+ Basis of Charges condition, so that cost orientation as applied in this review acts as a FAC control as an alternative to a charge control. These concerns are addressed in Virgin Media's response to the Fixed Access Market Review, and also note that Ofcom's response to the Cost Orientation Review may provide added transparency as to the full effects of this change of policy.

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.*

Virgin Media notes that Ofcom's assessment of the costs involved in delivering specified service levels is in a developmental stage, with a more thorough assessment being needed before proposals can be made as part of a specific Service Level consultation later this year. It is certainly the case that more information is needed to be able to understand the relevant relationships in order to meaningfully comment on the consequent cost effects. Virgin Media considers that it remains primarily for Ofcom to assess how best to obtain the required level of transparency, and would seek to comment in more detail when specific proposals are made. However, reliance upon an Openreach model needs to be understood and checked by Ofcom (noting the proposal to engage with E&Y) and that Ofcom needs to be in a position to be able to consult stakeholders by sufficiently explaining its position and underlying rationale. If there are any potential confidentiality issues that would undermine the substantive ability to understand and respond to a future consultation, these need to be addressed now by Ofcom in order for the next stage of the process to be meaningful.

Virgin Media does consider that the current level of service is not to an acceptable standard, and to the extent that an improvement in those levels will necessarily incur additional costs, then it is only right that these should be reflected in the regulated cost of relevant services.

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?*

Before commenting on this issue, it would be useful to see the outcome of Ofcom's analysis as to why fault levels differ between apparently similar services. Therefore, whilst there may be good policy reasons for aligning fault rates, this question is being asked prematurely and would suggest that this matter be revisited in the interim quality of service consultation to be issued later this year.

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.*

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.*

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.*

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.*

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.*

<u>Virgin Media Response to Q6.1 – 6.5</u>

Virgin Media understands the proposed approaches set out in the consultation and notes the consistency in modelling approaches with other key Ofcom derived models (although the reference to consistency with the 2009 Narrowband model ignores the distinctly different approach taken in the 2013 Narrowband Review), and Virgin Media broadly supports the consistent approach in this regard. A number of the proposals have been able to take account of the outcome of previous litigation before the CAT/CC and therefore may be regarded as the logical starting point for any proposal. Virgin Media does not seek to make further detailed comments on the modelling approach in this response.

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.*

Virgin Media has concerns over the approach undertaken by Ofcom in determining the range and, in particular, the relative weight placed on different sources to come up with the proposed range; it is addressed in more detail in the response to Question A7.2 below. Virgin Media has no comment on the proposal to apply a single efficiency target across both operating costs and capital expenditure.

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.*

Ofcom is proposing (in adopting the base case) to increase the efficiency assumption from 4.5% (as set under the 2012 control) to 5%. Whilst an element of efficiency will be derived from frontier shift (and therefore is not about catch up i.e. an inefficient entity becoming an efficient entity), the rationale for increasing efficiency on a legacy LLU network at this stage is unclear.

Whilst Ofcom had intended to commission an independent review of Openreach's efficiency, this did not occur due to a lack of interest by third party consultants. The absence of this independent assessment should lead to, at the very least, a stronger argument for maintaining the status quo, or even imposing a less stringent efficiency target, given other indicators. It is also of note that, although Ofcom seeks to rely on historic trend data showing cost reduction within Openreach, this is potentially misleading as: (a) the required cost reductions were driven by the imposition of a charge control; and (b) the cost reductions also appear to have been accompanied by an unacceptable reduction in service levels that suggest rather than Openreach having become more efficient at undertaking its duties, it has potentially cut costs below a level that enables it to carry out those duties (this would appear to be suggested in the relative base case performance difference between 11/12 and 12/13 shown by fig 5.2). It is accepted that the issue of QoS levels is not currently incorporated into the charge controls, but the reliance on cost reduction data stands independently of any decision to adjust future QoS levels via regulatory intervention.

The comment from external analysts that Openreach will find it increasingly difficult to achieve efficiency gains going forward also appears to go against increasing the efficiency assumption from the last control. Furthermore, given that this suggestion is based on independent sources, it counters concerns from other stakeholders that Ofcom has placed too much reliance upon BT's own claims on its ability to generate efficiency gains.

Virgin Media accepts that the assessment of the efficiency assumption is a matter of regulatory judgement (as stressed by the CC in not interfering with the decision of Ofcom in setting the last control). However, there appears little to justify increasing the level of efficiency from that control and, as such, the proposed base case would appear too high. The available evidence cited by Ofcom would support a base case of 4.5% with the current +/- range of 1% providing a consultation range of 3.5 - 5.5%.

Volume Forecasting

Question A8.1: *Do you agree with our proposed approach to forecasting volumes as set out in Annex 8 and Annex 9? Please provide reasons to support your views.*

Virgin Media has no substantive comment to make on the proposed approach to forecasting volumes noting that Ofcom has revised its approach partially in light of comments made in the recent CC judgement.

Detailed cost modelling assumptions

Question A13.1: *Do you agree with our proposed approach to calculating SMPF unit costs? Please provide reasons to support your views.*

Question A13.2: *Do you agree with our proposed approach to BT's pension deficit repair payments? Please provide reasons to support your views.*

Question A13.3: *Do you agree with our proposed approach to adjusting BT's linecard costs? Please provide reasons to support your views.*

Question A13.4: *Do you agree with our proposed approach to calculating dropwire costs for the purposes of forecasting to 2016/17? Please provide reasons to support your views*

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Question A13.5: *Do you agree with our proposed approach to allocating repair costs to services in the Cost Model? Please provide reasons to support your views.*

Question A13.6: *Do you agree with our proposed approach of excluding any pair gain adjustment for the purposes of forecasting D-side and E-side copper capital costs to 2016/17? Please provide reasons to support your views.*

<u>Virgin Media Response to Q A13.1 - A13.6</u>

Virgin Media, in response to questions asked within Annex 13, does not seek to make any detailed comment on the proposed cost modelling assumptions, noting that several aspects of the proposed approach have been recently tested before the CC.

Treatment of cumulo rates within the charge control

Question A14.1: *Do you agree with our proposed approach to the treatment of BT's cumulo costs in the calculation of regulated charges for WLR and MPF? If not please explain why and tell us how you would propose to treat these costs and outline the calculations that would be involved.*

Virgin Media does not seek to provide detailed comments on the proposed approach, noting Ofcom's overall approach to be consistent with the proposal that MPF and WLR should make similar contributions to the recovery of common costs and also the recent guidance derived from the CC decision following the appeal of the 2012 control.

Cost of capital

Question A15.1: *Do you agree with our proposed approach to estimating the cost of capital of BT Group, Openreach and Rest of BT? Please provide reasons to support your views.*

Virgin Media notes that the proposed approach is consistent with the approach adopted in the LLCC, but has no detailed comment to make on the proposed approach to cost of capital. As detailed above in the response to Question 3.13, this is an area where there is a potential for RPI to be used as the inflation index, whilst the control is subject to CPI, suggesting that retention of a RPI based control would be appropriate for this review period.

Virgin Media
30 September 2013