CHARGE CONTROL REVIEW FOR LLU AND WLR SERVICES

Cable&Wireless Worldwide

JULY 2011

EXECUTIVE SUMMARY

- This consultation contains a number of highly important decisions. We appreciate the additional data provided within the public models and the time taken by Ofcom to explain the workings of these.
- Ofcom proposes that the Co-mingling basket increases in line with an RPI+7.5%. Ofcom provides very little information to justify this increase. Co-mingling is a key service that we purchase. It is also the only WLA basket which is subject to price increases. Co-mingling services are not subject to EoI requirements as a consequence cost apportionment to these services requires a high level of scrutiny. Ofcom must provide sufficient information to allow effective consultation to take place.
- Our retail services are designed for large business users. These users require and expect care levels beyond standard care for their services which are often mission critical. As a consequence we see the availability of “enhanced care” on cost orientated terms as fundamental to the provisioning of these services.
- BT has adjusted its duct valuation methodology. We agree that Ofcom should reject BT’s basis for valuing post 1997 assets for the setting of these charge controls. Ofcom needs to go further than just remedying the issues with BT’s methodology and also reconsider the national discount that BT now proposes to apply.
- When disaggregating the BT Group cost of capital Ofcom estimates the cost of capital for different parts of BT (Openreach and Rest of BT) on the grounds that they have different systematic risk profiles. Ofcom uses the total Openreach capital employed within its calculation. However when applying the Openreach cost of capital to actual products Ofcom then only applies it to copper access products. This approach is flawed. Ofcom should either determine the cost of capital for just the copper access products or it should apply the Openreach cost of capital to all Openreach provided products.

INTRODUCTION

Co-mingling basket

Co-mingling is a key WLA service. The services within the Co-mingling basket are used to provide both LLU and Ethernet accommodation services.

With one exception all WLA service baskets are subject to RPI minus controls. In the case of the Co-mingling basket Ofcom proposes that the basket rises (at base case) to an RPI+7.5%. Purchase of Co-mingling is a core unavoidable service which LLUOs and providers of WES/EAD LA rely upon in order to be able to provide their services. Notably BT LoB do not purchase co-mingling services on an EoI basis. We believe that these factors (proposed cost increases, importance of the services to LLU and Ethernet services and lack of EoI) ought to promote additional scrutiny by Ofcom when considering BT's proposed cost apportionment to this basket and the relationship between costs and volumes for the basket.

Inexplicably Ofcom does not include a consultation chapter to discuss the factors which lead to the rise. Ofcom does not raise any specific consultation questions in regard of the co-mingling basket. Naturally consultation on all baskets is important but in the situation whereby an RPI plus is proposed (and at a relatively high level) consultation is even more important.

We are concerned that this consultation response provides only an opportunity for us to raise general questions due to the absence of detailed hard data or explanatory reasoning. During the consultation period we have raised with Ofcom the lack of data we have to work with and have been able to obtain some minor additional information.

We regard it essential that during the period post the consultation that Ofcom provides transparency of emerging information regarding the detail behind the cost drivers within this basket and allows us to comment on any data as and when it becomes available.

The proposal to increase charges for Co-mingling services is counter to our expectations. Following industry concern regarding lack of space availability at a growing number of exchange buildings it is our understanding that BT are planning to overhaul the space products in order to more efficiently provide space services. Whilst acknowledging any efficiency saving is more generally likely to be captured within the wider OR efficiency targets, rather than directly within the specific space products pricing, restructuring of the product is likely to have a knock-on effect on total volumes over which service costs are shared. We note in Annex 6 Figure 6.1 that Ofcom shows Comingling rentals (inc 21CN) to have volumes of 10,000 (with 13,000 in 2009/10). It is not clear what makes up the 10,000 volume (numbers of CPs multiplied by BT exchange sites, numbers of racks sold, and how BTLoB is included beyond 21CN). Meaningful commentary regarding the volumes would require this detail to be specified.

The primary information on which we have had to base our response upon lies within Figure 7.18 page 110 of the consultation document which we have replicated below.

Co-mingling basket	2009/10	2010/11	2011/12	2012/13	2013/14
	£'m	£'m	£'m	£'m	£'m
Current pay	3	2	2	2	2
Other operating costs	1	1	0	0	0
Transfer charges	18	14	13	13	12
Internal cost of sales	35	44	48	51	53
Other operating income	0	0	0	0	0
Internal capitalisation	0	0	0	0	0
Depreciation inc holding gain	10	13	14	15	15
ROCE (@8.6%)	13	13	13	12	12
TOTAL COST	80	87	90	93	95

The above table shows that over the period a number of changes occur to the cost base:

- "Current pay" reduces from £3M to £2M over the period.
- "Other operating costs" fall from £1M to zero. This is consistent with the overall WLA trend.
- "Transfer charges"[1] reduce from £18M to £12M over the same period. This is largely in line with the overall WLA trend.

[1] BT Group overheads transferred to Openreach and allocated to this basket

- “Depreciation including holding gains” rises from £10M in 2009/10 to £15M in 2013/14. The general WLA trend is for reducing depreciation and a reduction in holding gain. Ofcom must provide an explanation and justification for the rise to the Co-mingling basket.
- “Internal costs of sale” is primarily driving the increase in baskets costs as it increases from £35M in 2009/10 to £53M in 2013/14. Overall WLA market internal costs of sale are falling £1,054M in 2009/10 to £866M in 2012/14 (down circa 18% over the period). Yet the amount of internal cost of sale allocated to the co-mingling basket instead of falling in line with the general trend for decreased cost of sale is instead increasing by 34%. Co-mingling follows the trend for all other costs but does not follow the trend for falling internal cost of sales.

We have focused most of our effort in attempting to understand the internal cost of sale cost category, however the other above points remain relevant and important.

We understand from Ofcom that:

“Internal cost of sales relates to the cost of electronics, line cards other services purchased from BT Operate. The principle cost going into the Co-mingling basket is Power and ventilation used by co-mingling rentals.”

Looking into this explanation we first consider the rise in costs of electronics, line cards other services purchased from BT Operate. Co-mingling is essentially access to empty space. The service provides empty space within BT exchange buildings and also empty shelving onto which CPs place their own hardware and electronics. Co-mingling services do not include electronics or line cards (and consequently do not need line card “other” services). Ofcom tell us that the principle cost is power and ventilation. The services which we purchase include an AC or a DC feed. We are then charged for the power that we use on a per KW basis as per the price list. This might leave standing charges and it is difficult to see how these are rising so dramatically. We seek clarification from Ofcom that power costs are not levied twice – once via the internal costs of sale and secondly via the direct power charges we pay.

Should it be found that it is indeed the costs of power and ventilation that are the primary driver of the stark costs rises within the Co-mingling basket then we do not consider it appropriate for the entire basket of services to be affected by the RPI increases. Charge controls are designed to give BT incentives to be more efficient. However variations in power costs are far more to do with market fluctuations than BT actions and if that is the case then they are not well suited to a typical RPI-x charge control. Consequently we advocate that power and ventilation are removed from basket and treated separately. If a single component within a service basket is the driver for the RPI rise but by the very nature of control baskets all services charges within the basket could be modified by the control amount gives rise to significant risk that many charges will fall out of line with costs exists. Over time there is a high likelihood that many charges within the basket will become out of line with costs. The likely conclusion to this problem being that later intervention by Ofcom to realign costs will be required. This of course has a host of issues for how costs will be realigned and the risks of undermining product stability.

Ofcom further informs us that:

“This cost is inflated from 2010/11 are due to regulatory adjustments. The explanation which OR gave to us for the regulatory adjustments made to backhaul, access and line cards is as follows. The basis of calculation for both the management accounts and RFS numbers is ASPIRE, the costing system that generates the RFS. The values associated with the categories above (i.e. backhaul/acess and line cards) are derived by an analysis of costs with a pre defined set Plant Groups within ASPIRE. The relevant plant groups are those which contain the assets (depreciation) and associated operating costs for the different categories of BT Operate operated assets where a trading relationship exists with Openreach i.e. Openreach purchase the assets from BT Operate. There is a lag in the timing between the underlying ASPIRE data and any subsequent updating of the management accounts which means these have tended to show a different value than the true underlying cost of the last few years.”

This explanation suggests that BT has made adjustments that it deems are “regulatory adjustments” which when made inflate the level of internal costs allocated to Co-mingling services. The rationale for the adjustment is not in the least part clear. BT say that the adjustment is in relation to backhaul, access and line cards. We discuss in the introduction that Co-mingling is the provision of empty space with empty shelves. Access services are not provided. Line card services are not provided. Backhaul services are not provided. We recommend that Ofcom applies appropriate scrutiny to this area of supposed cost increase. We request that as Ofcom discovers greater detail on this matter that we are kept informed and able to comment in response.

When considering setting the charge control we believe that Ofcom needs to also consider past cost recovery by BT for Co-mingling services. We believe that some of the cost has been incorrectly allocated and has probably already been recovered through Openreach charges for room build and set up.

Analysis of BT's regulatory financial statements over the past six years shows that BT's revenue from exchange space has been consistently above cost. In particular the revenue from *room build* has been vastly above the costs reported against the activity. Revenue from *room rental* has exceeded costs in some years but not all and overall BT has reported £320m of revenue against only £175m of costs including its return on capital employed. We have included our analysis in the table below.

There are two possible explanations. The first is that BT's prices for *room build* have not been reflective of cost in the past. The second, which we consider more likely, is that the reported costs have not been matched accurately against revenue and some of the costs that are allocated to *room rental* should have been more appropriately considered under the *room build* costs.   We suspect that in the past some of the upfront costs which justified the build prices have actually ended up being amortised and are therefore still being seen in the reported costs today.

We note that a similar issue arose in the leased line charge control in relation to PPCs. In that project Ofcom found that PPC infrastructure costs were included in the costs for PPC rental whereas they had already been recovered in the up front prices paid by customers for the infrastructure install. In that case Ofcom excluded both the revenues and its best view of the costs from its analysis of the profitability of the basket.   In this case the adjustment required may be a bit more complex as the ratio of room builds to room rentals is now quite different to that of a few years ago, as a result current room build revenue is not likely to be reflective of the level of cost that needs to be removed. However a slightly different adjustment could be made.

Clearly it would not be appropriate to set a charge control now without addressing this issue and making an adjustment to the cost assumptions in the future. To fail to do this would effectively result in BT double recovering, once in terms of revenues from room builds and again in the rental price. The information available in BT's regulatory financial statements and the Ofcom consultation is not sufficient for us to be able to estimate the impact but given the £145m of revenue above cost over the last six years we would expect this to be a significant adjustment. Certainly the level of profitability of exchange space over the last six years is a pretty strong indicator that Ofcom's proposal to allow the exchange space prices to rise above RPI is not justified.

Analysis of BT Profits from sale of exchange space products

Year ending	Measure	Room Build	Room Rental		Total £m
2005	Cost (£)	1,720	14,989	Total Cost £m	7
	Price (£)	9,455	2,589	Total Rev £m	7
	Revenue (£m)	6	1		
	Units	635	386		`
2006	Cost (£)	2,337	8,016	Total Cost £m	20
	Price (£)	13,312	1,729	Total Rev £m	37
	Revenue (£m)	34	3		
	Units	2,554	1,735		`
2007	Cost (£)	1,157	4,758	Total Cost £m	33
	Price (£)	17,207	3,042	Total Rev £m	95
	Revenue (£m)	77	18		
	Units	4,475	5,917		`
2008	Cost (£)	254	3,462	Total Cost £m	31
	Price (£)	14,160	5,160	Total Rev £m	68
	Revenue (£m)	23	45		
	Units	1,624	8,721		`
2009	Cost (£)	923	4,442	Total Cost £m	42
	Price (£)	11,693	5,076	Total Rev £m	54
	Revenue (£m)	7	47		
	Units	599	9,259		`
2010	Cost (£)	400	4,217	Total Cost £m	42
	Price (£)	11,724	5,190	Total Rev £m	59
	Revenue (£m)	7	52		
	Units	597	10,019		`
6 Year Totals				Total Cost £m	175
				Total Rev £m	320
				Rev / Cost	183%

Notes

- figures taken from BT RFS. Unit costs include RoMCE
- Totals calculated by estimating volume (Revenue/Average Price) and multiplying unit costs

RESPONSES TO QUESTIONS

Question 3.1: Do you agree with Ofcom's proposal to set synchronised charge controls for LLU and WLR?

The consultation document identifies that LLU and WLR have service components and processes which are common to both. LLU and WLR can be substitutes for one another. Synchronising the charge controls therefore appears appropriate and we agree with Ofcom's proposal.

Question 3.2: Do you agree with Ofcom's proposal to set charge controls for LLU and WLR to expire on 31 March 2014?

We consider it very unfortunate that by the time that the charge controls are put in place that they will only run for a 2 ½ year period. Serious consideration needs to be given to finding a mechanism for managing market reviews and charge controls reviews to avoid the existence of time periods over which charge controls are not in place. We suggest that Ofcom investigates the ability for it to roll on the charge controls that it puts in place as an alternative to the controls ending and voluntary commitments from BT taking their place. Such an approach would incentivise BT in providing essential data at sufficient levels of detail and disincentivise BT against making late in the day accounting adjustments which delay the consultation process.

Question 3.3: 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 give reasons for your answer. (Note that respondents are also invited to comment on continuation of the RAV approach in Question 3.5 below.)

Yes, the CCA FAC approach is standard and there appear no reasons to depart from it.

Question 3.4: Do respondents agree with our proposal to apply anchor product pricing as a guiding principle in setting the charge controls, whilst including economies of scope which result from the allocation of costs in our financial modelling? Please give reasons for your answer.

The primary assets that go into the provision of LLU and WLR services are duct and copper/fibre. Ofcom follows the approach adopted for previous charge controls of LLU and WLR services. This charge control is a little different however as now BT's NGA services can take a share of the common costs associated with the duct facilities. We agree that it is appropriate to reflect this economy of scope. The share of common costs attributed to NGA services can be further increased to account for CP usage of the new PIA product. Consistency between the allocation of costs to BT's NGA and PIA is required. It is not clear whether Ofcom has included an allocation of costs to account for PIA.

Question 3.5: Do you agree with our assessment that the decision on the treatment of pre-1997 duct assets set out in the 2005 Valuing BT's Copper Network remains appropriate for this set of charge controls? If not, why do you consider that the basis of valuing pre-1997 assets should change and what valuation basis should be used?

Yes. In the 2005 Valuing BT's Copper Network Statement Ofcom decided the accounting basis to adopt when valuing BT's access assets. Pre 1997 assets where changed to follow a HCA basis and post 1997 assets remain on a CCA basis. It was proposed to maintain the 2005 Decision on approach to valuation of BT's duct assets until the competitiveness of the appropriate markets was reassessed. In this consultation Ofcom is reviewing if this is still appropriate following the market assessments undertaken in the reviews of Fixed Narrowband Services Wholesale Markets (WAEL) and the Wholesale Line Access Market (WLA) which consider BT's market power in the provision of wholesale access services.

The 2005 Decision satisfied the legal tests in the Communications Act 2003 which apply when setting charge control conditions; in particular, the requirements that;

- "The setting of a charge control condition should be appropriate for the purposes of promoting efficiency, promoting sustainable competition and conferring the greatest possible benefits on the end users of public electronic communications services; and

- in setting such a condition, Ofcom must take account of the extent of the investment in the matters to which the condition relates of the person to whom it is to apply"

We note that the 2005 decision passed without challenge and that the WAEL (2009) and WLA (2010) market review conclusions reaffirm BT's SMP within these market places and we share Ofcom's view that the prospect for local access competition has not improved, indeed the provision of PIA suggests that the prospect has in fact worsened. Therefore, as nothing material has changed we believe it appropriate to leave this pre-1997 methodology in place.

Question 3.6: We note that we would expect that the difference between the charges for MPF and PIA should be at least as great as the difference in their respective incremental costs. Thus, if we maintain the RAV adjustment in copper based access services, we would expect that any assessment that we make of duct access charges would reflect a consistent approach to asset valuation, recognising the RAV adjustment. We consider this to be consistent with economic considerations and the European Commission's NGA recommendation. Do you agree with this assessment of the need to recognise the RAV adjustment in the setting of duct access charges? If not, please give your reasoning.

We would support a consistent approach to this issue and consider that it is entirely reasonable for the new PIA duct charges to reflect the same RAV adjustment as copper based access services. Downstream MPF charges reflect this approach to duct valuation and it is therefore relevant to employ a consistent treatment to upstream PIA services.

In Annex 5.55 it is stated:

"Efficient relative prices can be achieved by setting the charges for PIA, MPF and other access products in a consistent way, reflecting a consistent asset valuation including the RAV adjustment in all cases."

We agree that a methodology for incorporating the duct valuation within charges for new service must be consistent with the approach taken for older existing services. Varied application of the methodology for new services (which will use a combination of pre and post 1997 duct facilities), would only serve to unjustifiably discriminate and introduce inefficient incentives for the purchase / use of one service compared to another.

We do not regard that the 2005 Decision allows for differentiated approaches to allocating duct costs to different services. The 2005 Decision sets a clear position for all services.

Question 3.7: Do you agree that it remains appropriate to value post-1997 assets on a replacement/CCA basis? If not, please give your reasoning.

This is a complex issue and one which needs to be considered carefully both in the context of this consultation and for the future. The issue was discussed at length in the paper commissioned by UKCTA from Towerhouse for Ofcom. The weaknesses in the current regime have been highlighted by BT's decision to re-value its local access duct network, as it demonstrates the level of judgement needed to derive current cost accounting numbers and the need to make entirely arbitrary assumptions. This has led to questions over BT's motives as it has had the opportunity and incentive to choose these assumptions in a self-interested manner, making it far from clear the extent to which charge controls allow BT to recover more than their actual costs and creates a high degree of uncertainty over the future path of prices subject to charge control.

In the short term, Ofcom's goal should be to protect stakeholders from unnecessary price volatility, however we would like to see a more strategic approach taken in the future, which will offer more transparency and will reduce the amount of regulatory uncertainty for all, with a careful balance struck between the need to promotion of competition and the desire to protection of consumers from excessive pricing.

In the longer term We are not convinced that the long term valuation of post 1997 assets should remain on a CCA /replacement basis. A CCA valuation, over time, increases the value of an asset leading to increasing costs for services supplied over that asset. A CCA valuation is only desirable in a situation in which it is expected that alternative providers might enter the market leading to the eventual competing down the prices for local access services potential rendering these costs as sunk and unrecoverable going forward. We remain doubtful that alternative network providers of this sort will enter the market, in particular now that PIA has become a regulated remedy which allows and encourages greater use of BT's duct facilities. However do recognise that the current transition from current generation networks to next generation networks presents the opportunity for the establishment of new networks and at present there might be some uncertainty around how these new networks might be established. In seeking not to undermine such investment plans continuation of the status quo for the time being is a safe option.

Question 3.8: Do you agree with our assessment that as BT's recent valuation of post-1997 assets is not consistent with alternative estimates of replacement values it does not form a appropriate basis for setting charges? If not, please give your reasoning.

BT's recent decision to revalue of its post 1997 assets is startling and we wholeheartedly agree with Ofcom that it cannot form the basis for setting future charges. This is the second time that BT has decided to modify its accounting practises during a period when Ofcom is working to tight deadlines to deliver new charge controls, adjusting numbers within the regulatory financial statements which, if taken account of, would ultimately improve the financial standing of BT to the determent of its competitors. In this situation BT has reported a considerably higher duct valuation as a result of a new hypothetical rebuild discount proposed by a new contractor.

We agree with Ofcom that an important and key principle for the valuation of the post 1997 assets is that the valuation should be prepared on a consistent and coherent basis, using similar assumptions regarding the national discount and indexation.

BT's decision to drastically alter the hypothetical national discount used to determine the replacement cost from 45% to 14.5% fails to stand up to scrutiny. The basis of their decision seems to stem purely from the fact that a new civil engineering contract for the maintenance and provision of duct was negotiated during the previous year, but nothing has been presented by BT which would justify such a big swing in the input assumptions for the regulatory financial statements and we welcome Ofcom's proposal to disregard it for the purpose of setting this charge control.

As BT's new supplier is now locked into a £1BN support service contract with Openreach, we would question just how impartial and competitive the quotation received was. To our knowledge the quotation was not conceived as a result of a competitive tendering exercise and as BT has a large incentive to reduce the discount and we would assume that the new supplier, who will not be impacted by the outcome of this theoretical exercise, would be keen to please a very large customer.

Whilst actual repair & maintenance costs are reduced on average by 8% under the new contract, it is inexplicable that the hypothetical rebuild national discount has moved in the opposite direction, falling to just 14.5%. This contradictory evidence, if taken at face value would means that BT was able to secure an 8% reduction in its own real world costs, but push through a massive change in RFS assumptions, which would in turn would lead to its competitors real world costs increasing to a level significant higher than would previously be regarded as reasonable, all because BT has secured a more advantageous supplier relationship.

Ofcom has sought to replicate the valuation that BT undertakes. Ofcom presents its own valuation within Figure A5.6. Historic cost net book value is uplifted to an inflated net book value (which uplifts for cost inflation or alternative costs in line with wage inflation). After reducing the inflated net book value to reflect the (proposed) discount value of 14.5% Ofcom estimates a valuation of £2BN to £2.2BN (Ofcom uses £2.1BN in its charge control calculations) compared to BT's valuation of £2.9BN. The difference in approach to valuation identifies a gap of almost £1BN.

There is an argument, for regulatory purposes at least, that it is Ofcom not BT which should calculate the CCA duct valuation – or at minimum prescribes a clear methodology for BT to follow. This is because Ofcom has also found numerous issues/faults relating to the manner in which BT carries out the duct valuation. Indeed PwC – BT's auditors – steps away from sanctioning BT's approach under its audit approval by suggesting that the audit it conducted for one valuation method and performed for one purpose cannot be assumed to provide any comfort or assurance over another valuation method for another purpose.

Ofcom has found that:

- BT's method for valuing the post 1997 assets assumes that the replacement cost of capital expenditure undertaken in each and every previous year should be inflated by 47%.
- The above approach means that relatively new assets have gross replacement costs significantly higher than the amount actually spent on those assets.
- Rather than reflecting underlying cost trends in it valuation BT's approach inflates actual expenditure.
- BT omits to apply the discount factor used in its aggregate valuation – or indeed any discount at all - to the grossed up post 1997 expenditure estimate.
- BT's methodology fails to weigh the impact of inflation and other adjustments correctly over the period during which the total asset base was constructed[2].

It is not clear what has prompted BT to make some of the methodology changes to its approach. What is clear however is that the changes lead to a far higher duct valuation and consequential higher charges for services to be purchased from BT. Closer examination of BT's approach has identified further serious issues with BT's approach irrespective of the change to the national discount. We believe that Ofcom has raised reasonable doubt that BT's methodology to obtain a duct valuation is not resulting in credible valuation numbers that can then be used for regulatory purposes.

The requirement for robust regulatory accounting information has never been greater, with BT's regulatory accounting output coming under far greater scrutiny than ever before. BT's decision to revalue its network asset base serves to remind us that the current regime needs to be reviewed and reformed to provide stakeholders with usable and reliable information, which in turn will deliver stability and certainty. A fundamental review of the regime is now overdue, with a strategic approach needed to drive improvements in the quality of the regulatory accounting output produced, bringing about changes to create the right kind of culture around the preparation of the accounts. It is crucial that cost allocations are made using objective and transparent criteria that are designed to align with

[2] Ofcom shows actual expenditure in a period at £360M. Adjustments should give a net replacement cost of £290M whereas BT calculates £480M which is circa 30% more than spent on the assets when acquired 1 year ago.

Ofcom's regulatory objectives and aren't influenced by the needs of BT's businesses or the objectives of its shareholders. The creation of this culture alongside a more robust assurance approach will help to deliver more transparent and useable output that will make a real difference, bringing benefits to the entire industry and ultimately end users and consumers.

Question 3.9: Do you agree with our proposal to include a valuation of duct in the charge controls based on indexation of post 1997 expenditure? If so, should this indexation be based on RPI; GCSI or GCSI adjusted for either productivity, scale economies or both (the detailed examination of these indices is set out in Annex 4? Please give reasons for your answer.

For reasons of consistency we would support the use of RPI in this instance. We don't believe that it would appropriate to deviate to another measure in this one instance, particularly one focused primarily on building construction rather than street works.

Question 3.10: Do you agree with our proposal to discount the indexed valued by an estimate of a national roll out of duct? If so, do you consider BT's estimate of 14.5% to be appropriate? If you disagree with our approach please give your reasons.

We agree that the duct valuation should be discounted to reflect a national roll out of duct. The 14.5% number that BT presents is hypothetical and arbitrary. We have no doubt that should a competitive tender be offered for such a project that a far greater percentage discount could be achieved.

The previous 45% figure resulted via agreement between various expert stakeholders within BT including the General Manager (Procurement & Supply Chain), the Chief Architect, Head of Cumulo & Special Projects and a Senior Finance Manager working on the Network Process Improvement Team.

The justification for the rate of the Discount Factor in 2008/09 is stated in the CCA Methodology as: "Contract costs were discounted to represent the effect of the benefits that might be gained from a total platform replacement over a short period of time, including economies of scale, revisions in working practices and the effects of competitive tendering. The degree of discount applied is necessarily a matter of judgement and for 2008/09 was set at 45% which was supported by the views of a number of senior managers within BT."

The justification for the rate of the Discount Factor in 2009/10 is stated in the CCA Methodology as: "During 2009/10, a long term contract was awarded to a sole national provider of civil engineering services, which brought with it a significant discount. In addition, it allowed a more rigorous approach to estimating the discount factor to be adopted, working with the supplier and based on an analysis of their cost structure. It was concluded that the available discount was 14.5% and this value was used for the valuation of the assets for 2009/10."

However, from the BDO report we understand that the new figure of 14.5% came about via an email exchange between BT Group Regulatory Finance and Carillion-Telient (23rd April 2010).

"In order to maximise the efficiency of direct costs we made a number of assumptions:

- Work is done on a programme basis, rather than reactively,
- The roll out is geographic,
- Duct is built in long, continuous runs, rather than in small jobs, minimising set up, travel and pack up time,
- Increases in labour efficiency (fewer manhours) would be reflected in similar efficiencies in Plant & Vehicles and Consumables, with fewer people needing fewer vehicles, less travel and therefore less fuel.

The maximum improvement in efficiency expected from these factors is equivalent to [%]or [%]%."

It is not clear as greater context is not provided, although it appears to be BT telling Carillion-Telient what appropriate discount factor should be.

Ofcom commissioned BDO to examine BT valuation methodology. The report included the following comment in respect of the 14.5% rate.

"The following observations are examples within the methodology in 2009/10 that highlight the assumptions made:

- The Discount Factor in 2009/10 is based on the cost in the first year of the contract with Carillion-Telent. If the first year "actual" costs or subsequent year costs are substantially different, there would be implications for the 14.5% rate;
- The stepped approach to extrapolate current cost base up to regional, double, national is a relatively simple approach. The assumptions could over simplify the process and might not capture all the nuances associated with a total network replacement such as what economies of scale could be achieved in components/plant/vehicles cost and reductions in the suppliers" margin which remains constant at [%]% in the model, regardless of the scale factor used."

"There is a clear difference between the calculation of discount factors in 2008/09 and 2009/10. In 2008/09, the discount factor calculation was based on the opinions of a number of BT stakeholders. In 2009/10, it was based on an efficiency model jointly developed and agreed by BT and Carillion-Telent.

The assumptions and approach agreed between Carillion-Telent and BT do not appear to accommodate all the complexities associated with a determination of the discount factor. These include economies of scale for both direct and indirect costs, and reductions in supplier margins. There are concerns that assumptions which underpin the approach application have not been considered in sufficient detail, given the effect that the Discount Factor has on the 2009/10 Duct Valuation."

We note that despite the doubt raised over the value Ofcom continues to use the 14.5% discount value within its own calculations. We do not support that approach.

Question 3.11: Our range for the duct value is defined by the degree to which BT is able to establish contracts with cost below the national average? Do you consider that it is reasonable to expect BT to achieve below national costs on average?

We agree that BT's scale will enable it to obtain contracts with costs below the national average.

Question 3.12: Do respondents agree with our preferred approach to use glide paths to align charges with costs except in the circumstances discussed above where one-off adjustments may be preferable? Please give reasons for your response.

We agree with the approach of using glide paths to align charges with costs. We understand this to be the standard approach unless there is significant divergence between costs and charges.

Question 3.13: Do you agree with Ofcom's proposal to impose the arrangements for charge control compliance and requirements for provision of data set out in Annex 13? Please give reasons for your answer.

We consider it to be good practise for Ofcom to transparently monitor the charge controls that it puts in place.

We believe that BT should in addition provide information as to the general effect of price changes in relation to both internal and external sales.

Question 3.14: Do you agree with Ofcom's proposal to use the RPI as the appropriate measure of inflation for indexation? Do you agree that change in RPI for the year to 31 October preceding the start of each Relevant Year should be used? Please give reasons for your answers.

Ofcom and before that Oftel have used RPI as the measure of inflation since the first charge control in the communications market was established. Since the introduction of CPI in the mid-1990s many organisations have adopted it as their preferred measure of inflation and the popularity of CPI in recent years has accelerated. We now believe this is the right point in time for Ofcom to consider this issue in far greater detail than has been presented within the context of this consultation. While we don't believe further debate on the measure of inflation should delay Ofcom's work on this charge control, we feel it is important for Ofcom to commence a comprehensive review of the two measures of inflation in the near future, so that stakeholders can help make an informed judgement over which to advocate in future Ofcom charge controls. We simply have insufficient detail on this issue on which to base a decision and we would therefore urge Ofcom to embark upon a new policy project to review this issue. With HM Government now using CPI for an increasing number of purposes, a review to determine the most appropriate measure of inflation is now overdue.

Question 3.15: Do you agree with Ofcom's proposal to retain provisions for "Carry Over" in the new controls? Please give reasons for your answer.

Carry over appears a fair provision, however it requires transparency. Ofcom should collect data regarding BT's use of carry over so that its use can be better understood. Within subsequent charge controls we would like to understand the materiality of the use of the carry over provision.

Question 3.16: Do you agree with Ofcom's proposal that charge changes made under the new controls prior to April 2012 should be made with a minimum 28 days notice? Please give reasons for your answer.

We agree that Ofcom should waive the 90 day notification and replace this with a 28 day notification for the initial charge change notices required by the conclusion of the charge control. The delay in implementing the charge controls has meant that higher than necessary charges are in place presently and it is important that this is speedily rectified.

A notable exception to this is the co-mingling basket of services which would lead to a steeper increase in charges. We are however certain that those increases are questionable and the outcome of the consultation will be a marked reduction in costs attributed to that basket.

Question 3.17: Do you agree with Ofcom's proposal that charge ceilings for key services should be set for the 1st period of the new controls – i.e. the period between the first day of the new controls and 31 March 2012? Please give reasons for your answer.

We understand the proposal for charge ceilings for the first period to be designed to provide certainty around prices. Ofcom does not offer a fuller explanation for the proposal and we suspect that given the uncertainty around timing of the start of the controls that it would also be beneficial for first year implementation.

Question 4.1: Do you agree that we should set separate line rental charge controls for (i) MPF rental and (ii) SMPF rental?

Ofcom identifies that controlling MPF rental and SMPF rental separately is consistent with previous controls and more importantly will ensure that CPs and Openreach have maximum clarity of the prices of the core rental. We therefore agree that the controls for MPF and SMPF must be separate.

Question 4.2: Do you agree that separate baskets for MPF ancillary services, SMPF ancillary services and co-mingling ancillary services is appropriate to mitigate the opportunity for gaming while providing Openreach some flexibility to efficiently adjust prices?

We agree with this proposal.

Question 4.3: Do you agree that we should set basket specific controls as opposed to a single control which is applied to all baskets?

The level of the controls on the specific baskets will be set depending upon the extent at which current charges are out of line with costs and the required trajectory to ensure that costs align with CCA FAC at the end of the control period. It is expected that this will vary by basket and therefore basket specific controls are required.

Question 4.4: Do you agree that measuring compliance of basket controls against prior year volumes (as opposed to current year volumes) is a proportionate and practical approach to charge controlling ancillary services?

C&WW does not wish to retain a system which enable Openreach to game the charge control, yet neither does C&WW wish to move to a system which results in volatile prices.

The use of prior year weights was significant enough to result in Competition Commission analysis and recommendation that safeguards were needed. Ofcom proposes to include a tighter inertia clause to fulfil that safeguard. We agree that this is a reasonable approach.

Question 4.5: Do you agree that inertia clauses applied to the ancillary services baskets should be tightened from their current level of 10%? Please give views on the appropriate level of inertia clauses in the range 2% to 7.5%.

Yes we agree that it should be tightened. In general we expect charges within a basket to follow the basket trend for price changes which are in line with the RPI set by Ofcom. The ability for prices to drift to an entirely different price point must be tightly limited and therefore we favour a far tighter inertia clause.

Question 4.6: Do you agree that we should not align or intervene to narrow the differential in charges for MPF and SMPF expedite?

We agree.

Question 4.7: Do you agree that we should align the price jumper removals?

We agree that jumper removal pricing for MPF and SMPF should be aligned. The justification for the current difference is not apparent. In both situations an engineer is required at site. The difference in activity is that for SMPF a second jumper needs to be removed. We cannot see how the second jumper removal results in a price differential of £13.09.

Question 4.8: Do you agree that we should use the weighted average of current prices to estimate the 2010 price of the service for jumper removals?

No we do not support this methodology. We regard the jumper removal charge for SMPF to be too high in particular when directly compared to the costs of the very similar activity of jumper removal for MPF. Ofcom has not suggested that MPF jumper removal is being provided below cost. It therefore does not follow that the charge for MPF jumper removal should be increased when seeking alignment of charges. We propose that Ofcom does not use a weighted average charge but that the charge of SMPF jumper removal is aligned to the current MPF charge (£16.80) or that it is moderately increase to account for the additional activity for the second jumper removal.

Question 4.9: Do you agree that option 1, that is ensuring the alignment of similar charges at the beginning of the charge control period but not imposing any further obligation on Openreach to keep charges aligned, is the most appropriate and proportionate way to avoid competitive distortion caused by the misalignment of prices?

Ofcom has undertaken the activity of identifying that certain key LLU ancillary services have very similar activities yet have very different charges. Ofcom proposes that these services have their charges aligned to ensure that there are not competitive distortions between MPF and SMPF. However Ofcom then proposes to allow the charge to become unaligned again in the future. Whilst agreeing with Ofcom that charge controls benefit from simplicity we believe that a simple obligation to keep charges aligned within a percentage range would not overly complicate the establishment and compliance with the charge controls.

Question 4.10: Do you agree that a charge control of RPI-X should be imposed on MPF new provide to bring the charge into line with CCA FAC by the end of the charge control period?

Yes.

Question 4.11: Do you agree that charge controls control in the range RPI-7.3% - RPI-10.3% (base case RPI-8.8%) should be imposed on MPF transfer and SMPF connection to bring the charges into line with CCA FAC by the end of the charge control period?

Yes.

Question 4.12: Do you agree that the charge for MPF and SMPF cease should be zero and costs recovered from rental charges?

The impact of including the cease costs within the rental charges is 51p per annum for MPF and 28p per annum for SMPF. We question the difference in the two charges in light of the difference in action being only the removal of an additional tie cable.

Whilst we agree that having a zero cease charge is desirable we also note that many end users move via the migration facility rather than the cease process.

Question 4.13: Do you agree that the 70 low volume products in the co-mingling basket should continue to be charge controlled within the co-mingling basket?

Yes.

Question 4.14: Do you agree that time related charges should remain out of the scope of the charge control and subject to general remedies applied in the WLA market review?

No we do not agree. These types of charges are important and unavoidable and therefore Ofcom scrutiny is required.

Our issue with time related charges is far wider than the price for the services currently offered under this heading. Ofcom also needs to give guidance to BT regarding the introduction and movement of charges to TRCs – this might be able to be related to the further guidance Ofcom proposes to give around the cost orientation obligation later in 2011. We come across regular occurrences of OR/BT introducing charges for previous non chargeable activities / breaking out components of services into “new” chargeable services. All of these activities are essentially revenue enhancing moves which increase Openreach profits for services which are supposed to be under tight charge control obligations. We would like to see rules around setting charges for previously uncharged services and rules for breaking out parts of services to create additional revenue earning services.

Question 4.15: Do you agree that special fault investigations should remain out of the scope of the charge control and subject to general remedies applied in the WLA market review?

C&WW has concerns with the SFI product. SFI is a service which for many consumers is critical to getting a service functioning as it should. Following SFI work on a consumer line improvements are generally made to line quality and line speed. SFI is a service for the consumer rather than the broadband provider. As such we believe that Ofcom should have higher regard to the cost associated. In our experience despite the breaking of the SFI function into unique modules it is generally the requirement that three modules need to be purchased in order to resolve an end user’s issues. SFI therefore remains expensive for end users. Completion of three modules can very easily amount to £275 for the average case, which for typical consumers far outweighs the cost of the them getting a replacement line and replacing all of their CPE. We truly believe that it is necessary for Ofcom to investigate and determine the level of these charges. Clearly at £275 they are a barrier to end users achieving the broadband service that their line could support.

Ofcom proposes to charge control expedite connections whereas in our view SFI is a far more important service which should be charge controlled.

Question 4.16: Do you agree that the charges for special fault investigations should remain aligned between MPF and SMPF?

We consider that the area of SFI requires detailed investigation by Ofcom.

Question 4.17: Do you agree that electricity charges should remain out of the scope of the charge control but subject general remedies set in the WLA market review?

We agree with this proposal, however Ofcom should impose obligations for swift pass through of charges. The notification and processing time to increase charges should match the notification and processing time to decrease charges. In our experience Openreach is quick to pre-empt increase in charges and far slower to pass on charge decreases. Both increases and decreases should be treated equally.

Question 4.18: Do you agree that both MPF and SMPF expedited connections should be charge controlled within the MPF and SMPF ancillary services baskets?

Yes we agree. However we do not understand why this service is being controlled more tightly than SFI which we would regard more important for broadband service provision and end user benefit.

Question 4.19: Please indicate which of the Options 1 – 4 you think would be the most effective method of regulation of LLU enhanced care services. Please indicate whether you think Option 4 (removal of the cost orientation requirement and creation of a new requirement that the charges for LLU enhanced care should not be misaligned from those for equivalent WLR enhanced care services) would be an effective remedy.

Cost orientation for LLU enhanced care must not be removed. We use this input to supply our retail business services. We regard business grade care levels non discretionary for access services into our retail business services.

We note that in the case of wholesale ISDN30 that Ofcom has gone further than cost orientation by proposing that each of the enhanced care services be subject to a safe-guard cap of RPI-0%.

C&WW therefore advocates at a minimum that Ofcom adopts option 1 which is no change to the current situation – cost orientation obligations are retained.

An approach consistent with the consideration for wholesale ISDN30 would be adoption of option 3 which involves directly charge controlling these services or setting a safeguard cap.

We do not agree that option 4 of aligning LLU enhanced care to WLR enhanced care is workable due to the distinct differences in downstream usage of LLU inputs compared to WLR services. We do not regard the protection that Ofcom believes might exist for WLR enhanced care via switching in the event of unacceptable price hikes flows through to users of LLU enhanced care. Indeed we regard the inclusion of LLU volumes and the non discretionary nature of enhanced care for business services to weaken the protection for WLR uses in the event that they are linked as proposed in option 4.

Question 4.20: Do you agree that new services which partially or fully replace existing services should be included in the charge controls?

Yes. We have experience of BT / Openreach seeking to charge for services that had previously not been charged for directly. Ofcom needs to provide clarity over the situation whereby BT / OR seek to introduce new direct charges for service which we believe the costs of which are already covered by the general bucket of costs within a charge control. We have particular concern in situations where BT/Openreach does not intend to reduce other services by the amounts sought to be recovered in the new additional charge. We believe that this is counter to the charge control regime which seeks to identify all costs and allow recovery of those costs. Where a service is not new it must be assumed that costs are already recovered. Whilst it might be appropriate to introduce a direct charge to encourage efficient behaviour by CPs we would expect offsetting reductions to also occur in order to ensure that BT/Openreach is not recovering the same costs twice.

Question 5.1: Do you agree that the core rental should be subject to a charge control which sets the price of the WLR core rental on a glide path to ensure it recovers CCA FAC costs by the end of the charge control period?

Yes.

Question 5.2: Do you agree that WLR transfer should be subject to a separate charge control? Please give reasons for your answers.

Ofcom has identified that a cost orientated WLR transfer charge even at the LRIC floor could be as high as £11 by the end of the charge control. A transfer charge at this level would be terminal for WLR competition. Margins for WLR are very low. Increases to the existing transfer charge will have significant impact on the viability of WLR without a considerable term (circa 18 /24 months) minimum contract period in order to recover costs.

We agree that a long term approach to achieving the appropriate charges is warranted in this situation.

Question 5.3: Do you think that Ofcom should adopt Option 1 or 2 above as its approach to the pricing of WLR transfer during the next charge control? Please give reasons for your answer.

Ofcom has adopted Option 1 within its modelling and we agree that this is the appropriate decision.

Question 5.4: Do you think that the cost orientation obligation should be removed from WLR transfer services? Please give reasons for your answers.

As BT cannot comply with the cost orientation obligation given that Ofcom will set the charge below cost, BT should be exempted from the cost orientation obligation.

Question 5.5: Do you agree that the price for WLR new provide should be subject to a separate control which ensures that the price is aligned with FAC by the end of the charge control period?

Yes.

Question 5.6: Do you agree that a charge control would not be practical for MPF to WLR conversion given the low volume of services.

Yes

Question 5.7: Do you agree that charges for MPF to WLR conversion should not be aligned precisely to the charge for WLR to MPF?

Yes

Question 5.8: Do you agree that charges for calling and network features should not be charge controlled? Please give reasons for your answers.

We agree that these services have appropriate regulatory protection under the cost orientated provisions.

Question 5.9: Do you agree that pre-validation charges should not be charge controlled? Please give reasons for your answers.

We agree that this is not a service that is sufficiently significant to warrant charge control obligations.

Question 5.10: Do you agree with that ISDN to WLR conversion charge should be subject to cost orientation obligation but should not be charge controlled? Please give reasons for your answers.

We agree. This is not a service we use significantly and a charge control would be disproportionate.

Question 5.11: Do you agree with that cancellation charges should not be charge controlled? Please give reasons for your answers.

We agree. This is not a service we use significantly and a charge control would be disproportionate.

Question 5.12: Do you agree that time related charges should remain out of the scope of the charge control and subject to general remedies applied in the WAEL market review?

Please see comments on time related charges in the earlier section.

Question 7.1: Do you agree with our general approach to estimating costs?

We have concentrated primarily on the co-mingling basket. Here we have identified that there is questionable cost allocation to the co-mingling basket as set out in the specific section above.

Question 7.2: Do you consider the task times to be reasonable? If not, please provide your reasons and alternative view, together with supporting evidence where possible.

We have not been able to estimate an alternative view.

Question 7.3: Do you have any views on our proposed assumptions regarding Openreach's ability to reduce costs through efficiency gains.

Ofcom has used as evidence all recent data available to it to inform a reasonable range within which BT's efficiency might fall. We note that Ofom has used the high end of the values for its modelling work. We note that BT's own forecasts are above the bottom of the range and consider that BT's own figures should be the minimum assumption used.

Question 7.4: Do you have any views on our proposed assumptions regarding the impact of inflation on Openreach's costs through efficiency gains?

We no additional views Ofcom's approach appears appropriate.

Question 7.5: Do you have any comments on our proposed approach to dealing with the changes in the cost of replacing the copper assets?

To ensure regulatory certainty Ofcom needs to ensure that a consistent approach is adopted. If there is an option to consider a reduced valuation of copper then Ofcom should pursue this.

Question 7.6: Do you have any comments on Ofcom's approach to projecting costs relating to Openreach's assets.

We have provided comment as requested in earlier parts of this response to the duct valuation and RAV adjustment.

Question 7.7: Do you have any comments on the proposed regulatory adjustments to be made in determining the recoverable costs

We do not question the need to contribute to BT's pension costs when we purchase regulated products. Pension costs represent a proportion of BT's labour costs and we believe BT should be compensated appropriately, based on efficiently incurred forward looking costs. However, any outcome that results in BT recovering more than efficient forward looking costs will have a detrimental impact on BT's competitors, consumers and the wider UK economy. Cable&Wireless Worldwide has been a strong opponent of any move that could allow the introduction of a deficit repair surcharge, believing it both unjust and inappropriate. BT has been the sole architect of the deficit, having benefited from contribution holidays in past. We are please that following a detailed examination of the evidence, Ofcom has reached the same view.

We agree with the drop wire adjustment.

Question 7.8: What issues should we consider when deciding whether to exclude costs relating to evoTAMs from the regulated cost stacks? If you consider that the costs should be excluded, please provide your reasons. If you consider that they should be included, how should they be allocated across services?

The cost of evoTAMs should only fall upon the parties that make use of the facility.

Question 7.9**:** With reference to Annex 12, do you have any comment on our approach to calculating Openreach's cost of capital.

C&WW responded to the approach to calculating Openreach's costs of capital via the WBA charge control. Our comments are replicated below.

A review of the history of the disaggregated cost of copper for BT Group suggests that Ofcom's approach to calculating the disaggregated values has evolved. If our understanding is correctly founded then we would argue that the present approach unfairly attributes a higher cost of capital to the services falling under the "rest of BT".

Within the final statement (18th August 2005) on "Ofcom's approach to risk in the assessment of the cost of capital" the methodology of disaggregating an access copper products cost of capital is based on the mean capital employed and on a split of access : rest being 40%:60% (para 7.78). At this time Ofcom's focus was on the mean capital employed by BT's copper access products while Openreach was just being established as a separate BT line of business.

In the next review (22nd May 2009) relating to the disaggregated cost of capital "A new pricing framework for Openreach" at para 8.74 it is stated "We also note that Openreach is now a larger proportion of BT Group (as measured by mean capital employed) than it was in 2005, having increased from around 40% in 2004 to around 50% in 2007 and 2008. This has a knock-on effect for the beta of the rest of BT". We believe that it was at this point that Ofcom moved from using a specific copper access mean capital employed to a calculation which instead included all of Openreach mean capital employed.

Within the current consultation Ofcom states that Openreach (in its entirety) accounts for almost half of BT's capital employed. The (all of) Openreach mean capital employed figure is again used in the disaggregating calculation. A cost of capital is calculated for Openreach. However having determined a cost of capital for the Openreach business Ofcom then only applies the Openreach cost of capital to Openreach copper products (LLU and WLR).

Disaggregation of the BT Group cost of capital to generate distinct Openreach and rest of BT costs of capital has resulted in a tight balancing act in which Ofcom choose to support the interests of CPs purchasing Openreach inputs (but in reality this means purchasers of LLU and WLR products) over the interests of CPs purchasing other services. The creation of a reduced Openreach cost of capital (for LLU and WLR) is to the detriment of (all other) services which incur the rest of BT cost of capital.

These other services must bear a higher cost of capital rate in order to arrive back at the overall BT Group rate. The present system approach is flawed. Ofcom should either

- determine the cost of capital for just the copper access products, or it
- should apply the Openreach cost of capital to all Openreach provided products.

6.1 We welcome stakeholder's views on Ofcom's approach to ERP estimates.

Ofcom's analysis and conclusions on this point is consistent with our own real life experience. It is our understanding the presently most commentators and companies are using an ERP of 5%. We ourselves would use 5% with reference to recommendation from LBS.

6.2 We would welcome stakeholders' views on Ofcom's approach to BT's Beta calculation.

We believe that the beta calculation needs to account for BT's pension treatment.

We note Ofcom's decision to exclude any adjustment to the cost of capital in connection with the existence of BT's large defined-benefit pension scheme deficit. We would reiterate the views that we expressed in October 2010, and disagree with the conclusion that Ofcom has reached on the issue. Based on the evidence presented, including the PWC report commissioned by Cable&Wireless Worldwide, Sky and TalkTalk we believe that there is more than enough evidence for Ofcom to mandate a small but significant reduction in BT's regulated cost of capital to remove the impact of the defined benefit pension scheme.

There has been an acceptance by Ofcom in the Pensions Review that the existence of a defined-benefit pension scheme tends to increase the observed WACC above the cost of capital of the operating assets. Given the size of the BT Pension scheme and its overhang (with comparatively few contributing members still employed) the phenomenon is likely to be more pronounced. We firmly believe that it is the WACC of the operating assets that should be used to derive wholesale prices. Ofcom has compelling evidence available to it on the size of the reduction and therefore we would urge Ofcom to reconsider its stance on this issue.

Ofcom proposes to rerun analysis on the BT Group beta to remove the period that fell within the uncertainty of the credit crisis. We support this approach as the credit crisis was an exceptional event.

Ofcom asks whether it should use reported net debt or Bloomberg's adjusted net debt. It is our understanding that the Bloomberg adjusted net debt includes adjustments for under funded pensions and capitalised leases. If this is correct then clearly Bloomberg's rate would be highly relevant.

Question 7.10: With reference to Annexes 8 and 9, do you have any comment on our approach to allocating costs

We identify in the section at the start of this response our concerns with the manner in which costs have been allocated to the co-mingling basket. Those comments are relevant to this question but we do not repeat them.

Question 7.11: Do you agree with the proposed adjustments to the cost stacks for pricing purposes?

In the LLU specific section we raised the issue of including LLU cease charges with the rental charges and information confirming that this would not lead to eventual over recovery or penalise customers using migration rather than ceasing.

Question 7.12: Do you agree with our approach for deriving the glide paths?

We have no comment.

Question 8.1: Do you agree with Ofcom's proposal to base charges on CCA FAC provided that this results in differentials between the core rental charges that are not less than the likely differences in LRIC and not significantly greater than the likely differences in LRIC?

We recognise the difficulty that Ofcom faces but also consider that it is important that services are not artificially promoted due to the manner in which CCA FAC charges have been built up rather than the actual differences in costs of providing each of the services.

Question 8.2: Do you agree with Ofcom's assessment of the likely differences in LRICs between MPF and WLR/WLR+SMPF?

Ofcom provides a wide range of what the differentials might be. We await the final figures to consider a firm view.