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Dear Markham

A New Pricing Framework for Openreach

This response has been prepared on behalf of the Fixed Service Providers Association (FSPA) a group within the Federation of Communications Services, which represents more than 130 service providers and resellers of fixed telephony services including Wholesale Line Rental (WLR), calls packages and broadband. A list of our members can be found on the FCS website- www.fcs.org.uk

We welcome the opportunity to respond to this consultation as we believe that an appropriate pricing framework is essential to support effective competition.

We agree that operational separation and the creation of Openreach has delivered some benefits to stakeholders but still believe that structural separation within BT may have been more effective in delivering these. It must also be recognized that the late delivery of WLR3 has limited some of the efficiency gains which Openreach could have made by improving service and reducing their costs.

We also note that, whereas Openreach has reduced the price of some features and ancillary products, the price of several service products and other unregulated services has been increased significantly and that charging has been introduced for some services which were previously free.

As a result of these increases, we believe that the guiding principle in determining the new framework must be based on the concept of "total cost of ownership" i.e. the total cost over the life of the contract of providing service to the end user customer.

Another fundamental principle is that the transfer costs should not represent a barrier to switching, but the current price profile is a disincentive. For example the cost of a WLR to WLR transfer is currently £2 whereas the cost of an MPF to WLR transfer is £34.86. Many services to end users are now provided via unbundled lines, a fact of which the customer will generally be unaware. When, subsequently, a customer consuming such a service wishes to move back to a WLR based product, the additional cost will become apparent; in these circumstances gaining providers or customers may not be able or willing to fund the additional cost of switching which can lead to the user being stranded and unable to move to the new supplier of choice.

Our responses to the individual consultation questions are set out below.

Question 2.1: *What do you consider to be the appropriate goals for a new Pricing Framework?*

In general, we agree with the goals identified by Ofcom. We would add increased transparency of investment and planning as a worthwhile benefit.

As noted in our introductory remarks, the impact on migrations is fundamental. We do understand the cost plus argument which is used to justify the price differential of, for example, MPF to WLR transfers, as additional jumpering work is required. However, this approach, where the cost based pricing is calculated for each product separately has led to a gross disproportion in the cost of WLR-WLR migrations compared to MPF-WLR migrations (£2 vs £34.86). The result of this imbalance is a reluctance of some Communication Providers to absorb the higher cost of migrating from MPF-WLR, where this is required in order to acquire a customer. We believe that either the cost structure of the MPF and WLR products in relation to migration processes should be aligned more closely to support ease of switching in all scenarios or additional exchange based work should be considered as an overhead that is required to facilitate migration which is then absorbed as a general cost.

Question 2.2: *To what extent do you think that the existing framework has supported the achievement of these goals, and when has it worked against them?*

We believe that the success has been mixed. We accept that the new arrangements for operational separation have incentivised Openreach in making the necessary investment to improve efficiency (e.g. we now experience lower fault rates) and growth of LLU is evidence of competition being established at a deeper level of infrastructure. However, consumers have benefited from the success of unbundling at the expense of business customers who require the delivery of a fit for purpose WLR3 product.

Question 3.1: *What do you see as the key developments in the provision of access and line rental services since 2005 and how have these affected customers and consumers?*

We agree with the key point in Ofcom's summary that the rise of LLU is the most significant development in this area but note that (non-BT Retail) WLR continues to grow. As noted above, WLR remains the most popular vehicle for delivering business services. There still remains a substantial difference between the demands of end users in the residential and business markets, which is not always recognised by regulation, and we urge Ofcom to consider the differences between these customer segments as part of this price review.

Since 2005 the most significant development in the line rental services market has been WLR3, which has the potential to introduce a step change improvement in the quality of service that Communication Providers offer to end users. WLR3 also offers benefits to Openreach in terms of improved efficiency through increased automation, re-engineered processes and reduced contact from their Communication Provider customers (as key information is more readily available). However, late delivery of WLR3 functionality has slowed take up by industry which means that Openreach has not been able to capitalise on potential further efficiency gains for itself as well as delivering a better service to CPs and, consequently, their end users.

Emergence of VoIP as an alternative business to business proposition and the potential impact of next generation voice and broadband products and their demands on the access network will also be significant in forthcoming years.

Question 3.2: *Within the context of the overall package of changes instituted by the TSR, to what extent has the current pricing structure for LLU and WLR contributed to market developments and how sensitive do you believe future developments will be to changes in the pricing of those wholesale access services?*

Reductions in the cost of unbundling has spurred very rapid growth in LLU, especially within the residential market, and the figures suggest that in recent times WLR has effectively been subsiding this (e.g. section 4.4). However, it seems that the growth in LLU may have peaked (ref. the OTA report July 2008- www.offta.org.uk) so the review is timely.

Question 4.1: *Do you accept that the evidence presented by BT on movement in costs provides a compelling case for a review of the price controls? Are the cost movements consistent with broader industry trends?*

We do not agree that the argument is compelling (see our response to 3.1).

Openreach is working on the basis of recovering the cost of infrastructure and IT investment within a 2-3 year timeframe, which we believe is far too short. We believe that the benefits of a more resilient network and improved strategic IT systems will continue to be felt for far longer, in excess of 10 years, as such the costs of such investments should be amortised over a longer period of time.

Ofcom needs to consider the total cost of ownership involved in service provision (including charges for installation, ancillary services, repair of a fault line and other service products) and not just the headline rental charge.

A specific area of concern is the additional development cost caused by LLUOs in particular being slow to adopt new EMP releases. Incentives should be provided to encourage earlier adoption of new releases.

We also note that there appears to be a disconnect between the estimated cost increases suggested in paragraph 6.4 which are in the 3-4% range and the projected increases shown in paragraph 6.5/figure 6.2 which are double this in some years.

Question 6.1: *What weight would you give to international benchmarks in comparing LLU prices? What other factors should we take into account in considering the comparison of prices?*

We believe that this international benchmarking is a valid comparison. We also believe that population density in a given country is a significant factor in this area and that UK demographics, with the third highest population density of the countries being compared by Ofcom, should favour BT in such comparisons; In fact the two countries with higher population densities than the UK (as shown at http://en.wikipedia.org/wiki/Area_and_population_of_European_countries) both have lower cost fully unbundled loops, as shown in figures 6.6 and 6.7. The implication is that Openreach is not as efficient as it could be, and consequently fully unbundled loop charges reflect this. We would welcome further investigation of this factor by Ofcom.

We are also aware of anecdotal evidence that BT's cost of labour may be higher than necessary as it employs a high proportion of contractors, often for long periods of time, whose remuneration is higher than comparative full time employees.

The introduction of 21CN should not be ignored in evaluating the Openreach's cost stack as Openreach will derive savings from the introduction of new line cards for example.

Question 6.2: *Our initial analysis on the potential for efficiency gains is set out in Annex 8. Please provide your views on the appropriate efficiency projections that should be assumed for Openreach over the period, given the evidence collected so far and your own experience in this sector. Please provide any additional evidence that may be relevant in assessing these projections.*

We agree that the Openreach projections may be overly conservative and that these assumptions should be challenged.

We have concerns that the current product development process, in particular, is cumbersome, opaque and lacks efficiency. Openreach have recognised the need to address deficiencies in the product development process and are working on a transformation plan in this respect. We believe that Ofcom should perhaps estimate, and certainly monitor efficiency gains delivered by the product development process transformation programme. Failure to achieve potential efficiency gains due to delays in development, as has happened with WLR3, should not be rewarded.

Question 6.3: *In Annex 7 we discuss the options with respect to the scope of services to be included within this review. Please provide your views on the appropriate scope for consideration within this review and the appropriate treatment of non core services.*

As noted elsewhere, we believe that scope should focus on the "total cost of ownership" for any service not just the cost of core service aspects.

Question 6.4: *Should we consider greater or lesser use of price controls for SMP non-core services? How should price controls deal with this in terms of charge controls and recovery of common costs?*

As discussed in our response to question 6.3 we believe that a principle of "total cost of ownership" should apply, which implies that a greater use of price controls for "non-core services" would be appropriate; although this does not necessarily mean specific controls on individual elements, especially if a basket approach is taken.

Question 6.5: *To what extent should we incorporate the revenues and contributions to costs from non-SMP services in the review?*

See our response to questions 6.3 and 6.4 - all costs must be appropriately allocated where these contribute to the cost of providing a total service to customers.

Question 6.6: *Please review the other cost assumptions set out in Annex 7. What are your views on the assumptions made and adjustments proposed?*

No comment

Question 6.7: *Please review the volume assumptions set out in Annex 9. What are your views on future MPF and WLR growth? What factors are likely to be most important in determining the future level balance of demand for wholesale access services?*

Our belief is that the rate of growth of MPF lines may have peaked, and this is in no small part due to the lack of take up by the business customer segment of the market who continue to rely on WLR for the most part. Whilst there is unlikely to be a paradigm shift in the nature of the access market in the next couple of years (i.e. before pricing is reviewed again), we do think that the recent announcement by BT of a commitment to the introduction of fibre in the access network will influence the volume assumptions in Annex 9.

Question 6.8: *Is it appropriate to update our assessment of Openreach's cost of capital? If so, what are your views on the key parameters that should inform that review and what account should be taken on the current uncertainties in corporate and global financial markets? To what extent should we take account of the implications of (and for) new infrastructure investment?*

No comment

Question 6.9: *In the context of the current markets for WLR and LLU what do you consider to be the key challenges for ensuring allocative, productive and dynamic efficiency in the context of the revision of charges?*

In the current situation we believe that productive efficiency is the key consideration as substantial gains are still to be realised and market forces will drive other forms of economic efficiency. However in a sector which is driven by innovation it is important that incentives are provided to enable Openreach to invest in the necessary infrastructure improvements (e.g. fibre)

Question 6.10: *How would price increases for MPF, SMP and WLR affect Communications Providers and the roll-out of LLU? How would this vary if the relative balance of WLR, MPF and SMPF prices were to change?*

We believe that increases in themselves will not have a significant impact on ability of CPs to sell products. However, if the relative cost of MPF is increased this may make the wholesale product a less attractive option. A slowing in the rate of growth may have an impact on exchanges which are not yet unbundled and may also arguably penalise new entrants whose cost of investment will be higher.

Question 6.11: *How will price changes at the wholesale level impact on consumers, taking account of network roll out and the potential impact on retail prices?*

We agree with Ofcom's analysis. There is a need to consider that rental costs along with call charges are increasingly components within "triple play" and "quad play" bundled packages in the residential market; this complexity makes analysis much more difficult as one product may cross subsidise another within a bundle, thus the impact of a change in price of one element cannot necessarily be easily assessed. The business market is distinctly different to the residential market and we urge Ofcom to take account of the differences when assessing the effect of price changes.

Question 6.12*: What are the implications of a new pricing framework for incentives to new infrastructure investment by BT and other Communication Providers?*

We think this is unlikely to impact on current plans which are largely aimed at improving efficiency and service.

Question 7.1: *Do you agree that it is appropriate to include an allowance for compensation payments in Openreach's cost base for the purposes of determining Openreach's service costs? If so, what level would you consider consistent with the level likely to be incurred by an efficient operator?*

We do not believe that this would be appropriate as it would dilute the incentive to improve performance which these payments were intended to provide. Arguably, Openreach has escaped the consequences of below par performance to date. We note that the first proactive SLA payments will not be made until 1st September this year.

Question 8.1: *Do price controls in the form of an RPI-X adjustment provide an appropriate basis for setting charges? If not, what alternative would you propose and why would this provide a more suitable basis? To the extent that adjustments in the current charge controls are required, should those adjustments be implemented immediately or spread over the term of the control?*

We do not believe that the precise form of the control is the most important issue; what is important is that it should be transparent, provide future visibility and that that the effect of changes should be staged to minimize impact on customers.

Question 8.2: *Should charge controls continue to be set separately for each of the individual services (WLR, MPF and SMPF) or would it be more appropriate to set an aggregate control covering some or all of these services?*

We believe that in general products should be independently measured and assessed, except in the context of those aspects of a product which relate to migrations (e.g. transfer charges), as mentioned in response to question 2.1.

Question 8.3: *Do you have any views on the appropriate structure of a control over all or any individual non-core service?*

We would once again highlight the importance of a focus on, and control of, the total cost of ownership of each product.

Question 8.4: *What are your views on the appropriate duration for a revised framework? Should Ofcom retain the flexibility to undertake a mid period review and what do you consider should be the appropriate triggers for such as review?*

We have no specific view on an appropriate duration, but any framework should recognise the need for a longer timeframe for assessment of the benefits and write off of capital expenditure on strategic IT projects, network improvements and other efficiency led projects.

Question 8.5: *Do you consider that it would be appropriate to consider automatic mechanisms for modifying the charge controls in the event of substantial volume change? Do you have any specific views on the start date for the new charge control framework?*

No comment

Question 8.6: *How should the Pricing Framework respond to new service offerings from Openreach? We would welcome examples of new services offerings which your would consider should be encouraged?*

We agree that the framework should not distort competition in the event of new service offerings arising. The principle of "total cost of ownership", which we favour, should be transferable to any new products or services. The pricing framework should encourage innovation which benefits customers (e.g. deployment of fibre in the access network), as mentioned earlier.

Question 8.7: *How would you suggest Ofcom be involved, if at all, in an assessment of the charges for these services? Do you agree that Ofcom should only consider regulating the prices of these services where issues of SMP arise or distortions might occur in respect of the recovery of fixed and common costs (between SMP and non-SMP services)?*

Please see our response to question 8.6

We trust that the above is helpful and our members would be happy to meet with Ofcom to discuss any of the issues raised in greater detail.

Yours sincerely

Jacqui Brookes

Jacqui Brookes OBE

CEO