

A New Pricing Framework for Openreach

Tiscali UK response to Ofcom consultation – August 2008

Ofcom committed to deepest level infrastructure competition during the Strategic Review, which brought about BT's undertakings and the regulatory environment that exists in the UK today. Tiscali supported Ofcom throughout that exercise and has invested heavily in the UK market as a result of changes to wholesale products and prices and the introduction of equality of access to promote competition. The success of LLU in the UK shows how effective the commitment to infrastructure competition has been and the process of rolling out continues, especially with industry plans to migrate to MPF in quantity. The benefits of infrastructure competition have passed from providers to consumers, as products have improved and prices have reduced.

Communication providers need to be able to rely on the regulatory settlement reached in 2005, in terms of a consistent treatment of regulatory bottlenecks, as well as Ofcom's willingness to control pricing for access to them. This does not necessarily demand unchanging conditions, but it does mean that potential impacts of regulatory actions must be assessed with great care. Ofcom now proposes to review price controls for critical Openreach copper network products, having not addressed pricing since reviews during 2004-2006. This comes at a time of continuing investment and physical roll out on the part of communication providers such as Tiscali and directly addresses the pricing and regulatory control of the products that Tiscali relies on to deliver services to consumers. As Ofcom models costs, volumes and market conditions, it must be completely confident in the validity of assumptions and not solely reliant on data received from BT, the incumbent monopoly that will benefit from any proposed price increases. Most importantly, Ofcom must aim to understand the effect of any proposed changes on UK consumers and avoid giving advantage to BT at the expense of competition and the ability of providers like Tiscali to innovate and improve.

The following submission deals with major concerns across the subjects raised by Ofcom's consultation and refers to consultancy work commissioned by Tiscali and others to inform responses and assist Ofcom in its deliberations.

Scope

Ofcom should seek to include all relevant services within its review exercise and take the opportunity to rationalise the regulatory regime dealing with Openreach services. Currently regulated SMP products should be included (covering rentals, connections, transfers, migrations, ancillaries and cable charges). It may be appropriate for some services to be charge controlled, as opposed to simply subject to cost orientation obligations. Cease charges and cable re-termination charges should be drawn into this review and placed under appropriate charge controls. This should cover the new 'soft' cease charge and future jumper recovery ('hard' cease) charges. Types of charges, such as capital versus operational, should be reviewed consistently so as to avoid any regulation favouring a particular business model or deployment strategy.

Structure

Starting price changes for the core services covered by the review should be avoided. It is unlikely that justifiable price increases modelled would warrant any such changes, but the destabilising effect would render them undesirable anyway. Prices are too sensitive in the market to allow such a policy; MPF rental has only just been increased to the existing ceiling, so a 'resetting' price change would appear unnecessary.

RPI-X% should be employed as a method to achieve a desired end point by a 'glide path' approach, allowing a sensible adjustment to individual prices or baskets of prices. Particular issues arise with the concept of applying a basket approach to price regulation: a) the potential for 'gaming' by the regulated party to gain advantage b) difficulties in monitoring experienced by the regulator c) a history of implementation challenges d) the need for baskets to address services with a consistent cost/activity focus.

Main service charges that should be controlled on a stand alone basis include core rentals, connections and ceases (covering WLR, SMPF and MPF). Other services could be grouped into baskets focused on commercial attributes and cost aspects (for instance, accommodation charges or cabling charges). Any use of the basket methodology must be reviewed very closely to assess any potential to exploit trade-offs between basket components, especially related to the specific timing of consumption or the blend of internal versus external consumption.

The setting of price controls to last for four years would be acceptable, as long as a review process is built into the new regime. This should enable assessment and revision to take place where relevant influencing factors have diverged significantly from a level incorporated into the original modelling. Thus, Ofcom could specify changes in volumes or market conditions or actual returns achieved that could trigger revision of the control factors set at the beginning of the period.

Efficiency

Tiscali expects to be able to see NERA and KPMG studies produced for Ofcom and also offers the results of commissioned research to assist in the review (see Appendix). BT has achieved historical efficiency gains of over 4%, yet Openreach appears to be making a case to Ofcom for a gain of only 1% to be built into financial models. The nature of Openreach and the relative inefficiency experienced and witnessed by customers suggests it should be able to improve efficiency at a faster rate than the rest of BT. It is appropriate for Ofcom to seek comparisons from all quarters, including other European incumbents and their regulators and even utility companies in the UK and Europe, especially where they have been subject to some sort of functional separation.

The UK industry is still in a growth phase and subject to the ongoing industrialisation of wholesale products and all the systems and processes that surround them. This includes examples such as continuing development of EMP by BT, the design and development of WLR3 as it reaches critical mass and various jumpering activities and the products that include them. The opportunities for efficiency gains are significant

now and still growing in number. It seems counter-intuitive that BT should argue for such low targets in the present environment.

Consumer Impact

The success of LLU since the completion of the Strategic Review and the inception of a new era in infrastructure investment has brought the UK to a point where close to 5 million broadband connections are unbundled and the roll out continues. Development of the platform has enabled product innovation and flexibility that has delivered benefits to consumers, at the same time as prices have fallen under the pressure of competition and facilitated by the cost efficiencies achieved with LLU investment. Much of the pricing flexibility available to providers, for any combination of services, has been used already and the relative significance of backhaul costs as a proportion of total cost of supply is low. This means that any increase in underlying costs that goes beyond a low level of material impact is likely to be passed on to consumers by providers.

The potential re-balancing between WLR and LLU would also affect consumers. Communication providers have developed their networks in good faith, based on the model for investment that emerged post-undertakings and LLU statements in 2004 and 2005. As the move towards MPF continues, for economic reasons and for the consumer benefit it can bring, there is increased sensitivity to any change in decision points or potential undermining of investment cases. Unwelcome impacts to investment plans, network roll outs and product innovation could easily occur. If any re-balancing based on cost analysis and modelling is required, Ofcom must ensure that the market is not damaged as a result and allow changes to flow through gradually to avoid destabilising effects and unfair advantage to the incumbent.

The risk of circularities affecting the validity of Ofcom proposals is also significant. It would be possible for changes made as a result of this review to influence plans and implementations that underlie the wholesale broadband access market review conclusions, deregulating geographic areas where LLU is deployed in concentration. This could render the conclusions invalid and force a review of that completed market review. Ofcom suggests that this would not be necessary, as nothing significant enough to bring about this situation would be proposed. This needs to be defined and quantified before anyone can draw such confident conclusions. Another circularity could exist where Ofcom uses data to build the current review (forecast volumes etc) that is then made irrelevant by what happens in the market as a result of the price controls implemented. The need for a review mechanism to be built into the control regime has been mentioned above.

It is important that Ofcom acknowledges and deals with these issues positively in the course of the review, to ensure that any actions taken are legitimate and do not store up negative market and consumer impacts for the near future.

Forecast Volumes

Tiscali has provided data on LLU planning, migration between platforms and assumptions made about the development of the UK market. Ofcom should be able to gain a composite picture from industry sources that can be compared to BT forecasts, OTA models and third party work that Ofcom has commissioned. It is important that

Ofcom is able to interpret subjective assumptions made by market participants, as well as pure numbers, to ensure that as complete a perspective as possible is achieved on the UK market and how it may be affected by any proposals. Issues to do with sensitivity and potential circularities have been raised above, along with the view that Ofcom must be able to build in a review process triggered by market factors deviating far enough from assumptions to risk invalidity of conclusions.

Tiscali believes that total lines in the UK market will be stable over the medium term and that growth in wireless or mobile broadband access will be mainly incremental rather than substitution for fixed access. The most important aspect of forecasting is assumptions made on the continuing growth of LLU and the transition from SMPF+WLR to MPF. Forecast numbers from BT include a large shift in internal consumption from SMPF to MPF. This must include major assumptions to do with the development of 21CN wholesale products, resolution of issues of equivalence and BT's retail strategy driving the need for bundled access. The choice that BT makes, MPF versus SMPF+WLR, is discretionary and mainly to do with internal transactions rather than networks and platforms. Therefore, the potential for BT forecasting to distort any modelling performed is large and must be eliminated. The rationale behind any BT plans must be transparent in this exercise and Ofcom must be able to monitor ongoing implementation and build it into any trigger mechanisms (see above). The fact that BT forecasting large scale transition to internal consumption of MPF could significantly disadvantage competitors, distort markets and create perverse incentives must obviously be accounted for and resolved in the course of this review.

Benchmarking

It is important that Ofcom continues to seek opportunities for meaningful benchmarking, even it is proving difficult to find useful comparisons. It would seem likely that regulatory authorities in other European countries and data concerning other national incumbents would be most enlightening. Analysis should focus on cost information and efficiency assumptions, especially where it appears that a comparison country is able to get services for substantially lower amounts than in the UK.

Tiscali suggests that gathering productivity and efficiency information from around the UK industry could inform the review and allow wider ranging assessment of Openreach achievements and objectives.

It may also be helpful, as suggested above, to obtain data from different industries that have experienced forms of functional separation, to assist reflection on what Openreach has done and what could be expected of it for the future.

Cost of Capital

Tiscali acknowledges Ofcom's work on the WACC applicable to BT and Openreach and has provided the results of some commissioned consultancy work to inform further (see Appendix).

It is important that current modelling accurately reflects market conditions and BT specifics, to prevent over-recovery (such as that achieved during recent years) being built in to the price control regime.

Answers to Ofcom Questions

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

The objectives that Ofcom sets out, related to Openreach and the TSR, are all legitimate and worthy goals. It is vital that Ofcom maintains a commitment to deepest level infrastructure investment and the regulatory principles established as a result of the TSR, as the UK market relies on this for competitiveness and ongoing consumer benefit. Any decisions made from now on must not be allowed to destabilise a developing market and investment environment.

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?

The framework has enabled the growth and success of LLU in the UK and forms the basis of the regulatory environment that companies like Tiscali rely on. The combination of wholesale access product availability, price controls and equality of access has allowed product innovation, price reductions and increased competition that benefits UK consumers.

The existing framework does not work against objectives, but incompleteness and unwillingness to enforce obligations would. Current projects, including SLA and SLG implementation, the BCMR and this pricing controls review should allow Ofcom to rationalise and strengthen the regulatory regime. In particular, the chance to resolve omissions in charging arrangements and ensure that all relevant Openreach services are included should be taken.

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?

The key development is the roll out of LLU and WLR across the UK, enabled by price reductions and equality of access obligations. Unbundling has proved cost-effective and successful in allowing more competitive, innovative offerings from alternative providers. The LLU footprint has expanded beyond initial expectations and now the transition from SMPF+WLR to MPF is reaching significant levels.

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?

The large price reductions included within the changes mentioned were the single most important factor in making LLU viable and competitive in the UK market. The pricing differential between MPF and WLR was the catalyst for free broadband and free line rental product offerings in the UK.

The sensitivity of the future of LLU to further price adjustments cannot be overstated; margins are so fine that any change will have a direct impact on investment, product development and consumer pricing.

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

Tiscali is in no position to comment on cost data supplied to Ofcom by BT. It is very unlikely that third parties will be allowed to see enough evidence to offer views on the legitimacy of it.

Tiscali agrees with Ofcom's conclusion that overall financial returns achieved by Openreach exceed the cost of capital estimated by Ofcom and built into the model for existing regulatory controls.

On the basis of what Tiscali is able to assess, there is an argument to be made for reviewing price controls to ensure that Openreach's cost of capital is correct and to prevent over-recovery within the regime. It may also be advisable to review expectations of the market and the development of networks and services, to ensure that the regulatory environment is in step with it.

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?

Benchmarking UK LLU prices against those found in other European markets is a valid exercise and Ofcom should continue to pursue comparisons. Physical and technical similarities between networks are enough that significant differences between prices should indicate issues with cost efficiency, at least. All local factors should be taken into account in any analysis, including regulatory approach, differences of geography, labour markets and cable penetration.

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 the sector. Please provide any additional evidence that may be relevant in assessing these projections.

Tiscali agrees with Ofcom's belief that Openreach's 1% projection is too low and that evidence of efficiency gains in recent reports from BT tends to support this view.

In the Appendix to this submission Tiscali offers a study commissioned (by Tiscali and others) to review efficiency expectations, amongst other things. As is shown, efficiency projections should likely be greater than either BT or Ofcom proposes, but a great deal more analysis and information disclosure is required to resolve this aspect of the review.

The UK market is still in a period of growth and active roll out, so one would expect opportunities for efficiency gains to be significant. Some examples are as follows:

- The continuing development of the EMP system to rationalise and improve the way the industry deals with equivalent products should enable efficiency gains of over 5% per annum, especially when the development of 'zero touch' solutions is a stated aim.
- The transition of the WLR base from WLR2 to WLR3 (both BT and industry connections) expands the use of EMP and efficiencies enabled by it, contributing in scale to the opportunity presented.
- Industrialisation of LLU products and engineering processes (along with 21CN work within exchanges) should enable step changes in efficiency on certain Openreach activities, particularly jumpering and cabling work that benefits immediately from economies of scale and improved practices.

It is difficult for a third party such as Tiscali to suggest an efficiency target that Ofcom should adopt for Openreach controls. It seems reasonable to suggest that a business such as Openreach should be able to aim for improvements of more than 5% a year, especially given actual recent achievements and overall BT expectations. Ofcom should also take account of lower level inputs on Openreach inefficiency that it receives from provider customers and that it experiences itself, alongside communications providers and OTA. Areas and examples for attention include the following:

- The size of Openreach corporate overhead seems very large and difficult to justify, especially given the nature of the business and the principles that gave rise to its creation. Expensive duplication of corporate functions that exist in BT Group already should be stripped out of a division such as Openreach.
- The level of Openreach bureaucracy, middle management proliferation and unresponsiveness experienced by the rest of the industry community is well-known. The organisation can generally be relied upon to be slow in reaction, over-represented at meetings and usually offering a changing cast of characters to deal with on any single subject. The contrasts sharply with the extreme leanness that is required in the super-competitive environment that Tiscali competes in.
- Openreach fault levels are high and suffer in comparison (see Appendix).
- The development of records-only cease capabilities revealed the serious inefficiency built into engineering activities previously and supports the view that more gains can be made (see above).
- Openreach product development has been poor in performance and inefficient, forcing the instigation of an expensive external consultancy review project to fix problems.

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.

The scope of services included should be widened to include all SMP services, therefore covering ancillary services along with core rental services. Cease charges

should also be included in this exercise, ensuring consistent treatment with other jumpering activities. The range of services would therefore cover rentals, connections, transfers, ceases, re-terminations and cabling. Charges for new line provision should also be addressed in the review, as they are currently at a high level and could constitute a barrier to entry and effective competition when customers have to transfer to and from MPF.

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?

Price controls should be extended to cover the non-core services, so the regime deals consistently with every relevant aspect of Openreach charging and market impact. The model used to derive the control regime should accurately reflect common cost recovery across all of Openreach's activities, therefore properly allocating between core, non-core and other products.

It may be appropriate for Ofcom to use a basket methodology for the price control of some groups of products and services, where their nature makes such an approach effective and any risk of detrimental impacts resulting from balancing between basket prices can be mitigated.

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

Any financial model used by Ofcom to design charge controls for Openreach should account for all relevant costs and activities within Openreach, otherwise there is a risk that analysis results will be deliberately inaccurate and incomplete. Once it has been decided that a new model should be constructed and a definite list of products to be included for charge controls is derived, the aim should be to incorporate all relevant functions, activities, cost elements and revenues into the model to achieve maximum completeness and accuracy in the output.

All the data needed for such a thorough approach should be available from BT and included in information that is shared with Ofcom under regulatory obligations. Reluctance to draw a line and restrict the depth of the modelling activity may cost money and time, but the importance of the exercise to the UK market and potential impact on UK consumers is too great to make sacrifices of that nature.

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

Tiscali is in general agreement with Ofcom's approach and conclusions.

Assumptions made on the level of compensation payments to be included in the cost model must be tested in discussion with the industry and possibly benchmarked against comparable cases before finalisation.

The potential for efficiency gains through EMP development has been mentioned above. If Openreach has detailed plans for development that can be separately

analysed and assessed for consequences, then this should happen as part of the next phase of Ofcom work, prior to decisions on cost calculations.

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?

Tiscali generally agrees with the view that SMPF+WLR will continue to be replaced with MPF, as that is clearly a favourable transition in the market. Tiscali has provided Ofcom with internal forecast data, but is not able to offer a more accurate view or estimate than Ofcom is able to derive from the sources available to it. Continued data collection (from BT, OTA and individual operators) and work to assess the direction of the market that Ofcom has referred to are vital to gain the best possible forecast for the UK. Tiscali is of the view that the total number of lines in the UK will remain relatively static over the relevant period and does not believe that this aggregate total will be significantly impacted by wireless and mobile substitution.

Migration to MPF for providers such as Tiscali is based on cost advantages, allied to increased ability to develop and innovate services for consumers. Price changes of any significance will affect the current business model and potentially change the relative situation and invalidate the modelling that led to changes. Assessment of the future balance of demand will only be reliable if a very careful approach is taken to the development of the model and implementation of any changes derived from its output.

Ofcom acknowledges the importance of the external versus internal sales split in using data from BT and other sources to model the market. Tiscali expects this issue to be a priority to resolve in further work. Most importantly, BT appears to be forecasting significant internal consumption of MPF, especially from 2009/10 onwards, and this must be reviewed and tested by Ofcom as modelling is developed. BT can choose what strategy to adopt as 21CN rolls out and whether to use MPF or SMPF+WLR without the same sensitivities and considerations as competitor organisations. However, any shift to MPF potentially loads cost into that area, impacting other providers and benefiting BT. If the forecast shift is not valid or if it is accepted but does not transpire, Ofcom must be prepared to review and change the model and regulatory provisions based on it.

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?

Tiscali welcomes Ofcom's update of the Openreach cost of capital and agrees that the WACCs for Openreach and the rest of BT should be lower than currently set (since 2005). Tiscali believes that Ofcom's initial analysis may give results that slightly favour BT and has provided some third party research to assist in the assessment of this, indicating an alternative range of 7.7% to 8.8%. Clearly, more work is needed on this aspect of the review.

A realistic account of current market conditions should be taken, without distorting analysis so that it is unreliable for future years within the life of any new regulatory regime. Calculations should be based on robust and defensible assumptions, taking reasonable account of any relevant investment conditions, without creating a bias that favours one party over another.

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?

Tiscali is not in a position to usefully comment on the task of reviewing cost allocation and attribution within BT, as it is not party to detailed data and modelling or capable of analysing it if it was.

The key challenge for Ofcom is to ensure that it is able to apply an objective view to the information it is given to derive a financial model that is accurate and robust and can support a regulatory regime that is valid for the medium term. BT's copper network is a well-established asset that underpins the whole UK telecommunications market and supports most of the competition that exists within it. Priority should be given to allocative efficiency and accuracy to ensure valid conclusions and prevent bias against competing providers.

6.10 How would price increases for MPF, SMPF 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?

Tiscali has provided Ofcom with some data on decision points for LLU investment, including the point at which MPF becomes desirable at an exchange level.

Decision-making is extremely finely balanced, mainly due to the price sensitivity in the market and the fact that margins of return are so low. Therefore, the potential for price increases to affect either profitability of operators or consumer pricing is very high. Ofcom may be inclined to attempt to balance proposals to minimise impacts on the consumer, but even small increases are likely to have to be passed on. This may then affect forecasts for sales and flow through to forecasts for LLU roll out and infrastructure investment. It would be wrong to argue that the regulatory regime should be based on out of date financial analysis, but it is vital that Ofcom understands the sensitivity of the market and investment behaviour to changes in these core wholesale prices.

The relative balance between prices would obviously affect any outcome for LLU investment. The commitment to MPF will become questionable if the model loads cost onto it to the benefit of WLR (and BT). Further roll out of MPF will depend on maintenance of the price differential between MPF and WLR. If the balance were to shift against MPF, investment would be likely to halt, as the 'hidden' costs of deployment (such as extra resilience, indirect support costs and increased call propensity) render the model unviable. Per customer, backhaul pricing is not normally significant enough to affect decision-making, although distance from exchange can drive extra cost by requiring extended reach backhaul products from Openreach. Tiscali acknowledges the importance of the BCMR and awaits conclusions with interest.

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?

Potential consumer impacts have been discussed in the first parts of this submission.

As has been stated, sensitivities are very high and the ability to absorb price changes very low. It is likely that increases would have to be passed on to consumers, but no precise knowledge of this would be gained until changes had already been made.

The risk of circularities in modelling and outputs is high. Ofcom may use assumptions that are invalidated by actual market outcomes, rendering the regulatory regime damaging and ineffective. Changes proposed may also cause alterations to plans for network roll out that invalidate the conclusions of the wholesale broadband access market review, leading to calls for that exercise to be repeated very soon after its conclusion. Ofcom may aim to ensure that nothing significant enough to cause this outcome will be implemented, but it does not know what the relevant significance test should be.

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

This subject area has been addressed, to some extent, in answers and comments given.

Ofcom should continue to promote deep level infrastructure investment, in accordance with the principles established during the Strategic Review process. The currently competitive state of the UK market and its healthy outlook depend on this. Decisions on LLU roll out, migration to MPF, product innovation and price reductions would likely be retarded by core price increases by Openreach and a shift in cost and price loading to MPF from WLR.

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?

It is appropriate for these payments to be included in the financial model, to the extent that they reflect activities and policies that exist within the industry and across similar cases in other industries. Ofcom should continue to research this and engage with industry participants on the subject, aiming to assemble views on the correct levels to allow and draw a realistic conclusion from what is available.

Benchmarking against other European telecommunications incumbents and regulatory regimes would be useful, along with intelligence on comparable utility industries and regulated companies.

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?

A price control regime based on RPI-X adjustment would be an appropriate way to implement the results of this review. It would be desirable to review and possibly introduce the use of the RPI-X methodology for Openreach SMP products, even without revisions to cost assumptions and calculations.

Any adjustments should be built into the modelling performed and then implemented over the term of the control regime. It is unlikely that any adjustment required would be so significant that a case for immediate 'starting charge' resetting could be made. In view of the sensitivity of the market to any actions that may be recommended, it is essential that a 'glidepath' approach is taken to any price increases.

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?

This subject has been discussed in the earlier parts of this submission.

Core rental, connection and cease charges should be charge controlled on an individual basis to avoid the risks associated with basket pricing methodologies and the opportunity for the incumbent to unfairly benefit from them.

As long as adequate provision is made for the reduction of risk of 'gaming' within baskets, a basket approach to common sets of ancillary services could be practical and effective.

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

See above for comments on the basket approach to price controls.

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 a review?

It is sensible to aim for a traditional four year framework duration, so that modelling and the price control regime put in place are manageable.

Ofcom should also ensure, as a matter of priority, that a trigger mechanism for mid-period review is put in place. The triggers specified should include volume assumptions (absolute line volumes, MPF growth, BT internal versus external etc) and potentially other market development indicators such as product and bundle specifications, pricing and LLU roll out. Review should be possible after one year of the control period, however undesirable the exercise would be, and Ofcom must commit to the work needed and enforcement capabilities to change the price controls where conditions require it.

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?

Mechanisms as described above are likely to be the best that can be expected in such a complex environment and modelling is probably too sensitive and multi-dependent to be able to introduce any truly automatic change process.

Tiscali assumes that April 2009 would be the earliest feasible start date for any new control regime, dependent on Ofcom meeting the target of final publication at or around the end of 2008.

If this target is not met and April 2009 implementation is not possible, the start date should be October 2009. The exact nature of the regime will dictate when during a control year price changes are actually made and how compliance monitoring is performed.

8.6 How should the Pricing Framework respond to new service offerings from Openreach? We would welcome examples of new service offerings which you would consider should be encouraged.

Ofcom will need to be very responsive to the introduction of new products by Openreach that are related to existing SMP products and therefore of key importance to providers relying on them. This is not to suggest a regime that inhibits Openreach innovation or investment. It is not clear from the consultation text that Ofcom has yet considered the full potential impact of new product developments and the risk of BT's competition being disadvantaged versus BT downstream divisions for significant periods of time in situations where no adequate regulatory provision has been made for new product offerings.

Openreach must supply products on an equivalent basis, so no advantage should confer simply from the introduction of a product. Ofcom must be able to deal with new offerings in terms of their inclusion within the charge control framework, on the basis of SMP assessment or relation to an SMP product. Openreach should not be able to launch a product variant that is not subject to a consistent and fair price control, where inclusion within the regime is clearly warranted. The difficulties and work involved in administering such a regime should not be underestimated, hence the insistence on making this point.

A current example of a product design and launch discussion taking place is xMPF (or voice only MPF), which has been requested by industry parties and is being finalised for launch by Openreach. This will obviously be related to MPF and SMPF, will be based on the copper access network and will be consumed by BT Wholesale as well as other communications providers. If the product is introduced it must be regulated consistently with the other Openreach copper products, both in terms of cost orientation and potential price control. This means that Ofcom must be prepared to incorporate the product into the financial model that drives the price control regime and adjust the regime accordingly. To do otherwise would allow unfair monopoly advantage to BT and invalidate the regulatory pricing framework immediately.

8.7 How would you suggest Ofcom should 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)?

As covered in the text above, Ofcom has a responsibility to determine how to run the regime of charge controls in a way that can deal with these situations.

It must be a requirement that Ofcom deals with the introduction of any SMP or SMP-related product. It must also be a requirement that Ofcom deals with any impact on the financial model behind the price controls that would substantially alter those price controls. This relates closely to earlier points regarding triggers for review and mid-term changes to the regime. Ofcom must resolve this issue in advance of finalising the present review, to ensure that rules are in place and the new regulatory regime starts with a clear understanding on how it will be enforced and reviewed.