Vodafone

June 2017

Response to Ofcom's Consultation:
Automatic compensation protecting consumers from quality of service problems
Non confidential version

1. Executive Summary

Ofcom has identified consumer harm resulting from particular forms of service failure. Ofcom proposes to put in place regulation that would require retailers to provide, and flow through the compensation payments, that Ofcom sets via an automatic process to end consumers. The intended goal is to both compensate consumers for the harm and also to incentivise higher levels of service provision.

We consider the incentives for improved service provision are in the best interests of consumers as ultimately consumers do not want to be compensated for a missed appointment, failed provision or delayed fault repair. They simply want their provider to turn up when promised, deliver on time and where faults occur, for these to be fixed quickly.

However by placing an obligation on retail service providers ignores the effects of SMP in the market. We consider the service failings that Ofcom has most concern over that will result in mandatory compensation, and the service failings that will endure, will relate to the Openreach portion of the service activity. The commercial power of retailers to drive the required performance improvements from Openreach does not exist – for this very reason Ofcom has intervened to put SMP Quality of Service controls in place. The consultation document fails to properly analyse the root cause of service failures. Understanding whether these are root causes of the retailers, or wholesalers is critical to ensuring that intended incentives effects can be realised.

Whilst we support the principle of Automatic Compensation, the proposals as set out fail to create the right incentives and fail to recognise commercial risk, reward and decision making are not aligned, leaving significant imbalances between industry parties which must be addressed. To effectively deliver improved industry performance standards, the impact must be felt where the cause of problems lies.

I. The consultation proposals leave the detail of the pass through arrangements to commercial discussion between retailers and Openreach. This expectation that retailers can put in place adequate contractual protection for a regulatory obligation create significant risk which is unacceptable to impose on retail CPs. Ofcom should instead set specific regulation on the timing and value of wholesale automatic compensation pass through.

II. Automatic compensation is distinct from wholesale SLGs (which cover other costs). The two should not be merged as it does not provide accounting or audit transparency.

III. Ofcom is proposing to allow Openreach the ability to recover the cost of the automatic compensation in the charge control framework – as a result, not only are all consumers paying the cost of compensation but the incentive to invest to deliver better service rather than manage the cost of failure is lost. Ofcom should preserve the incentives of automatic compensation which seeks to promote services levels above the regulatory service floors and therefore exclude the compensation costs from the charge control.

Ofcom's cost benefit analysis fails to capture the whole supply chain, and therefore fails to capture the costs associated with Wholesale Local Access Quality of Service. It is unthinkable that we can consider that 90% to 94% to be an acceptable service standard at the wholesale level, but that consumers are compensation at 100% and leave the retail market to deal with the gap. The two proposals must work hand in glove for the incentive effects to work.

Contents

2. Introduction

1. Ofcom is consulting on proposals to put in place Automatic Compensation regulations for voice and broadband consumers. This paper sets out Vodafone's response. As a relatively new entrant in this market, we have no ambition to deliver poor service or indeed for the market as whole to be perceived as one that delivers poor service. A compensation scheme would provide customers with a level of comfort in this regard. However, before a highly mechanistic regime is defined and put in place, a number of measures should be explored:
    a. Understanding the impact of more visible contractual promises for installation and repair.
    b. Allowing providers to set their own contractual standards in line with their product values.

    And only then should Ofcom define service levels that apply across the industry with automatic compensation applying.

2. The rest of this response is set out as follows:

    Section 3 describes the impact of Openreach on the broadband market and the need for joined up regulation.
    Section 4 reviews Ofcom's proposals in detail and
    Section 5 sets out the Vodafone response to Ofcom's questions.

3. The role of Openreach in the supply of retail service

3. Ofcom's consultation document does not adequately take account of the market dynamics:
    a. Openreach supplies approx. 87% of retail fixed line connections[1].
    b. The service failures for which Ofcom wishes to require automatic compensation and that will endure once this policy is in place will most likely to fall within the Openreach service provision domain.
    c. Payment of the compensation is intended to act as a mechanism to incentivise service improvement – unless the incentive falls where the improvements are required this will not work.
    d. The Wholesale Local Access Market Review sets out proposals for an economically efficient level of service performance which are far lower than that proposed in these Automatic Compensation proposals.

4. Openreach's service provisioning crisis started in 2009 and regulation is still required to move forward and improve their service levels – suggesting that Openreach finds no benefit or incentive to improve service beyond that set out in those wholesale regulations. As it stands, Ofcom's Automatic Compensation proposal fails to adequately join up with Wholesale Local Access Minimum Service Levels to be imposed on Openreach. Currently, the regulatory quality framework allows 1 in 5 repair activities by Openreach to fail the contractual standards (Service Level Agreement (SLA)). By 2021 it will still allow 1 in 10 repairs to fail their SLA. Ofcom must demand a higher rate of improvement from Openreach.

[1] https://www.ofcom.org.uk/about-ofcom/latest/media/facts fixed line market share 2016

5. For provisioning, it is Openreach that is the entity at risk of failure. Openreach's role is to undertake the physical installation, activation and or transfer of the consumer line making it ready for service. All higher risk activities and therefore where failure likely to lie. It is Openreach's engineers who will visit the customer's premises for fixed appointment slots. Therefore, it is Openreach's engineers who are at risk of missing appointments, and it is Openreach that is at risk of failing to provide adequate notice to the customer.

6. For repair, it is most likely that all "total service loss" repairs will fall within the domain of Openreach's responsibility. To date, Vodafone has yet to see a total service loss event occurring in our own network that was not remedied within a very short time period. Where our customer equipment has failed we courier this to the customer for same day delivery.

7. Based on Ofcom's data[2] of total compensation likely to be due to consumers and taking Openreach's market share we estimate that Openreach will pay out up to £175M[3] per annum in compensation costs, We understand that the automatic compensation costs which relate to the WLA market are allocated in the WLA charge control and as a result, are fully funded by customers wholesale rental charges. As such, Ofcom should consider whether retailers and consumers would be better served by accelerated plans for service improvement at the wholesale level.

8. Ofcom's 2014 Wholesale Local Access market review first recognised the substandard and declining levels of service provision provided by Openreach to its customers. As a result, Ofcom imposed quality of service regulation to enforce a minimum level of service. Between 2014/15 and 2016/17 Ofcom has enforced an improvement from a minimum of 67% of repairs conducted to SLA to a minimum of 77% of repairs achieving this. Provisioning has had an obligation to achieve 89%[4] of installations against SLA promise.

9. The industry needs to know whether it will be constantly apologising on Openreach's behalf or whether we will see improve service levels. At the current rate of service improvement, we could not expect Ofcom to set a 100% performance to SLA target until 2025. In the coming WLA QoS consultation process we will undoubtedly hear from Openreach that the minimum service standards will be challenging for Openreach to meet. Indeed, Ofcom will already have a sense of how challenging improvement will via the engagement that will have occurred to date resulting in the current proposal formulation. The fact remains that in 2021, Ofcom believes that best that Openreach can only be forced to attain repair service levels which will lead to 1 in every 10 faults failing to meet its SLA and consumer expectations.

10. We note that the WLA quality of service consultation does not propose to increase the capex allowance, or in any way directly require or facilitate Openreach to invest more aggressively in network health in order to proactively reduce fault levels. Instead, Ofcom requires Openreach to improve repair levels from 77% to 90% over the three-year period 2018/19 to 2020/21. Ofcom arrived at this requirement after collecting data from Openreach on the improvement that can be achieved given current costs, and after carrying out Analysis Mason modelling on the resources needed to achieve this improvement. But in our view, this approach will fail to achieve optimal service improvements within an optimal time frame. This is because

---

[2] Figure 12 of the consultation document Total compensation £163.7M - £201.2M (we use the top of the range)
[3] £201.2M divided by Openreach share of the market of 87% = £175M
[4] We quote the adjusted standard for force majeure value rather than the headline value as force majeure is allowed each year and consequently the headline value is never required to be attained.

neither the costing work requested from Openreach nor the Analysis Mason modelling work considers a fundamental issue: whether Openreach should, or could, spend some or all of the potential automatic compensation pass-through payment (circa £175M per annum) speeding up the time taken to improve its service and raising Openreach's service performance target.

11. In our view, customers will be best served if Openreach substantially increases investment in its network. Over the 3-year market review period, the reallocation of consumer compensation pass-through payment from Openreach could result in some £350 million of additional service improvement investment (assuming an overlap of 2 years between the live review period and the start of a compensation regime). Such investment would result in far better service levels for all users and would have a superior collective effect when compared with distributed per-customer compensation payments.

12. As set out the proposals will fail to have the necessary incentive effects on Openreach for two reasons:

    a. Ofcom fails to give proper effect to the proposals and suggests that industry negotiate the pass through arrangements of the compensation.
    b. Ofcom fails to give adequate transparency to the role of wholesaler's contribution to automatic compensation payments and we consider this is key to giving all stakeholder the correct information over the root cause of failure.
    c. Ofcom includes an estimate of the costs of automatic compensation with the charge control, allowing Openreach to recover the costs and therefore removing the incentive of unrecoverable costs to encourage service improvement.

13. In order to give proper effect to the intended incentives of the regime Ofcom should also propose detailed regulation to make the compensation regime properly functional. Ofcom must impose a Direction setting out the value and timing of the key pass-through payments from Openreach to retailers. Ofcom must also ensure the proposals for the WLA QoS regime has the same objectives of 100% service success, do not dampen the incentive effects by allowing cost recovery and is working together with the compensation proposals taking a joint view of cost benefit analysis decisions.

4. Ofcom's proposals

4.1 Repair

What is Total Loss of Service?

14. Ofcom proposes to set a regime that requires the payment of compensation following a total loss of service fault lasting longer than 2 to 3 days. We regard **total loss of service** to be the inability to receive a dial tone, or to be totally unable to access the internet (therefore not including intermittent issues). However, Ofcom will be aware of the concerns about Openreach's fault clearance test standard, which is discussed in the WLA QoS consultation. While Openreach continues to shut down in-tariff fault clearance once compliance with SIN349[5] is achieved, then surely retailers cannot be expected to deliver a higher performance standards? The problem of poor broadband service quality delivered over a copper network has been raised time and time again for nearly 20 years. The only real solution is to deliver fibre based broadband. In the meanwhile, setting service levels that are unachievable given the supply into the market creates a false promise.

Repair Timescales

15. We do not believe there is sufficient evidence for Ofcom to propose retail service standards in a market where Ofcom would like to see competition flourish. Setting the timescales by which compensation is payable overrides the contractual service promise to the customer. Retail service provision is competitive, benefiting the consumer with a variety of offers. Retailers vary their proposition pricing based on a number of variables including speed, inclusive capacity and service levels. This results in a variety of pricing offers ranging from basic to standard and premium, which have related service performance promises.

16. Ofcom's compensation measures should instead apply when a retailer has failed to meet its contractual promise relating to a product variant. For this to work effectively we agree that customers require adequate transparency regarding the detail of the service level accompanying their package.

17. Ofcom's compensation proposals have additional practical issues also fail to recognise the service provision levels that are available today. Notably, the Ofcom QoS measures require Openreach to perform to SLA and not to reduce the SLA timescale. The following charts are extracted from the Openreach website and show repair performance over an extended time period.

Average time to fix faults - maintenance level 1 Wholesale Voice Line – (working days)	Jan-Mar 2014	Apr-Jun 2014	Jul-Sep 2014	Oct-Dec 2014	Jan-Mar 2015	Apr-Jun 2015	Jul-Sep 2015	Oct-Dec 2015	Jan-Mar 2016	Apr-Jun 2016	Jul-Sep 2016
Overall	2.78	2.20	2.33	2.58	2.67	2.38	2.57	2.69	2.82	2.18	2.64

Openreach repair trends for Service Level Maintenance (SML) 1

18. Openreach's own statistics show that SML1 repair timescales are over 2 days (Ofcom's proposal).

[5] http://www.sinet.bt.com/sinet/SINs/pdf/349v2p5.pdf

Average time to fix faults - maintenance level 2 (working days)	Jan-Mar 2014	Apr-Jun 2014	Jul-Sep 2014	Oct-Dec 2014	Jan-Mar 2015	Apr-Jun 2015	Jul-Sep 2015	Oct-Dec 2015	Jan-Mar 2016
Combined	2.12	1.61	1.92	1.90	1.79	1.74	1.87	1.80	1.94
Wholesale Voice Line	2.45	1.91	2.09	1.95	2.25	2.03	2.16	2.17	2.39
Fully Unbundled Line	2.04	1.54	1.89	1.89	1.72	1.69	1.82	1.74	1.86

Openreach repair trends for service level maintenance 2

19. The SML 2 performance levels varies by service, but is just under 2 days on average.

20. A large proportion of faults take longer to repair and these types of faults are more likely to be in the total loss of service category of faults. Faults within the Openreach exchange are likely to be more readily repairable, whereas faults on the line - between the exchange out to the cabinet and end customer - are the faults that take longer to deal with. The charts below show a breakdown of faults not cleared within the target date – 20+% miss their target date by 1 day.

% faults not cleared after target date – maintenance level 2 –Combined	Jan-Mar 2014	Apr-Jun 2014	Jul-Sep 2014	Oct-Dec 2014	Jan-Mar 2015	Apr-Jun 2015	Jul-Sep 2015	Oct-Dec 2015	Jan-Mar 2016
1+ day past	18.52	11.01	14.91	16.31	16.96	16.99	18.76	18.32	20.79
5+ days past	9.08	4.85	7.04	7.62	8.72	8.30	8.90	8.64	11.80
11+ days past	4.13	2.30	3.40	3.62	4.44	4.21	4.55	4.09	6.87
31+ days past	0.49	0.49	0.55	0.69	0.84	0.90	0.91	0.91	1.79
Wholesale Voice Line	Jan-Mar 2014	Apr-Jun 2014	Jul-Sep 2014	Oct-Dec 2014	Jan-Mar 2015	Apr-Jun 2015	Jul-Sep 2015	Oct-Dec 2015	Jan-Mar 2016
1+ day past	21.29	9.50	12.97	12.59	17.27	17.93	19.12	19.25	23.10
5+ days past	11.21	4.21	6.50	5.45	9.64	9.50	9.80	9.86	13.77
11+ days past	5.37	2.05	3.40	2.05	5.31	5.05	5.10	4.77	7.95
31+ days past	0.68	0.47	0.76	0.46	1.11	1.27	1.33	1.02	2.09
Fully Unbundled Line	Jan-Mar 2014	Apr-Jun 2014	Jul-Sep 2014	Oct-Dec 2014	Jan-Mar 2015	Apr-Jun 2015	Jul-Sep 2015	Oct-Dec 2015	Jan-Mar 2016
1+ day	17.55	11.61	15.39	16.90	16.86	16.70	18.65	18.04	20.10
5+ days past	8.34	5.10	7.17	7.97	8.40	7.95	8.63	8.28	11.21
11+ days past	3.69	2.39	3.40	3.87	4.14	3.95	4.39	3.89	6.54
31+ days past	0.42	0.49	0.50	0.72	0.75	0.79	0.79	0.88	1.69

Openreach repair trends for failed SML repair

21. When a consumer fault occurs, several factors can cause an elongated flow of fault resolution. This includes the nature of the supply chain and the roles of Openreach as well as other wholesalers and end retailers. Ofcom recognises that a proportion of repair resolutions are the responsibility of the retailer, and retailers are obliged to ensure that all potential onnet fault resolution methods have been fully exhausted before passing a fault on to Openreach. But this activity takes time and may require ongoing engagement with the customer.

22. It is not clear whether Ofcom has considered the time needed for retailers to fully exhaust all fault resolution methods before we contact Openreach. We suggest that Ofcom allows retailers up to 48 hours of diagnostic processes to ensure issues do not lie with the customer or our service before progressing the fault onward to Openreach

23. The complexity of a particular retailer's supply chain and the service levels purchased from a supplier will determine the service levels that a retailer can contractually commit to the customer. {confidential} Measuring the compensation due falls within our current processes. A breach of our promise would occur in the event that Openreach fails to repair to the SML we purchased for that particular customer. This process is consistent with the timing of the current service failure Service Level Guarantee (SLG) trigger.

24. Ofcom is clear that "the party responsible for the quality of service problem should bear the cost of retail level compensation". As Openreach supplies approx. 87% of exchange lines (assumed from Ofcom market share data), it would be reasonable to assume that of the £120.5M compensation Ofcom attributes to total loss of service, Openreach will be liable for circa £105M of the costs via the pass-through mechanism.

25. We can only see Ofcom's compensation proposals creating the right incentive, and ensuring costs fall in the right places where:

26. The regime centres around the retailers failure to meet his specific customer promise, {confidential} days for total loss of service

    a. Openreach's processes are capable of informing us of the Openreach failure, and
    b. Openreach pays us the compensation set by Ofcom sufficiently in advance of the customer's payment being due.

4.2 Provisioning

27. The provisioning process for a landline and broadband service from a retailer's perspective is relatively simple. For a landline activation, the customer is allocated a number. That number is set up on the supplier's voice switching system. Where broadband is requested, the customer is sent a home router to be connected to the home NTE port. The retailers' activities are straightforward. Routers are sent by special delivery and line activation is a simple network activity. Both activities are within automated work stacks.

28. Delayed provisioning typically occurs when Openreach is required to make physical changes to its network to support a line or broadband service. As such, the delayed provisioning and provisioning inconvenience that Ofcom is targeting with its compensation proposals fall within the domain of Openreach.

29. Ofcom calculates that delayed provisioning will result in customer compensation of £73.2M. If we again assume that market share will dictate the proportion that will need to be passed on by Openreach, that would amount to circa £63.7M of necessary pass-through payments.

30. Missed engineering appointments can occur in the provisioning and repair processes. Missed engineer appointments will often relate to the Openreach portion of service activity. Ofcom estimates that compensation payments for missed appointments will total £7.4M. Based on market share, we expect that Openreach will at least need to pass through circa £6.4M.

31. We consider the proposals for provisioning could be workable where compensation is payable once a retailer has:

   a. failed his promise to a customer for service installation or missed an appointment without adequate notice and
   b. Openreach's processes are capable of informing us of the Openreach failure, and
   c. Openreach pays us the compensation set by Ofcom sufficiently in advance of the customer's payment being due.

Appropriately legislating pass-though

32. Analysis of the likely pass-through as a consequence of Openreach failure on service repair and provisioning shows that the automatic compensation payment will result in Openreach making pass-through payment to retailers of circa £175M per annum.

33. As is the case with pass-through arrangements in the gas and electricity sector, we expect Ofcom to provide "legislative" protection of the pass-through and the pass-through arrangements, by way of a Direction specifying the occasions when payment must be made, the level of the payments and the timing of the payments.

34. We disagree with Ofcom that the pass-through from Openreach, which will form a key part of implementing the Ofcom policy, is appropriately excluded from a final decision on the automatic compensation policy. It leaves retailers at considerable multi-million pound risk of failure due to automatic compensation[6].

35. We disagree with Ofcom that this level of pass-through could be successfully negotiated by industry – and given that the pass-through is simply to comply with the Ofcom obligation, it is unclear what would be negotiated. The pass-through regime needs to be substantially differentiated from the current SLG regime. Rather than combine the two regimes to achieve a single SLG payment, we consider it desirable to separate out the two compensation payments for transparency reasons.

36. This regime would need:

   a. an audit trail per Caller Line Identification (CLI) failure which can be tracked by the retailer and
   b. is paid in advance of the retailer's onward compensation payout to the consumer becoming liable.

37. An appropriate Direction by Ofcom would be akin to the following set out for gas and electricity suppliers. Electricity standards of performance have until recently been provided for in Statutory Instruments (SIs) separately from gas standards of performance. In both, the standards for retail suppliers were contained in the same SI as the standards for the local infrastructure providers – the electricity distribution network

---

6 We note that the cost of the cost of handling that failure as well as the reputational harm are covered in the existing SLG payments

operators and the gas transporters. However, as the standards actually applying to retail suppliers were very similar they have recently been combined into a single SI[7]:

38. It is notable that these regulations make explicit provision for the retail energy suppliers to pass on payments that have been made to them by gas or electricity network companies due to their failures under the standards framework.

> "*Distributed payments*
>
> *7.—(1) When a supplier receives a distributed payment for onward transmission to the supplier's customer, the supplier must relay the distributed payment to that customer within 10 working days of receipt of the distributed payment.*
> *(2) In this regulation—*
> *"customer" means any person who is supplied or requires to be supplied with gas conveyed through pipes or with electricity at premises which that person owns or occupies; and "distributed payment" means a payment to be made by—*
> *(a) a gas transporter to a customer—*
> *(i) in fulfilment of an obligation imposed on it by regulations made under section 33AA(1) of the Gas Act; or*
> *(ii) following a determination by the Authority under section 33AB of the Gas Act; or*
> *(b) an electricity distributor to a customer—*
> *(i) in fulfilment of an obligation imposed on it by regulations made under section 39A(2) of the Electricity Act; or*
> *(ii) following a determination by the Authority under section 39B of the Electricity Act.*"

39. These make provision, within regulation 21, for distributors to make payment directly to customers or via their supplier in the form of a further standard which requires a further payment to be made if the principal payment is not made within a specified time[8].

4.3 Cost benefit analysis

40. The Automatic Compensation Cost Benefit Analysis appears to exclude Openreach focusing on the ability of retailers to absorb levels of compensation cost, yet when we consider the effect of the proposed regime on Openreach including the plan to include pass through compensation costs in the WLA charge control it is apparent that the proposals come with significant cost to end consumers. The proposals also have an

---

[7] The Electricity and Gas (Standards of Performance) (Suppliers) Regulations 2015 SI 2015/1544 available at this link: http://www.legislation.gov.uk/uksi/2015/1544/contents/made The main set of standards affecting electricity network providers are The Electricity (Standards of Performance) Regulations 2010 SI 2010/698 available at http://www.legislation.gov.uk/uksi/2010/698/contents/made

[8] (5) Where this paragraph applies and the distributor fails to make the payment to the customer or the customer's electricity supplier for onward transmission to the customer of the sum to which he is entitled, in either case as soon as is reasonably practicable in relation to regulation 7 and within the prescribed period from the applicable date in relation to any other regulation, the distributor shall, except in any of the circumstances described in paragraph (7), pay the prescribed sum to the customer.

asymmetry whereby non SMP retailers are asked to absorb some / all costs yet Openreach the SMP party is allowed to recover costs.

41. We consider that Ofcom's cost benefit analysis on compensation payments has been incorrectly structured:
    a. The harm to consumers from the failure to their fixed service delay / loss is likely to be less than experienced in other utilities as most customers are likely to have a mobile back up[9]
    b. Ofcom has focused on the actions of Retailers alone
    c. Ofcom does not consider the costs or cost recovery by Openreach. The WLA charge control proposes to include recovery of automatic compensation pass through and therefore works in conflict with the incentives proposed by this policy.
    d. Consumers will pay higher rental charges to cover the costs of automatic compensation as these costs are included in the WLA charge control.

42. The total value of the compensation payments that customers receive is merely an estimate based on consumer research and will vary depending the accuracy of the research and on Openreach's success in improving its service standards and the number of network total loss faults that occur.

43. There is substantial risk that the costs of implementing automatic compensation for all parties in the market is underestimated. Ofcom proposes to implement the measures via a change to General Conditions, and therefore the obligations and costs of implementation will apply to all market participants regardless of size, profitability and stage of market entry. A review of the cost model indicates that some key costs proposed are considerably lower than those consulted upon at length during the mobile switching implementation costs consultation process.

44. Ofcom has considered in its analysis (within Annex 7 and within its assessment of impacts in section 9) the six identified retailers' ability to bear the extra costs of auto compensation themselves. Ofcom stresses that these companies in aggregate have a combined EBTIDA of £5,474M. However, this EBITDA number relates to a number of other product markets ***irrelevant*** to compensation payment, and fails to consider or address whether the policy is or might be cross subsidised by the suppliers' other sales activities. Ofcom should align these analyses.

45. Ofcom fails to consider the impact of its compensation proposals on new market entrants or the market in totality. Openreach financial data shows that Openreach is supplier to >580 Communications Providers (CPs)[10] across the markets it serves. Ofcom's cost benefit analysis looks at only six retailers, while the Cartesian cost to implement model considers implementation costs for only 71 market participants.

46. Ofcom fails to consider the role of Openreach within the supply chain and that the majority of the costs of automatic compensation will in fact fall to Openreach. We estimate that 75% of the total cost of consumer payments will fall to Openreach.

---

[9] 93% of adults have a mobile phone Q1 2016 https://www.ofcom.org.uk/about-ofcom/latest/media/facts
[10] Slide 69 http://www.btplc.com/Sharesandperformance/Quarterlyresults/Investormeetingpack.pdf

47. Ofcom fails to allocate these costs to Openreach and consequently fails to consider how Openreach might seek to recover the additional costs to itself, for example via higher rental costs for its regulated and unregulated services.

48. If Ofcom had undertaken the usual approach of evaluating the proposals in line with its own cost recovery principles, the tension between Openreach spending £175M per annum on consumer compensation which adds a potential further 15% of costs to wholesale broadband products, compared to that spent in 2015/16 would be identified. Or it might be considering a superior cost benefit to spend the circa £350M cost over the coming market review period in genuine service improvement activities to the benefit of all users of the Openreach network.

49. The cost benefit analysis fails to take account of the market complexity, simply reviewing current retail performance with a multiplier. The market is much more complex and the Cost Benefit Analysis model has failed to address this.

50. In addition, assuming that the industry is rich enough to pick up costs simply because it generates revenue is wrong. A simple analysis of industry EBIT shows that Virgin Media, Talk Talk, Sky and BT's retail EBIT is broadly the same as BT's wholesale EBIT generated through Openreach and BTWholesale. Demonstrating that any policy based on allocating costs based on revenue (even excluding non-relevant revenue) is flawed.

5. Consultation questions

Question 1: Do you agree with our framework for assessment?

51. We agree with Ofcom that certain aspects of service provision fail to meet customer expectations. However, Ofcom fails in its assessment to properly consider the root cause of the service failure which it deems requires consumer automatic compensation payments.

52. An in depth review would reveal it is in fact Openreach that is responsible for the failure of service installation occurring on time. Failure of timely service installation typically occurs when a customer requires a physical change to their line and or site / rather than when the activation request is a computer- or an exchange-based activity, such as rejumping. In line with its 87% market share of underlying connections we can expect that Openreach will be responsible for a least 87% of these failures.

53. Similarly, with total loss of service faults, the resolution is likely to lie with Openreach.

54. None of this should be news to Ofcom. Vodafone has continuously raised these service concerns since 2009. During this period, we have seen underinvestment, cost reduction measures and resource sharing measures put in place by Openreach. The consequences for the end customer have been negative.

55. While Ofcom is correct to identify the need for pass-through compensation payment where Openreach is responsible for the consumer failure, the regulator has failed to consider whether there are superior methods to achieving the desired goal of improving service provision as well as reducing the amount of time taken to fix a loss of service fault.

56. Using Ofcom's numbers, we estimate that Openreach will be directly liable for circa £164M of the £200M cost per annum to run this scheme.

57. We consider that Ofcom's goal should be to:
    a. increase the transparency of the service provider commitment regarding installation and repair timescales for the package that consumers are purchasing. This enables customers to understand the trade-off between price and quality they face when choosing a service package.
    b. accelerate the progression and investment by Openreach of service provision far closer to 100% of its SLAs. This should be achieved in the market review 2018/19 to 2020/21, rather than the subsequent period of almost 2025.

Question 2: Do you agree that in landline and broadband markets consumers are insufficiently protected from poor quality of service and that intervention is required?

58. The service provision issues Ofcom is concerned with rarely fall within the control and domain of the service retailer, in our view. Ofcom is well aware that as a wholesale service provider, Openreach currently lacks required service levels, and this lack has consequences for the retail customer.

59. We do not agree that retail markets are at fault for the service provision issues Ofcom is concerned with. Rather, it is the failure of the wholesale supplier to deliver the desired level of service.

60. With respect to retail service provision, we do believe that the transparency of service aspects can be improved.

61. Consumers would benefit from greater transparency relating to the service standards that accompany the services they purchase. We believe customers should have clear contractual commitments from their provider concerning:
    a. the engineer appointment date for their installation;
    b. the date of service activation;
    c. the expected time period for repair of services specific to their contract; and
    d. the process of and level of redress they can expect when these contractual terms are broken.

62. Access to this type of information would ensure customers are fully aware of the potential trade-offs they face when selecting a retailer provider. It could be that customers are happy with a lower price and a longer repair period knowing the average line fault (leading to a total loss of service) typically occurs only once every 6 to 7 years for superfast broadband, 9 years for standard broadband, 12 years for voice. Such customers may have 4G mobile and internet access at work, and may consider it unnecessary to purchase a speedy repair level when it is unlikely to be required.

63. Our review of Vodafone's proposition shows our customers have good levels of transparency regarding service installation appointments and service activation commitments. We inform our customers in writing of their engineer appointment date (when such a visit is necessary) and the service commencement date.

64. Our service packages and pricing propositions were designed to be supported with a specific fault repair service wrap standard. We consider that this information in particular could be made clearer to our customers. We consider a good outcome of this consultation processes would be the provision of useful information to customers about the promise their supplier makes for the service aspects.

Question 3: Do you agree that it is appropriate for automatic compensation to be introduced for landline and broadband consumers?
Question 4: Do you agree with our proposal to provide automatic compensation when a loss of service takes more than two full working days to be restored?
Question 5: Do you agree with our proposal to provide automatic compensation when there are delays in provisioning a landline or fixed broadband service?
Question 6: Do you agree with our proposal to provide automatic compensation when missed appointments take place with less than 24 hours of prior notice?

65. Vodafone does not consider it appropriate for Ofcom to enforce such regulation in the forthcoming period. This is because:
    a. Ofcom has overlooked service issues in the supply chain
    b. Ofcom is not best placed to set retailers' repair terms
    c. Ofcom has failed to recognise the repair sequence across the supply chain

Service issues in the supply chain

66. Given its role in regulating Openreach, Ofcom should be well aware of the issues with Openreach's service provision and the ongoing programme to enforce a higher service level attainment.

67. 87% of end retail customers are reliant upon the service provision that Openreach provides. It seems contradictory for one regulatory policy to require a slow but steady plan to improve service levels and determine efficient levels of service improvement while a second regulatory policy sets contradictory service goals.

68. We believe a consistent, joined-up approach is required. Ofcom should consider plans requiring Open reach to accelerate its service improvement and boost investment in its networks. As part of this approach, the anticipated £175M per annum of compensation pass-through by Openreach should be funnelled into service improvements.

69. In future, once we have reached a position of improved and standardised service provision by Openreach, we believe Ofcom's proposal would then be entirely rational and reasonable.

70. Vodafone considers it appropriate for a customer to have redress when a retail provider's promise, as outlined in a customer's contract, has been broken.

Removing the market's ability to differentiate nullifies competition

71. We disagree that Ofcom should specify the repair timescales a retailer should provide a customer. This proposal is inappropriate on a number of counts:
    a. It forces retailers to take a higher service level from Openreach than they might otherwise choose.
    b. It reduces retailers' ability to offer a range of differentiated services, including service as a differentiator
    c. It eliminates the ability to offer low cost, basic service propositions

72. Such a proposal does not give appropriate regard to the fact that retailers packages differ in price and service depending upon whether they are in the category of premium, standard or basic (and possibly an even wider range – premium plus[11]). Services are designed with differing levels e.g. inclusive calls and broadband capacity (limited v unlimited) and speed (standard, fast, superfast) along with specific care levels (premium, standard and basic).

73. Different retailers will choose to differentiate their packages and pricing with differing care levels. Similarly, different retailers will target different market segments with their propositions. The options to offer differing care levels and associated pricing should not be removed via regulatory compensation policy.

---

[11] For example, BT has 5 care levels across its consumer and business services – Standard Care, Total Care, Prompt Care, Critical Care and Priority Care. http://www.bt.co.uk/pricing/current/Maintenance_boo/2-0201_d0e5.htm

Ofcom has failed to recognise the repair sequence across the supply chain

74. A further difficulty with Ofcom's proposals is that it fails to consider the effect of the supply chain within the repair process.

75. Retailers typically seek to resolve a range of customer service issues in-house, passing only network fault reports on to Openreach. Reporting of service issues will first seek to determine whether an issue lies with:
    a. the customer or
    b. the retailer's equipment (the home router) or
    c. the retailers own network / platforms.

76. These activities take a period of time and Vodafone a maximum of {confidential} hours to this activity. When it is established that neither the customer nor the retailer is responsible for the service issue, the fault (which is then assumed to be a physical network fault in the Openreach domain) is passed to Openreach to be resolved in accordance with the Service Maintenance Level that the retailer has purchased from Openreach in association with the rental input (WLR line, MPF line, GEA). In the case of Vodafone, we purchase {confidential}.

77. Our service packages and pricing propositions have been designed to be supported with a specific fault repair service wrap standard. {confidential].

78. Overall, we consider that Ofcom has failed to consistently propose regulation across the WLA QoS obligations. A holistic review would result in a superior choice being made, which would be of greater benefit to all consumers.

Question 7: Do you agree with our proposals on transparency?

79. Even without this regulation, we agree that the customer should have access to information regarding the potential for compensation payments when things go wrong.

80. Retailers should provide information about this on their websites as Ofcom recommends.

81. Ofcom also proposes that retailers inform customers about compensation when they request the installation of a service or report a fault. We do not agree with this proposal.

82. We believe informing customers at the point of initial contact that a service installation or repair might be delayed sets the wrong tone between the customer and supplier. This immediately casts doubt over the supplier's ability to provide or repair the service as promised.

83. We believe the most appropriate time for this discussion would be held later in the process, when failure is becoming a real prospect, such as when we update the customer about a delay in service activation or a delay in repairing a fault.

Question 8: Do you agree with our proposals on the method and timing of payment?

84. We agree that suppliers should be given a choice regarding how to make a compensation payment.

85. The timing of the payment should occur during a time period when the customer can recall the incident. We agree that within 30 calendar days would be optimal.

86. Where the service failure is Openreach's responsibility, we will first need to ensure Openreach concurs that it has breached its SLA, and we will also need to confirm we have received the appropriate pass-through payment from Openreach. Following this procedure will ensure that the CP is confident Openreach has recognised the service issue is its own responsibility and will not challenge the matter. It will also ensure that the retailer need not have to advance cash flow to Openreach for its service failures.

87. At present it take up to 6 months before a retailer receives its full SLG payment from Openreach. We would need to receive the compensation pass-though from Openreach in advance of our payments to the customer. Openreach will therefore need to escalate its payment to us within 15 to 20 days after the service issue is reported.

88. We propose that when Ofcom introduces this policy, it includes a Direction stating: the precise amounts that Openreach is to pass-through to support these compensation payments, that pass-through has no time period cap that pass-through has no Matters Beyond Our Reasonable Control (MBORC) exemption, along with an obligation to provide the pass-through payment to the retailer in 15 – 20 days from the failure event, in order to support the final proposal that Ofcom makes.

Question 9: Do you agree with our proposal not to have a payment cap (and our assessment of the reasons for and against it)? - If you consider there should be a payment cap, what should it be and why?

89. We agree with Ofcom that there should not be any payment caps and this should be supported by ongoing pass-through from Openreach.

Question 10: Do you agree with our proposed exceptions?

90. We agree with the proposed exceptions.

Question 11: Do you agree we should not allow for a blanket exception for force majeure-type events?

91. Should Ofcom wish to compensate consumers in MBORC events, Ofcom must ensure that the pass-through compensation payments are mandated in these situations.

Question 12: Do you agree with our proposal on complaints and disputes?

92. We agree that a single mechanism for consumer complaints and disputes including compensation is desirable

Question 13: Do you agree with the impacts we describe? Please wherever possible give your reasoning and provide evidence for your views.

93. We consider that Ofcom's cost benefit analysis on compensation payments has been incorrectly structured:
   a. The harm to consumers from the failure to their fixed service delay / loss is likely to be less than experienced in other utilities as most customers are likely to have a mobile back up[12]
   b. Ofcom has focused on the actions of Retailers alone
   c. Ofcom does not consider the costs or cost recovery by Openreach. The WLA charge control proposes to include recovery of automatic compensation pass through and therefore works in conflict with the incentives proposed by this policy.
   d. Consumers will pay higher rental charges to cover the costs of automatic compensation as these costs are included in the WLA charge control.

94. The total value of the compensation payments that customers receive is merely a guesstimate based on consumer research and will vary depending the accuracy of the research and on Openreach's success in improving its service standards and the number of network total loss faults that occur.

95. The costs of implementing automatic compensation for all parties in the market are underestimated, in our view. Ofcom proposes to implement the measures via a change to General Conditions, and therefore the obligations and costs of implementation will apply to all market participants regardless of size, profitability and stage of market entry. A review of the cost model indicates that some key costs proposed are considerably lower than those consulted upon at length during the mobile switching implementation costs consultation process.

96. Ofcom has considered in its analysis (within Annex 7 and within its assessment of impacts in section 9) the six identified retailers' ability to bear the extra costs of auto compensation themselves. Ofcom stresses that these companies in aggregate have a combined EBTIDA of £5,474M. However, this EBITDA number relates to a number of other product markets irrelevant to compensation payment, and fails to consider or address whether the policy is or might be cross subsidised by the suppliers' other sales activities. Ofcom should align these analyses.

97. Ofcom fails to consider the impact of its compensation proposals on new market entrants or the market in totality. Openreach financial data shows that Openreach is supplier to >580 Communications Providers (CPs)[13] across the markets it serves. Ofcom's cost benefit analysis looks at only six retailers,

[12] 93% of adults have a mobile phone Q1 2016 https://www.ofcom.org.uk/about-ofcom/latest/media/facts
[13] Slide 69 http://www.btplc.com/Sharesandperformance/Quarterlyresults/Investormeetingpack.pdf

while the Cartesian cost to implement model considers implementation costs for only 71 market participants.

98. Ofcom fails to consider the role of Openreach within the supply chain and that the majority of the costs of automatic compensation will in fact fall to Openreach. We estimate that 75% of the total cost of consumer payments will fall to Openreach.

99. Ofcom fails to allocate these costs to Openreach and consequently fails to consider how Openreach might seek to recover the additional costs to itself, for example via higher rental costs for its regulated and unregulated services.

100. If Ofcom had undertaken the usual approach of evaluating the proposals in line with its own economic principles of cost causality and cost recovery rather than applying an analysis akin to punitive taxation, the tension between Openreach spending £164M per annum on consumer compensation which adds a potential further 15% of opex costs compared to that spent in 2015/16 would be identified. Or it might be considering a superior cost benefit to spend the circa £330M cost over the coming market review period in genuine service improvement activities to the benefit of all users of the Openreach network.

Question 14: Do you agree with our provisional conclusions on residential landline and broadband services?

101. We do not agree that Ofcom has made a correct assessment of the impacts. We consider that Ofcom has departed from analysing this policy proposal in line with a standard economic appraisal of cost causation and cost recovery.

102. A proper analysis of the i) market, ii) the supply chain and iii) the service issues that Ofcom is concerned over would reveal that Openreach is typically the primary party at fault. As such, Openreach is likely to be liable for the lion's share of customer compensation payments. We estimate that this will be £175M or some 87% of the total cost

103. Taking a wider review Ofcom would identify that the WLA QoS framework that Ofcom is proposing will permit an ongoing environment of consistent service failure for the coming 3 year period and concludes that there is today an efficient level of service failure.

104. In its review, Ofcom has focused on just 6 retailers when its own implementation model identifies some 71 retailers that will be affected. Ofcom' s stated rationale that a retailer's EBITDA will adequately absorb any increased costs is incorrect. Indeed, this rationale may prove to be a barrier to future market entry and competition. Looking at corporate EBIT from a variety of markets is not a good indicator of financial returns in these specific markets. Additionally, this approach does not take account of Ofcom's six principles of cost recovery, which have been established for over 20 years.

105. The proposals as drafted leave a significant gap with respect to the pass-through of any payments from Openreach to retailers. For the following reasons we believe Ofcom should instead require by Direction that Openreach increase the current payments made, by amounts that Ofcom considers appropriate:

a. It is standard practice for this arrangement to be clearly specified in legislation. We discuss in the opening section the legislation that achieves this for the gas and electricity sectors.

b. In our view the SLA/SLG review process is not a successful one. The process is extremely time consuming and never timely. The process is designed to achieve a negotiated compromise. A negotiated compromise would inevitably result in retailers footing parts of the bill for Openreach's failure and therefore mute the intended incentives for service improvement.

c. The desire for transparency of the compensation scheme would be better aided by differentiating it for the existing SLG regime.

d. Since Ofcom will specify compensation levels and compensation events, it is difficult to identify what else is left to negotiate. As such, it is unclear what Ofcom means when it states that the level of pass-through can be successfully negotiated by the industry.

106. The primary cost to most retailers will be the cost of implementing system changes to facilitate the reconciliation of timely pass-through from Openreach to accommodate the near term consumer compensation payment. The system development by all retailers seems to be entirely overlooked in Ofcom's current proposals. The Cartesian report with respect to implementation costs appears to make a number of incorrect assumptions. It also takes no account of the costing exercise which has already taken place for mobile switching,[14] during which it has already been established that. an IT engineer's salary is £65k and not £50k. The number of Retailers' Connectivity Services Agreements (CSAs) appears rather small compared to that concluded in the Mobile cost estimate which found:

Number of CSAs		
MNO	10,400	Average based on information received from providers
Large MVNO	4,000	Assumption based on information received from providers
Medium MVNO	500	Assumption
Small MVNO	20	Assumption based on information received from providers

107. In the case of Auto compensation, the following is included in the cost model

Number of CSAs to be trained

	Small	Medium	Large	Vertical	TPI	
Number of consumer CSAs to be trained	20	100	2500	2500	0	Cartesian assumption

108. Comparing the two estimates of CSAs shows a significant and unexplained difference between the number of CSAs needed to support mobile in comparison to fixed, which we question.

14 https://www.ofcom.org.uk/consultations-and-statements/category-3/proposals-to-reform-switching-of-mobile-communications-services-revised-cost-estimates

109. It is unclear how the model calculates or includes the costs to the Retailer of the process interaction between the retailer and Openreach, and the pass-through validation and flow through to the customer bill. It is unclear if the necessary process developments by Openreach are considered in the cost model. Openreach will be required to provide information as to whether it has failed a relevant automatic compensation SLA earlier than it currently does. Openreach will also need to make the pass-through payment far earlier than it does for standard SLG payments. This should be a separate payment that we can differentiate and track.

Question 15: Do you agree with our proposal of 12 months to implement automatic compensation?

110. We will require a period of 18 months to implement the proposals for the Vodafone related aspects of the proposal.

111. The ability to pay compensation will, in the majority of cases, hinge on the conclusion of pass-through arrangements, as these will account for the largest proportion of the money flow.

112. Without a clear Direction setting out the obligations of Openreach, Vodafone would not be able to commence participation in the scheme for service issues related to Openreach.

113. We will be reliant on the ability for Openreach to meet the timescales and therefore caveat our own ability with the fact that Openreach will also need to be ready inadvance.

Question 16: Do you agree with our proposal to monitor the impact of automatic compensation?

114. We agree that Ofcom should, as good regulatory practice, monitor and measure where feasible the impact of its regulatory policy decisions.

115. In this situation it is especially important to collect data to understand precisely where the service failures are occurring in the supply chain. As such, Ofcom should seek to obtain this information from both service wholesalers and retailers.

116. The Cartesian cost model identifies some 71 retailers in the market, but the Openreach financial presentation suggests there are several hundred. We consider that Ofcom should set a materiality threshold as to when a Retailer is required to provide this information.

117. Ofcom should make any information collected publicly available in aggregate, but with sufficient detail to provide readers a clear understanding of failure points.

Question 17: Do you agree with our proposals for greater transparency regarding service quality and compensation for products targeted at SMEs?

118. We agree that SME customers should receive clear information concerning the contractual promise related to the service they purchase including installation and repair.

119. Business services generally come with the ability to elect the service level associated and consequently business customers will already have far greater knowledge about the service wrap they should receive.

120. We are happy to review our terms to ensure they are adequate and consistent with Ofcom's policy objectives for transparency and clarity.