LLU & WLR CHARGE CONTROLS CONSULTATION (ANCILLARIES)
NON-CONFIDENTIAL RESPONSE BY BSKYB ("SKY")

KEY MIGRATION SERVICES, ANCILLARY SERVICES AND OTHER CHARGES

1. Individually price capping certain key migration services does not go far enough because there are still important services that either remain within one of the "ancillary service baskets" or are not charge controlled at all. Often Sky spends more on these items then it does on LLU services that are subject to more stringent price regulation. Ofcom should set individual caps for more key migration services and set up new baskets.

Ofcom's approach

2. Ofcom's approach to the structure of the LLU and WLR charge controls is to cap individually the prices of each of the three core rental services – WLR, MPF and SMPF – as well as certain key migration services:

   - MPF New Line Provide;
   - MPF Connections;
   - SMPF Connections;
   - WLR Connections; and
   - WLR Transfer.

3. Some of the remaining LLU services are then put into one of three Ancillary Service baskets – MPF Ancillary, SMPF Ancillary and Co-Mingling[1]. The individual baskets are then separately price capped so that the weighted aggregate prices of each basket glide to the weighted aggregated FACs for that basket.

4. Certain services are excluded from the charge control structure entirely and are subject to cost orientation and non-discrimination obligations only. These include widely used services such as Special Fault Investigations ("SFIs"), Time Related Charges ("TRCs" such as Abortive Visit Charges) and Power Usage charges.

5. Prior to 2009, Ofcom individually capped most charges before moving to an ancillary service basket structure.

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1 Related to space and cables in the local exchange.

More migration services should be capped individually

6. Sky supports the individual price capping of certain key migrations services. However, there are certain migration services upon which Sky is dependent but which Ofcom is not proposing to cap in this way. Ofcom argues that services that generate relatively low revenues are most appropriately included within one of the ancillary service baskets.

7. However, placing certain services within one of the ancillary service baskets is not always the best approach. For example, presently, only two LLU operators are unbundling significantly more exchanges – TTG and Sky – and, as such, co-mingling set up charges will be relatively more important to these operators than would appear from looking at costs in aggregate across the industry as a whole.

8. As LLU expansion is planned with BT well in advance and as the charge controls work on a prior year weighting mechanism, it is relatively straightforward for Openreach to price services that are growing in demand in such a way as to generate greater profits than the charge controls would allow if volumes were in a steady state.

9. BT retains the flexibility under Ofcom's proposals to earn excess returns and discriminate against individual operators (and their customers). As such, there is a strong case for removing certain services from the ancillary service baskets and controlling them singly instead. From the MPF ancillary basket, they are:

- MPF Connection – Stopped Line Provide; and
- MPF Mass migration[2].

Sky spends approximately [✂] respectively on these two services and, between them, they account for nearly [✂] % of Sky's forecast charges for this basket. To put this in perspective, Sky spends between [✂] on each of the key migration services (other than WLR Transfer).

New baskets are required

10. Tie-cable charges should be taken from the co-mingling basket and put into a separate tie-cable ancillary basket. Sky spends approximately [✂] on tie-cables which constitutes nearly [✂] % of Sky's spend on the co-mingling basket. Most of these charges are one-offs that are incurred when expanding capacity in an exchange or unbundling new exchanges – something that Sky is doing more of than most other operators.

11. Notwithstanding these issues, Sky's biggest concern, however, is that some important services are not included in the charge control structure at all and are merely subject to cost orientation obligations. Specifically, Ofcom is proposing to exclude power usage (or electricity)[3] charges, TRCs[4] and SFIs from price caps.

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[2] The scale economies that stem from mass migrating lines simultaneously in one exchange do not appear to flow through to significantly lower prices compared to singleton migration charges.

[3] LLU operators are charged for the electricity that their equipment consumes in the co-mingling area.

12. Put together, Sky anticipates spending more on these non-price regulated services each year than it does on either the MPF or SMPF Ancillary Service baskets ([✂] respectively):

- Power - [✂]
- TRCs - [✂]
- SFIs - [✂]

13. They constitute [✂] of Sky's total spend on non-rental services and, of all the ancillary services that Sky buys, it only spends more on tie-cables and "MPF Connection –Stopped line provide".

14. Ofcom offers the following arguments for not pricing capping SFIs, Power or TRCs.

15. First, for power, it claims that BT has little control over these prices as they are closely linked to the prices BT has to pay its wholesale energy supplier. However, this approach (of not price regulating services where BT has less control over input costs) is inconsistent with Ofcom's approach elsewhere. For example, BT can claim to have little influence over the price of copper cabling – a key cost input into MPF and WLR that, like power, is subject to price volatility – but Ofcom does not propose to exclude this cost element from the charge control as a result.

16. Furthermore, power costs feed into other cost categories which are included in the cost stacks for other charge controlled services such as WLR and MPF rental. For example, Group HQ costs will include power costs and will be allocated to Openreach and then on to individual services. Moreover, BT can claim to have little influence over fuel prices but that does not mean that the cost of running BT's fleet vehicles are not included in the cost stacks of charge controlled services.

17. Therefore, there is little foundation to Ofcom's approach. Power charges are significant and if Ofcom were consistent in its approach to costs over which BT has influence then it would include them within the charge control structure.

18. Second, Ofcom has explained that it is not justified or proportionate to require SFIs and TRCs charges to be capped because:

- they will be aligned between SMPF and MPF;
- they are subject to a cost-orientation condition; and
- not all SFIs and TRCs are SMP services.

19. However, as previously stated, Sky's expenditure on SFIs (and often TRCs) exceeds most ancillary service charges. Therefore, if it is proportionate to charge control certain ancillary services then it is inconsistent not to charge control these more important cost items as well. Further, Sky has little choice but to buy these services and, as such, for the most part, they are SMP services and cannot be sourced

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4 Openreach charges for additional engineer time on jobs outside of the standard provisioning and repair tasks. Examples include Abortive Visit Charges or missed appointments.

elsewhere. In any event, it would not be too difficult to extract the far smaller subset of services that are non-SMP and leave these charges unregulated.

20. While Ofcom's SMPF/MPF alignment initiative may go some way to addressing the risk of competitive distortion, it will do nothing to address excessive pricing. Moreover, cost orientation remedies have no efficiency incentives built into them - unlike an RPI-X charge control. In fact, quite the contrary, BT can be incentivised to "gold-plate" these services by introducing additional costs.

21. Sky considers that there is a strong case for by establishing a SFI/TRC ancillary service basket and a power service basket under the price cap regime.

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