Virgin Media
Communications House
Bartley Way
Bartley Way Business Park
Hook
RG27 9UP

Ciaran MacCann
Floor 4
Competition Policy Group
Ofcom
Riverside House
2A Southwark Bridge Road
London SE1 9HA

8th July 2011

Dear Ciaran,

Charge control review for LLU and WLR services

Virgin Media is pleased to respond to Ofcom's consultation relating to the review of the charge controls applying to LLU and WLR services. We set out our views on the matter below.

On this occasion, given our position in the affected markets and broader interests in the matter, we have chosen to focus our response on high level principles and approach, rather than addressing the questions contained within the consultation specifically. However, our response does cover aspects raised in certain of the questions – and we have sought to highlight where that is the case.

Introduction

The level and structure of charge controls is a critical factor in, and in many respects determines, the functioning and operation of the market in which the regulated entity, and indeed its customers and competitors operate. The controls must therefore be set at an appropriate level, compliance with them must be monitored and such compliance should be enforced from the outset. By the same token, 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 to the effects of Significant Market Power, and ensuring that unintended consequences – particularly the distortion of competition – do not materialise.
Furthermore, it is important that this approach is applied consistently regardless of the nature of the product subject to the control (e.g. passive, active etc).

Broader Impact of Controls and Approach

While we would of course not advocate the setting of controls at such a level that allowed a regulated entity to make excessive returns, or to operate inefficiently, it must, by the same token, be permitted to recover its legitimate costs of providing the services in question. In this regard we urge Ofcom to be mindful of the indirect effects that the level and structure of any control has on competing, non-regulated entities operating in the same market. In markets where competing entities are present the charge levied by the regulated (incumbent) operator effectively sets the benchmark price for the market – in other words the regulated entity becomes the price setter, with competing providers becoming price followers. In wholesale markets such as Wholesale Local Access ('WLA') and Wholesale Fixed Analogue Exchange Lines ('WFAEL'), this phenomenon then flows through to the retail markets, influencing line rental charges and charges for internet access services in particular.
Competing providers in the market will invariably have higher costs of provision than the regulated entity (due, for example, to an inability to realise equivalent economies of scale and scope). If the regulated price is set at too low a level, therefore, it could very likely cause those competing providers, in attempting to compete, to lower their charges to a level which renders them unable to recover their costs. Moreover, at the extreme, it could lead to them exiting the market.

At the very least, an inappropriately valued and structured charge control would very likely have strong disincentivising effects on existing and prospective competing investors in the same market and would quite probably undermine and de-value investments that have already been made.

This is particularly true in the case of the WLA and WFAEL markets. Competing providers in those markets are not able to replicate the benefits of scale and incumbency etc that BT is able to realise – and they certainly do not enjoy BT's ubiquity. Setting a charge control at too low a level or, indeed, setting efficiency targets for BT that are overly aggressive could therefore 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 their competitors. In the UK, the substantial investments made by the Cable industry in competing access network infrastructures has acted as a catalyst to further network investment by other operators - particularly BT. For example, Virgin Media and its forerunners were pioneers in the evolution from dial up to broadband services and latterly in the upgrade to superfast broadband, with BT making upgrade investments of its own in response.

The need to avoid disincentivising and/or undermining competing infrastructure investments is all the more critical at the present time, given the Government's broadband deployment objectives. Prospective investors will not invest if they cannot be sure that they will be able to make a sufficient return. Equally, those entities that have already invested in competing infrastructures will not contemplate further deployment of infrastructure, or upgrades to their existing investments, if regulated (and de facto benchmark) prices in the market are set at a level which renders them unable to recover their costs. We therefore urge Ofcom to take careful account of the indirect effects of the level and construct of the LLU and WLR charge controls and ensure that the controls are not set at such a level that undermines and/or disincentivises competing infrastructure investments.

Certainty and Control Duration

In setting any control on the level of BT’s charges, we consider that Ofcom should, as a principal objective, ensure an appropriate level of certainty and stability. This is important not just for BT as the regulated entity, but for its customers and competitors alike. The controls should therefore be unambiguous, absent of scope for alternative interpretation and their period of applicability should be definitive from the outset.

From a broader perspective (and in the context of Question 3.2), we would observe that a trend towards shorter control durations – driven, for example, by the amended EU Framework requirement for national regulators to normally undertake market reviews to a three year frequency – could result in less certainty and stability in the relevant markets. While we recognise that Ofcom must of course comply with the European Directives we urge it, in the undertaking of market reviews on a more frequent basis, to be mindful of the potentially lower levels of assurance that this could lead to.

Transparency and Control Standards

In order to provide BT’s customers and competitors with an appropriate level of confidence in the controls – not to mention the aforementioned certainty – transparency is key. It is vital that BT’s cost base is transparent and auditable and that exploitation of the system is prevented. BT’s Regulatory Financial Statements must be sufficiently clear and comprehensive such that compliance with its control obligations is easily scrutinized and the gaming of costs etc is immediately apparent.

Exploitation of the controls and/or ambiguity in their application would be detrimental not only to BT’s customers, but also to its competitors – particularly if this lead to a need for charges to be retrospectively adjusted, thus causing disruption to the ‘benchmark’ price in the market.

In this regard, and related to Question 3.3 and 8.1, it is our view that the LRIC + Equi-Proportional Mark-Up (EPMU) accounting standard would better meet the transparency objectives than CCA FAC, as LRIC + EPMU effectively removes the ability for BT to allocate common costs in its own interests. We encourage Ofcom therefore to set controls based on LRIC + EPMU and to require BT to produce its RFS on the same basis. Such an approach would, we believe, deliver tangible benefits in transparency and monitorability and would, for example, allow Ofcom and others to more easily ascertain whether accounting treatment accords with cost orientation obligations.

Regardless of which approach is ultimately taken, we consider that there is a fundamental requirement to ensure that the relevant figures are audited. We urge Ofcom to ensure that such activity is undertaken on a regular and proactive basis, and that it includes an assessment of whether BT is complying with its cost orientation obligations. Furthermore, it is vital that any audit is sufficiently robust, independent and underpinned by relevant supporting evidence.

We would be happy to elaborate on the concerns and observations outlined above or to discuss the matter further. Please do not hesitate to contact me should you wish to do so.

Yours sincerely,

Andrew Wileman.
For and on behalf of Virgin Media