Writer's Direct Dial:
703.755.6730
Facsimile Number:
703.755.6740
Sheba.Chacko@bt.com

February 29, 2016

Via Electronic Filing

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: *Special Access for Price Cap Local Exchange Carriers*, WC Docket No. 05-25; *AT&T Corporation Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, RM-10593

Dear Ms. Dortch:

BT Americas Inc. ("BT Americas") hereby responds to a recent white paper in which the USTelecom Association ("USTelecom") makes a variety of claims about BT Americas' and British Telecom's (collectively, "BT") advocacy regarding the regulation of special access in the U.S. and in the U.K.[1] For the reasons set forth below, USTelecom's claims are without merit.

I. BT's Special Access Advocacy in the U.S. Is Consistent With Its Advocacy in the U.K.

USTelecom asserts that BT's criticism of Ofcom's proposals to further regulate leased line services in the U.K. (which are similar to special access in the U.S.) is at odds with BT's advocacy in support of special access regulations in the U.S. USTelecom willfully misapprehends BT's responses to the very different regulatory environments in the U.K. and the U.S. In fact, BT's position in the U.K. is entirely consistent with its advocacy in support of additional regulation in the U.S., where the incumbent LECs are dominant and unrestrained by regulation and competition, and where business customers, consumer welfare, and the U.S. economy are harmed as a result.

BT has asked Ofcom to refrain from further tightening regulation of leased line services in the U.K. given the *already rigorous* regulatory regime that has delivered many benefits to U.K. consumers. As is shown in the WIK Study that BT submitted with its reply comments in

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[1] *See* USTelecom Association White Paper, *The FCC Should Not Pick Winners and Losers*, at 6-7 (Feb. 2016).

this proceeding, U.K. business customers enjoy lower Ethernet access rates than in most other countries, the migration to Ethernet is taking place more quickly in the U.K. than elsewhere, and entry level speeds are higher in the U.K. than in many other countries.[2] No company understands more clearly than BT that these benefits have been achieved in the U.K. against a background of rigorous regulation, such as functional separation, tight price controls, accounting transparency regarding BT's costs and margins, and nondiscrimination transparency, amongst other things, via BT's publication of its performance metrics. BT does not argue that *any* of these regulatory mechanisms is unnecessary. Rather, it has argued against Ofcom's proposed *further* regulation of leased lines in the U.K. because outcomes for consumers are already very good – better, as the WIK Study shows, than in many other EU countries.

USTelecom asserts that BT advocates for stricter regulation of special access in the U.S. because BT "prefers" to rely on incumbent LEC facilities rather than investing in last-mile facilities in the U.S. Not only is this statement hypocritical, given that AT&T and Verizon also rely on the last-mile networks of incumbents in other countries and do not build out last-mile networks in the dozens of countries outside the U.S. in which they operate, it is also inaccurate. That is because, as USTelecom, AT&T, and Verizon well know, there seldom is a business case for competitive telecommunications providers to build last-mile connections into all or most of their business customers' locations worldwide. Moreover, even if such buildout were economically feasible, it could not be completed within the timeframe needed to initiate service to most customers. Therefore, BT's decision not to build last-mile facilities in the U.S. is the result of sound business judgment, not mere "preference," and is no different from the incumbent LECs' decisions to rely on leased line facilities outside of the U.S.

II. The Incumbent LECs' Special Access Advocacy Before the Commission Is Inconsistent With Their Advocacy Abroad.

Outside of the U.S., major incumbent LECs argue for more restrictive regulation, but they advocate for the opposite at home, where they dominate the market for special access services and are not subject to consistent economic regulation. Thus, it is the incumbent LECs, not BT, that would like to have it both ways. For example, AT&T applauds new regulations in Mexico constraining the dominance of monopolists but argues against regulation of incumbents' special access services in the U.S. even though the data gathered in response to the mandatory data request shows that the incumbent LECs have the only connection into the vast majority of commercial buildings.[3] According to AT&T Chairman and CEO Randall Stephenson:

> "[r]eforms introduced by President Peña Nieto, with support from the Mexican Congress and IFETEL, have given us the ability to invest in building an advanced mobile network in Mexico . . . . As we are now seeing in Mexico, business investment increases with thoughtful, responsible regulation. And when

[2] *See generally* WIK-Consult Report, Ethernet Leased Lines: An International Benchmark (Feb. 2016) ("WIK Study") (attached to Reply Comments of BT Americas Inc., WC Docket No. 05-25 and RM-10593 (Feb. 19, 2016)).

[3] *See* Declaration of Stanley M. Besen & Bridger M. Mitchell ¶ 43 (attached to Comments of Sprint Corporation, WC Docket No. 05-25 and RM-10593 (Jan. 27, 2016)).

> companies invest – whether in expansion or improved services for consumers and businesses – they create jobs. It is a simple, powerful formula."[4]

AT&T should share these views with the Commission. For its part, BT has only asked the Commission to adopt a thoughtful, responsible approach to special access regulation that is like the U.K.'s current approach to leased line regulation, and that is like the regulations that AT&T has sought in other contexts outside of the U.S. in countries where dominance is established.

Verizon leases last-mile connections from BT in the U.K., where Verizon advocates for tighter price controls of BT's TDM-based and Ethernet access services, increased regulation of Next Generation Access ("NGA") services, and the publication of BT's regulatory accounts and more detailed performance metrics. Even though the regulatory regime applicable to leased line services in the U.K. has been described as "nondiscrimination on steroids" (as a result of functional separation, publication of regulatory accounting information, tight price controls, and publication of performance metrics, amongst other things), Verizon has called for regulations that are even more restrictive than those currently in place. But Verizon consistently argues *against* regulation in the U.S. that would constrain its market power in the provision of facilities-based special access. This is particularly remarkable in light of the fact that Verizon's Ethernet special access services are not even subject to common carrier (let alone economic) regulation in the U.S.

For example, Verizon argued in 2014 that there were no grounds for further deregulation of BT's TDM-based and Ethernet products. Verizon asserted that Ofcom should instead require BT to publish more rigorous and transparent performance metrics regarding BT's non-discriminatory provision of those services, and that BT should be held to account when those metrics are not met. Verizon also argued that even though BT is required to resell broadband services to Verizon and others in the U.K., more should be required of BT because Verizon is unable resell BT's Fiber to the Cabinet product with the level of service required by Verizon's business customers.[5] And in 2012, Verizon argued for revisions to the structure of basket and sub-basket caps proposed by Ofcom because, Verizon claimed, the existing structure was insufficient to ensure that prices were based on a reasonable measure of costs. Verizon also advocated that Ofcom should not take action that would lead to "an end to BT's publication of cost accounting information, which has historically proved crucial to industry in [scrutinizing] BT's [behavior]."[6] Verizon has not attempted to explain the wild inconsistencies between its position on the regulation of special access in the U.S., where Verizon is the dominant incumbent, and its position on the regulation of special access abroad, where Verizon is not the

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[4] *See* Press Release, AT&T Inc., AT&T to Invest Approximately US$3 Billion in Mexico to Extend Mobile Internet to 100 Million Consumers & Businesses by Year-End 2018 (June 25, 2015), http://about.att.com/story/att_to_invest_approximately_3_billion_in_mexico_to_extend_mobile_internet_to_100_million_consumers_and_businesses_by_year_end_2018.html.

[5] *See* Verizon Enterprise Solutions response to Ofcom's Business Connectivity Review – Timetable and initial call for inputs, at 7 (May 2014) (attached hereto as Exhibit 1).

[6] Verizon Enterprise Solutions response to Ofcom's Business Connectivity Market Review and Leased Line Charge Control consultations, at 11 (Aug. 2012) (attached hereto as Exhibit 2).

incumbent. That is because there can be no explanation beyond Verizon's fervent desire to maintain its dominant status in the U.S.

III. Verizon Argues That Three or Four Providers in Telecommunications Access Markets Are Needed to Ensure Competitive Conditions – Just Not in Its Home Market or in the U.S.

In the U.K., Verizon has strongly opposed deregulation of BT's enterprise access services in West London on the grounds that the regulator did not demonstrate with sufficient granularity that the competitive conditions in Central and East London ("CELA") also existed in West London.[7] According to Verizon, the showing of competition needed to be comparable to what was previously demonstrated in CELA, *i.e.*, that the incumbent plus at least two competitors were present, that the competitors' infrastructure was within network reach of 97 percent or more of business locations, and that a third competitor was within reach of a substantial percentage of business locations. In addition, Verizon sought a demonstration of a similar level of customer density in West London as in CELA.[8] Table 25 of Ofcom's June 2012 Business Connectivity Market Review ("BCMR") Consultation[9] shows the level of granularity Verizon sought. Verizon did not argue that best efforts cable broadband infrastructure or fixed wireless infrastructure should be counted toward the demonstration of competitive conditions. Rather, Verizon sought a showing that three or four fixed line enterprise access providers were present in a geographic market before Ofcom could deregulate the incumbent's access services. Table 26 of Ofcom's June 2012 BCMR Consultation[10] shows the competitive conditions that the U.K. regulator demonstrated for the West, East and Central London area, *i.e.*, the presence of the incumbent and two operators within network reach of 80 to 90 percent of businesses, and with presence in 96 to 99 percent of the geographic area, *and* the presence of two additional operators within network reach of 44 to 47 percent of businesses, and with presence in 74 to 76 percent of the geographic area. This, according to Verizon, was an inadequate basis for deregulation.

IV. Contrary to the Incumbent LECs' Claims, Regulatory Intervention in the U.K. Has Not Disincentivized Investment.

USTelecom's claim that the U.K.'s "heavy-handed regulations" have deterred investment by BT and others is belied by recent Commission and Ofcom statements about the availability of, and investment in, superfast broadband in the U.K. According to the Commission, "as of June 2015, [NGA] coverage in the U.K. stood at 89 percent of households."[11] And Ofcom has found

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[7] *See id*. at 12-13.

[8] *Id.*

[9] Ofcom, Business Connectivity Market Review Consultation, at 216 tbl.25 (June 2012), http://stakeholders.ofcom.org.uk/binaries/consultations/business-connectivity/summary/section5-6.pdf (attached hereto as Exhibit 3).

[10] *Id*. at 217 tbl.26 (attached hereto as Exhibit 4).

[11] *International Comparison Requirements Pursuant to the Broadband Data Improvement Act; International Broadband Data Report*, Fifth Report, DA 16-97, at 133 (Jan. 29, 2016) ("*Fifth International Broadband Data Report*").

that 152 Mbps cable and/or 76 Mbps fiber is available to 90 percent of U.K. premises.[12] This is comparable to or better than high-speed broadband availability in the U.S., where, according to the Commission, 89 percent of households were passed by high speed broadband as of the end of 2014.[13] The investments that have resulted in this explosive growth of high-speed broadband in the U.K. have taken place against the backdrop of Ofcom's current regulatory regime. Thus, contrary to USTelecom's claims, the current level of regulation in the U.K. has not disincentivized investment.

Just as increased regulation has not been an impediment to investment in NGA networks, a study commissioned by Ofcom in July 2015 did not find that forbearance from regulation of access to NGA networks stimulates deployment.[14] In fact, the Ofcom study found that regulatory factors may have less influence on NGA coverage and adoption than market-based factors, such as infrastructure competition, and demand-based factors, such as the availability and consumption of local language online content and applications. The Ofcom study did find, however, that the existence of regulation and the type of regulation affect the number of providers offering fast broadband services to end users, and where retail offers for fast broadband are limited the result is high consumer prices.

Please do not hesitate to contact the undersigned if you have any questions regarding this submission.

Respectfully submitted,

Sheba Chacko
Senior Counsel and Head, Americas Regulation and
Global Telecoms Policy, BT Americas Inc.

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[12] *See* Ofcom Communications Market Report at 267, (Aug. 6, 2015), http://stakeholders.ofcom.org.uk/binaries/research/cmr/cmr15/CMR_UK_2015.pdf.

[13] *See Fifth International Broadband Data Report* ¶ 18.

[14] WIK-Consult Report, Competition and Investment: An Analysis of the Drivers of Superfast Broadband (July 2015), http://www.wik.org/fileadmin/Studien/2015/Competition_and_investment_superfast_broadband.pdf.

EXHIBIT 1

Verizon Enterprise Solutions response to Ofcom's Business Connectivity Review – Timetable and initial call for inputs

NON-CONFIDENTIAL VERSION (redactions indicated by [✂])

1. Verizon Enterprise Solutions ("Verizon") welcomes the opportunity to respond to Ofcom's Business Connectivity Market Review initial call for inputs.
2. Verizon is the global IT solutions partner to business and government. As part of Verizon Communications – a company with nearly $108 billion in annual revenue – Verizon serves 98 per cent of the Fortune 500. Verizon caters to large and medium business and government agencies and is connecting systems, machines, ideas and people around the world for altogether better outcomes.
3. Verizon's approach to responding to this consultation has been to provide a summary of our position in relation to the issues under review and then move on to address the specific questions raised by Ofcom in the call for inputs document.
4. Please note the views expressed in this response are specific to the UK market environment and regulatory regime and should not be taken as expressing Verizon's views in other jurisdictions where the regulatory and market environments could differ from that in the UK.

Summary

5. In general, Verizon supports Ofcom's outlined approach to conducting the 2016 Business Connectivity Market Review. The key issues from our perspective are the review of BT's quality of service in the delivery of wholesale leased lines and Ofcom's approach to any potential charge control remedy.
6. The outcome of Ofcom's review of these matters could have a significant impact on competition for the period covered by the BCMR, either positively or negatively, dependent on the decisions taken. As such we fully support Ofcom's early initiation of its review into these important aspects. Ofcom needs to ensure that it has the time and adequate resource to fully investigate the matters that arise in relation to this work.
7. The remainder of this response addresses the specific questions posed by Ofcom in the call for inputs document. Verizon only offers a response to those questions which have relevance for our business.

Business Connectivity Market Review: Timetable and initial call for inputs – Ofcom questions

Market questionnaire

Question 1: Is your organisation active in the provision of leased lines and related services? Would you be willing to help Ofcom with its analysis of the leased lines markets by completing a questionnaire?

8. Verizon is a significant provider of leased lines to retail customers and in principle would be willing to assist Ofcom with its analysis of the leased lines market by completing a questionnaire.

Proposed approach to the review

Question 2: Are there any developments since the last BCMR or prospective developments that may be material to our analysis of competition in this market? Please identify specific developments, explaining why they may be material.

9. Verizon does not consider that there have been any significant developments in this market since the last review that have had a material impact. It is very much the same story with the demand for Ethernet growing whilst traditional leased lines decline, although perhaps not as rapidly as Ofcom forecast.
10. From Verizon's perspective, competitive conditions outside of the two defined geographic markets remain unchanged and therefore we do not see any potential for either expanding the deregulated zones or generating additional geographic markets.

Quality of service

Question 3: What is your experience of the quality of BT's provision and repair of wholesale leased line services? Are there any consistent trends? Can you provide evidence to support your views?

11. Verizon fully supports Ofcom's early review of BT's quality of service performance; this has been a considerable source of concern over a number of years, during which time there has been a fluctuating level of performance. Overall, however, the trend has been a continuous degradation of the level of service provided by BT; this applies to both provisioning and repair, although the provisioning performance has been the most volatile.
12. We are simply unable to rely on the consistency of provision and repair performance, which makes it very difficult for us to provide the corresponding consistency to our customers. Our customers do not necessarily understand the relationship that we have with BT at a wholesale level, or the fact that we are reliant on BT for provisions and repairs. As explained below it is our view that the provision / repair elements of BT are not currently incentivised enough to take all reasonable steps to provision / repair as

soon as possible. This appears to be the case even though BT can start billing for the services as soon as they are working.

Question 4: Do the KPIs that BT publishes / shares with industry give you sufficient visibility of its performance? If not, please explain what further information should be provided and why.

13. Verizon does not consider that the published KPIs are satisfactory as they do not accurately reflect the actual level of performance experienced by CPs. BT's KPIs are skewed by factors such as the use of 'deemed consent', which was an issue Verizon highlighted during the previous BCMR. The use of Deemed consent is arguably the single biggest problem with the current QoS reporting set up, and Ofcom really must look very carefully at this issue. BT's Repair validation process also allows them to show a 2 minute outage because BT have deemed the fault to be an erroring circuit; even if the erroring is such that the service is not useable by the End User and has been handed over for intrusive testing.
14. Openreach's (OR) service delivery for Ethernet products has been in a poor state for some time, with long running issues and little to suggest there is any desire by OR to address the problems. Without meaningful interaction with industry, backed by appropriate regulatory engagement, Verizon does not see how the situation will improve. As indicated above, the major issue for Verizon in relation to Ethernet provision, an issue shared by the wider industry as a whole, is the use of deemed consent by OR. A review of OR's statistics for provision would suggest that provisioning is not an issue and that OR is performing in line with their service level agreement (SLA). However, OR's stated provisioning statistics are severely distorted by the use of 'deemed consent', which they use as a 'get out of jail free card' – and this totally masks their shortcomings. OR invoke 'deemed consent' to suit their needs and as a result, SLA/SLG payments from them are almost non-existent.
15. Although the above issue has been discussed at great length with OR at various industry fora, little substantive progress has been made. Verizon considers that a more forceful approach from Ofcom is needed to ensure OR move this forward with the required degree of urgency.
16. At the heart of this issue lies the complete control BT exerts over the reporting criteria, which allows it to manipulate situations to its advantage. Such overriding control of the reporting process is one reason why industry has little or no confidence in the performance levels reported by BT. Indeed, such is the level of control that even when a CP is able to prove that BT has misreported its performance there is no way for the statistics to be corrected within the reporting database; any such corrections are only applied manually, if at all, so are not reflected in the reported performance.
17. A major area of concern relates to the practice of BT Engineers claiming that appointments have been kept but access was not provided by either the CP or their customer, despite the fact that the engineer has no proof of an attempt being made to

gain access to the site. This practice allows BT to record that the appointment was met although no actual progress was made with the provision or repair.

18. This practice is seemingly driven by the way BT's contractors are remunerated, with the onus being on the number of appointments attended rather than on tasks completed. What is required is an increased burden of proof on BT to support not only claims of appointment attendance but also that a genuine attempt was made to gain access to the site.

19. One proposal to address this issue would be for BT to provide a time stamped photo of their arrival at site and any blockages or problems encountered to demonstrate why they could not gain access. It would also be extremely valuable, in terms of customer engagement, if BT Engineers called the Customer contact ahead of arrival and before departure from site, especially if an issue has been encountered. This is now standard good practice in the utility industries when new services are installed or existing ones repaired, and would significantly improve the situation.

20. Verizon also considers that Ofcom should look at the DSO process, as this is a clear example of a process that does not work and provides evidence of the inefficient processes which exist to manage the interface between OR and the rest of industry.

21. Verizon offers two clear reasons for calling for such a review. Firstly, the escalation process itself is ineffective and time-consuming for both OR and CPs; particularly so for CPs who need significant additional resources to engage with OR and the end-user, who make significant demands at such times. Secondly, the fact that such a process exists is itself reflective of the issues around the poor service delivery process and the significant problems around delivery timescales. Data from the DSO process should provide clear documented evidence of where the service delivery process is failing and why. However, this is not the case as the broad and rather vague escalation reasons prescribed in the DSO process are not helpful in providing such analysis.

22. For example, one reason for escalation is described as 'brand damage'; which for business customers could equate to situations where premises are not able to open without the timely installation of a line. However, it is difficult based on the reason flag to determine why intervention is required as there is no clear link between reason, responsibility and impact.

23. Accordingly, Verizon would urge Ofcom to investigate OR's actual motivations for implementing DSO and not place any reliance on the reasons indicated by the flag. Verizon considers that in many instances OR use DSO as a smoke screen to mask their deficiencies and to protect their own interests, due to the fact that they are unable to provide service in a timely manner. There is very little that CPs can do to challenge the use of DSO once it is cited.

24. The above proposals, if adopted, would go a long way to addressing CPs concerns associated with the KPIs and finally tackle the delta between BT's reported performance and the actual performance experienced by CPs and their Customers.

Question 5: If there are quality or timeliness concerns, how do these affect your business and how do they affect your customers? Please provide evidence to support your views.

25. Verizon has significant concerns with BT's performance in meeting the dates agreed for both provisioning and repair as expressed in the response to question 4. Timeliness issues have serious detrimental consequences for both the CP and the end Customer, financial and operationally.
26. From the CPs perspective, delays cause significant resource scheduling issues as well as additional costs due to repeat appointment charges and potentially 3rd party tail charges which can't be passed on the end customer. There are also issues around brand damage, as the end customer will tend to blame the contracted CP for any delays rather than BT. We consider that this is a strong factor in the performance which BT provides – ie its own brand is effectively "protected" from blame. It is aware that most customers will simply see the contracted CP as being responsible for providing service.
27. From the end Customers perspective, delays can have a significant impact in terms of meeting their business plan, especially if the service being provided is required to launch or support a new business opportunity.
28. Often where delays occur the impact can be mitigated to some degree if communication between the parties is timely and accurate. Unfortunately this is seldom the case with BT, with notice of delays often being provided at very short notice.
29. Verizon considers that there should be rigorous and transparent metrics in terms of timeliness and quality – and BT should be held to account when they are not met. We would hope that this review provides the opportunity to make concrete improvements in BT's performance in this respect, and that CPs such as Verizon can concentrate on customers rather than these issues as a result.

Question 6: Do BT's current provision and repair services for wholesale leased lines meet your customers' needs, for example in relation to lead times, keeping appointments or adhering to agreed delivery dates? If not what changes do you think BT should make to its provision and repair services?

30. BT's performance for keeping appointments and adhering to agreed delivery dates is extremely poor, despite the official KPIs suggesting otherwise, as highlighted in the responses to previous questions.
31. BT's SLAs are not really suited to Business consumers, where business plans rely on services being delivered on time and repaired in a timely fashion. In terms of repair, BT's SLA targets have not changed for many years and are inferior to the targets Verizon sets for on-net repairs.
32. One thing BT should do is improve its communication with CPs and end customers to keep them updated with developments and provide sufficient prior notification of changes in timescales and appointments.

Question 7: Do you consider BT has appropriate incentives to provide the quality of service which you and your customers require? If not, what changes do you think should be made to BT's incentives?

33. Verizon does not consider the incentives to be sufficient as to prompt BT into providing the quality of service Business consumers require.
34. Firstly, BT should review the current SLA targets to ensure that they are capable of delivering to customers' expectations as current targets haven't changed for a number of years despite significant changes to the services provided and the requirements of customers for more rapid delivery and timely repairs.
35. Second, the burden of proof needs to be shifted towards BT proving that it was unable to complete a provision / repair, rather than the CP effectively having to prove the opposite. It should not be enough for an engineer to simply claim deemed consent because no-one was available at a site to allow access. The engineer needs to take all reasonable steps to prove this with evidence, such as time-stamped photos (as discussed above), records of calls placed to the customer etc. In repair it is not acceptable for an engineer to go to a site apply and remove a loop which restores then claim that not fault was found and apply time related charges.
36. Third, CPs should have an effective means to challenge the use of deemed consent where necessary. The onus should be on BT to prove that it was justified in using it, and an independent arbitrator should be available for serious cases which cannot be resolved. If deemed consent is used, BT should also be forced to prioritise
37. It would also seem that currently BT employees are incentivised on the basis of the number of appointments met rather than the number of repairs / provisions completed on time. This needs to be changed so that incentives are based on the number of jobs they successfully complete.
38. One action BT could take would be to improve the management of the 3rd party contractors they engage, as often there is a misalignment of the commitments BT enters into and the working practices of their contractors. There are currently no real incentives for BT to improve the poor quality of service provided given the level of discretion they enjoy over setting targets and measuring compliance against those targets.

Broadband substitution

Question 8: Can broadband, particularly NGA-based services be used effectively for the delivery of business connectivity? Has this changed over the last three years? How do you think this might change over the coming three years?

39. Verizon considers that whilst broadband products do offer an effective solution for business connectivity in principle; in practice this potential is closed off for providers such as Verizon. This was a situation Verizon highlighted in its response to the 2011 BCMR call for inputs but unfortunately nothing has changed materially over the intervening 3 years.

40. The primary issue is that BT's Fibre to the Cabinet (FTTC) offering is [✂]. The BTW Repair Service Centre is not aligned to the support of business customers and does not provide the level of service required by business customers. The morning appointment time window (08:00 – 13:00) is not practical for retail end users. Many a time an engineer will turn up before the shop opens at 09:00, Verizon are then faced with trying to arrange an afternoon appointment which can be days later. The retail end users are therefore faced with 2 options - risk a morning appointment or wait hours for an afternoon appointment.

41. In many ways, the current roll out of FTTC mirrors the regulation of FTTC and other NGA broadband services. These are traditionally viewed from the perspective of retail (consumer) broadband services; however the business possibilities and impacts are at least as important to the business market as the residential.

42. These products have the potential to be absolutely transformative for the UK, bringing services traditionally only available to large businesses in major conurbations to the whole country. [✂]

Question 9: Are new business customers that would traditionally have taken leased line products now opting for a broadband service? If yes, what type of broadband service are these business customers taking.

43. Verizon [✂].

Question 10: Are existing business customers actively migrating from leased lines to broadband products? If yes:
• which types of business customer are migrating?
• which types of leased line product (interface and bandwidth) are they migrating from?
• which types of broadband service are they migrating to?
• does switching vary between different areas of the country (e.g. depending on NGA availability, the number of broadband providers present or other factors)?
• What are the barriers (if any) to switching from leased lines to broadband products?

44. There has been some migration from leased lines to broadband products but this is not a broadly focussed trend that Verizon recognises, [✂]

45. [✂]leased lines are still seen as providing the level of reliability that many businesses demand.

Passives

Question 11: Do you have any comments about the scope of our planned work on passive remedies?

46. Verizon considers that the areas Ofcom has identified for further investigation in relation to passive remedies are appropriate and addresses the key questions.

47. [✂]

48. [✂]

Question 12: Which of the following types of passive remedy might be technically feasible and suitable for leased lines?
• Physical Infrastructure Access (i.e. duct and pole sharing);
• Dark fibre;
• Wavelength unbundling;
• Other passive remedies (please specify).

49. [✂].

50. [✂].

Question 13: For what applications could communications providers use each of the types of passive remedy listed in question 12 above?

51. [✂].

Question 14: How might passive remedies extend the geographic reach of infrastructure competition?

52. [✂].

Question 15: Would the presence of physical infrastructure belonging to other CPs affect usage of passive remedies? For example would you expect passive remedies to be used only or mainly in areas where only BT has passive infrastructure or would you also expect passive remedies to be used in areas where other CPs have passive infrastructure?

53. [✂].

Question 16: What are the benefits that passive remedies might offer in comparison to active remedies? Please consider specifically:
• Service innovation benefits e.g. the ability to differentiate service features and functionality (such as fault finding, configuration options, etc.)
• Network innovation benefits e.g. the ability to configure the network in a different way to BT's network configuration.
• Technology innovation benefits e.g. the ability to adopt new technologies, or introduce new technologies earlier than they might otherwise have been introduced.
• Avoiding duplication e.g. the ability to avoid the duplication of network elements for network monitoring purposes.
• Other benefits (please specify)

54. [✂].

55. [✂].

Question 17: How valuable would the innovation benefits of passive remedies be? Would they be sufficient for you to choose passive remedies if there was no overall cost advantage compared with active remedies (i.e. if the price of the passive remedy was exactly *equal to the price of the active remedy less the cost of the network components that you would need to provide)?*

56. [✂].

Question 18: What are technical and operational challenges associated with deploying and using passive remedies and how might these be addressed?

57. [✂].

58. [✂].

59. [✂].

Question 19: What are the strengths and weaknesses of different pricing structures that might be adopted for passive remedies, in particular:
• uniform prices that do not vary either by geographic area or the use to which the passive remedy is put (e.g. residential NGA versus leased lines); and
• prices that do vary according to geographic area or the use to which the passive remedy is put, and which reflect the value of the services provided or geographic differences in the intensity of passive infrastructure usage, more like the way BT's prices active products now?

60. [✂].

61. [✂].

Retail remedies for very low bandwidth TI services

Question 20: Do you think we should continue to regulate BT's retail analogue and Kilostream services after March 2016? Please provide reasons to support your views.

62. [✂].

63. [✂].

Question 21: Are BT's retail analogue and Kilostream services used for any other critical applications that might have difficulty migrating to alternative services?

64. These services are utilized mainly by Utility companies, in a wide range of metering activities, and also by Banks, to some degree. Although ready alternatives already exist to a large degree for the Banking industry, Utility companies depend on the reliability and security of such services and the migration options are not so attractive. As such, it will take much longer for the Utilities to find suitable alternatives and end their reliance on low bandwidth TI services.

Charge control remedy

Question 22: How effective do you consider the current leased line charge control has been in balancing Ofcom's objectives? Please provide evidence or give reasons/examples for your views.

65. As Ofcom is aware Verizon appealed the current TI charge control. It is Verizon's view that the concerns highlighted in our appeal have been borne out.

66. Verizon has significant concerns regarding the effectiveness of the current leased line charge control. The TI price control has allowed BT to increase its prices significantly above inflation. To illustrate this point, in the base year of the 2011/12 charge control, BT's prices were already significantly higher than the level that Ofcom would set for the end of the glide path. In fact, BT's prices were already 27% above what BT needed to enable it to earn a return on mean capital employed at the weighted average cost of capital.

67. One key test of whether the charge control is effective is whether BT's ROCE is near its cost of capital. In fact BT continues to enjoy returns very significantly above the WACC and in some markets these levels of return have increased. For example (based on BT's 2013 RFS):
    - TISBO up to 8Mb/s – ROCE: 19.5%
    - TISBO 8 – 45Mb/s – ROCE: 23.3%
    - TISBO 45 – 155Mb/s – ROCE: 35.5%
    - AISBO up to 1Gb/s – ROCE: 30.8%

68. This is against a nominal WACC of 9.3% (TISBO) and 8.8% (AISBO). It is clear that these returns exceed BT's cost of capital very significantly indeed; it is hard to imagine that they might be justified entirely by efficiency increases. Ofcom must examine why this is the case and explain it fully in the next consultation.

69. Ofcom's decision to set the TI charge control basket at RPI+2.25%, in conjunction with BT's ongoing pricing strategy (as set out above) has been to the material detriment of those stakeholders who are making direct or indirect use of TI services and ultimately to the detriment of consumers in the form of higher prices. Verizon remains of the view that BT's common costs should have been reallocated to reflect forecast migration and allowed BT to recover its costs from those services that <u>actually incurred</u> the costs.

70. Ofcom's approach to the TI charge control raises significant concerns about how Ofcom views and balances its regulatory objectives on this matter. By allowing BT to over-recover (and leaving the costs with TI services), Ofcom went further than was necessary to provide BT with the opportunity to recover its common costs, and instead decided to take the approach that its role was to ensure BT's common costs were recovered from TI regardless of which service incurred those costs.

71. Ofcom has demonstrated a differential treatment of TI services, as compared to other technologies and services. The difference of treatment of TI in comparison to AI and other services, and the decision to provide for the recovery of common costs associated with other BT services from TI services, means that Ofcom has not fulfilled its obligation with respect of equal treatment and technological neutrality. If the relative usage of those services rises as a result of migration from TI services, BT would be able to recover additional common costs from those services. However, the implication of Ofcom's approach is that (a) BT is precluded from choosing how to recover such costs and (b) that there will be double recovery.

72. Ofcom's approach to setting the TI charge control has failed to promote its statutory objectives for the reasons set out above. The excessive allocation of common costs to TI services as compared to other services to which users of TI services might migrate has increased the relative price of TI services. As such, TI services have been rendered less attractive to intermediate and final consumers. This ultimately results in inefficient migration and distortion of competition.

73. The current level of the charge control is not appropriate for promoting the interests of UK and EU citizens, promoting competition and ensuring that users of TI and other services derive maximum benefit in terms of choice, price and quality as required by sections 3 and 4 Communications Act 2003; nor is the charge control appropriate for the purposes of promoting efficiency, promoting sustainable competition conferring the greatest possible benefits on the end-users of public electronic communications services as requires by section 88(1) Communications Act 2003.

74. [✂].

75. [✂].

76. As such, overall, Verizon does not consider that the current leased line charge control has been effective in balancing Ofcom's objectives and there is great potential for the situation to become even less so.

Question 23: If you do not consider that the current charge control has been effective in achieving Ofcom's objectives, what changes do you consider should be made and why?

77. Verizon is of the view that Ofcom needs to apply a migration based approach in a proportionate and consistent way (i.e. apply BT's cost methodology without the unjustified variations implemented in the last BCMR). TI services are in decline and the services will cease in the future. This means that BT will need to be able to recover the common costs allocated to TI from other services. Therefore when the time comes and TI is 'switched off' Ofcom faces the unenviable problem (as highlighted in the appeal) that not only will it have to reallocate the costs that TI incurs, but it will also have to reallocate the common costs that have been allocated to TI services which it did not incur. Ofcom should be facilitating this change now.

78. Once TI services are withdrawn in 2020, customers will have migrated to services such as LLU, NGA and ADSL. In light of the fact that over the course of the next charge control, TI services will be in use (albeit in decline), Ofcom must reallocate those costs to the services that TI customers are forecast to migrate to. Ofcom should also prevent BT from continuing to be able to double recover as it has been under the current charge control.

Question 24: Given the expected decline in TI service volumes over the current control period, do you consider an alternative type of control, such as a simple charge control with charges capped by reference to their current level, would be more appropriate and proportionate in the next control period? If so, why?

79. TI services will continue to be important for some customers who have inelastic demand for other BT services in the short and medium term. Some customers remain of the view that the proposed alternatives to TI services are not yet suitable for their needs and have no plans to migrate. In light of the fact BT has delayed the withdrawal of the service until at least March 2020, TI services will remain crucial and extremely important for the duration of the next charge control.

80. Taking all of these factors into account shows that it is not the right time for Ofcom to be adopting a simple charge control with the charges capped at their current level. Ofcom has also not set out in the CFI exactly what it thinks the “simple charge control” would be. The appropriate methodology for Ofcom to use is one which will ensure that the issues highlighted at question 22 above are not permitted to continue.

81. [✂], Verizon considers that any further relaxation of controls would be a significant gamble and one it is simply unnecessary and dangerous to take now; such considerations should be reserved until the outset of the next BCMR.

Verizon Enterprise Solutions
May 2014

EXHIBIT 2

Reading International
Business Park
Basingstoke Road
Reading
Berkshire,
RG2 6DA

Verizon Enterprise Solutions response to Ofcom's Business Connectivity Market Review and Leased Line Charge Control consultations

Non confidential version

Verizon Enterprise Solutions ("Verizon") welcomes the opportunity to respond to Ofcom's Business Connectivity Market Review and Leased Line Charge Control consultations ("BCMR" and "LLCC" respectively).

Verizon is the global IT solutions partner to business and government. As part of Verizon Communications – a company with nearly $108 billion in annual revenue – Verizon serves 98 per cent of the Fortune 500. Verizon caters to large and medium business and government agencies and is connecting systems, machines, ideas and people around the world for altogether better outcomes.

Summary

Verizon is, overall, disappointed with Ofcom's proposals emanating from these two consultations. The area of most concern is the suggestion that a cost orientation remedy is no longer appropriate. Given Ofcom's entirely proper conclusion that market conditions in the UK demand the imposition of charge controls on dominant providers in order to support competition in business markets, Verizon is at a loss to understand the rationale that has led Ofcom to propose the removal of the cost orientation remedy previously determined necessary to underpin the charge controls.

Verizon can see no justification for such a radical change given that market conditions have not changed significantly since the last market review and the fact that, as demonstrated by the number of disputes relating to charges during the previous review period, there is a clear need for tighter remedies and increased compliance monitoring rather than less in order to safeguard against excessive prices. Nothing Ofcom has said provides such a justification.

Verizon's strong view is that a cost orientation obligation should continue to be imposed on BT in these markets.

It is especially disappointing, given the time it has taken to finalise the consultations, that Ofcom has not "taken a step back" and looked at the broader picture of business connectivity in the UK, and what is needed to stimulate and sustain competition over the next three or so years. Ofcom's review, as far as it is possible to tell from the consultation documents, appears to rely heavily on BT's submissions and view of the competitive market. Submissions that Verizon and other Communication Providers (OCPs) have presented appear to have been largely overlooked. Verizon considers the current set of proposals will result in a less competitive market, and indeed possibly the exit of one or more players.

In Verizon's view, what is needed to sustain and enhance competition in this market is, as a minimum:

- Business-grade (uncontended, robust, strong QoS) FTTP solutions, suitably regulated, that cater for providers without presence at BT's exchanges;

- The ability to hold BT to account if it charges excessively, by means of both charge control and cost orientation remedies.

In essence, these points boil down to the need to be able to compete with BT (and OCPs) on a fair and transparent basis, in order to obtain the best deal for our customers and ultimately end users. Such aspirations should be mirrored by the requirement on Ofcom to meet its primary statutory duties to promote competition and further the interests of consumers.

Unfortunately, we see little to convince us that this will be the outcome if Ofcom continues down the path that it is proposing:

- On business-grade solutions, there is no substantive mention of business-grade solutions using NGA. Virtual remedies such as VULA, and passive remedies such as Dark Fibre, are not properly addressed in a meaningful way despite the clear benefits that they may bring to the business connectivity market; and

- On the ability to hold BT to account, losing cost orientation would be a step in the wrong direction for a whole host of reasons – not least it would allow BT undue flexibility given its past behaviour in these markets and would reduce the transparency that OCPs rely upon

Under Ofcom's current proposals, Verizon (and OCPs) will have a far less fair and transparent relationship with BT. For example, we will in all likelihood lose the ability to scrutinise BT's regulatory accounts that has proved so important in providing a mechanism for identifying excessive charging by BT.

Verizon regrets that Ofcom has not taken the opportunity to look strategically at how it can improve the regulatory environment to make the business market more competitive and work for alternative operators and users alike.

The remainder of this submission provides the detail to support our key concerns with the current proposals.

Interim pricing

<u>BT's voluntary commitments</u>

Ofcom has been unable to impose new price controls by the time that the current charge controls expire on 30 September 2012. After that date the industry is reliant on BT's voluntary commitments until the new price controls are finally introduced. This is expected to be during the Spring of 2013. During the period from 1 October 2012 until the new charge controls take effect (the "interim period"), BT will not be subject to ex-ante regulation in this market as Ofcom consider that it is not necessary. We strongly disagree with this view.

We set out in the cost orientation section below our view that BT has the ability and incentive to effectively "game" the charge control baskets. This as the proposed charge controls provide BT the flexibility to set prices in such a way as to maximise revenue for BT Group while restricting the ability of competitors to do likewise. Given BT's previous pricing behaviour there can be little doubt that the outcome will be a distortion of competition whereby particular products are priced excessively high or low.

In case there was any doubt about this, it is only necessary to look at BT's voluntary commitments during the interim period. In relation to Ethernet services, BT appears to be reducing Ethernet prices only for niche or rarely used products (eg WES 155 and 622), whereas it is making no changes for products where there is material demand, such as EAD 10 and 100. ✂. On the other hand, Openreach intends to make significant reductions on Ethernet 1 Gig services, where there is arguably the greatest competition from other carriers, and order volumes are comparatively low.

As BT is fully aware of which OCPs buy which wholesale products, it has the ability to discriminate by setting prices in a way which will particularly impact one provider, or a group of providers. ✂.

We are deeply disappointed that Ofcom does not see the need to engage with BT Openreach on this matter, despite our requests for them to do so. Ofcom seems content to rely on BT making token commitments without investigating their true impact.

Ofcom delay

This disappointment is compounded by the fact that the interim period has arisen due to the very considerable delay to Ofcom's publication of the BCMR and LLCC consultations. Ofcom issued a call for inputs back in June 2011, and yet it took a further year to publish its proposals for consultation. During this period the reasons for such delays were not adequately explained and there was no evidence of a desire to keep industry informed on a pro-active basis. We appreciate that this is a significant and complex piece of work. However we really hope that Ofcom has learned lessons from this and takes appropriate steps to better manage future projects and also its communication with its core stakeholders.

Unfortunately, Ofcom's delay means that the industry and end users are effectively penalised by having to rely on BT's highly unsatisfactory commitments until the final Statement is published. We sincerely hope that there will be no further delays in achieving this objective and that Ofcom does everything necessary to reach its final conclusions as swiftly as possible.

Length of charge controls

We would also urge Ofcom to consider setting charge controls which only expire once new charge controls take effect, to avoid future instances of an effectively unregulated "gap" between charge control periods. This would enhance regulatory certainty and consistency and would prevent BT making voluntary commitments which damage the interests of competition.

Cost orientation

Ofcom's proposals do not include a cost orientation remedy, which is a highly unexpected and somewhat baffling provisional conclusion.

Given the history of regulatory disputes brought successfully against BT, Verizon has grave concerns about the way Ofcom seems to have reached its conclusion and the rationale that it considers sufficient to make such a seismic change in this market. We set out details of these concerns below.

Statutory duties

Cost orientation is now a well-established remedy in the UK and well-understood by the relevant stakeholders. Ofcom now proposes to remove it, but has not provided an appropriate explanation as to why it has reached this conclusion.

We consider that Ofcom has failed to properly consider this proposal from the perspective of its statutory duties. In fact the only duty it mentions is proportionality (see below). If considered properly, Verizon holds the view that Ofcom would conclude that this major policy change is not consistent with its statutory duties for the following reasons:

a. Ofcom's principal duty is "to further the interests of consumers in relevant markets, where appropriate by promoting competition." In terms of competition, the specific design of Ofcom's proposed charge control without any additional constraint will afford enough flexibility to BT to increase prices for services bought largely by its competitors, while keeping prices for services bought by its own downstream divisions relatively low. Whether BT chooses to behave in this way is another matter but it certainly has the ability and incentive to set prices across the baskets in a manner contrary to the interests of competition while remaining compliant with the charge controls as envisaged by Ofcom.

b. There may also be a detrimental knock-on effect on consumers. In the recent PPC Disputes it was found that in breaching the Basis of Charges Conditions, BT had over-charged OCPs for PPC products which could have had an effect on the prices paid by end users of the services. We draw Ofcom's attention to the Competition Appeal Tribunal ("CAT") view on this specific point:

   "If BT's prices breach the constraints of Condition H3.1, then it follows that BT's customers [..] are paying more than they should for the services they are purchasing from BT and ***may well pass these on to the ultimate consumers****"*[1] [emphasis added]

   It is hard to see how the ultimate outcome of higher retail prices, for some if not all products, can be in the interest of consumers.

c. Ofcom is under an obligation to have regard to consistency at section 3(3)(a) of the Communications Act 2003 (the "Act"). This change of policy is not consistent with what has gone before, nor is it backed up by good reason (see below). Indeed it appears that Ofcom has entirely

[1] Paragraph 3.23 of the main CAT judgment in the PPC dispute
http://catribunal.org/files/1146_BT_Judgment_CAT5_220311.pdf

failed to consider consistency or to seek to balance it with its other duties.

d. Ofcom also fails to have due regard to the Community Requirements set out in Section 6 of the Act (of which the duty to promote competition is particularly important).

The meaning of "excessive pricing"

From the analysis that it has carried out, Ofcom has identified that there is a risk that BT may price excessively in the markets under consideration. Ofcom has therefore considered how to prevent this risk, and ultimately concludes that the risk will be sufficiently constrained by the charge control basket and sub-basket caps.[2]

However, it is striking that at no point in either the BCMR or LLCC consultation documents does Ofcom define exactly what it means by excessive pricing. Therefore the first observation under this heading is that it is impossible for any stakeholder to make a fully informed assessment of whether Ofcom proposals will meet their objectives.

It might be reasonable to assume that, in considering excessive pricing and how it might be avoided, Ofcom had in mind the first order test that it typically employs when assessing compliance with the current Basis of Charges obligation. In other words, prices that are set consistently above DSAC (on a non-mechanistic basis) might be considered excessive.

This view is supported by the CAT in recent statements on the matter:

> *"It is clear, therefore, that there was an implicit expectation that if Condition H3.1 were to be breached by BT, adverse economic consequences would follow.[..] As we noted in the preceding paragraph,* ***the whole point of Condition H3.1 was to prevent BT from using its significant market power to maintain prices at an excessively high level."***[3] [emphasis added]

The obvious question to ask is therefore, how will the proposed new regime constrain BT from charging prices that have previously been deemed excessive?

Ofcom's view is that this constraint flows from the design of the charge control structure (including sub-baskets and sub-caps). However, it is not made clear how this will happen given that the structure is similar to that currently in effect

[2] Paragraph 5.12 of the LLCC consultation
[3] Paragraph 323 of the main CAT judgment in the PPC dispute

and there do not appear to be any substantive changes within the structure of the charge control itself which are specifically aimed at providing this constraint.

It is also unclear from the documents whether Ofcom still considers that prices should be reflective of costs for each and every product, or whether it simply expects prices to be constrained when the overall basket is considered in aggregate. The economic analysis conducted on behalf of UKCTA sets out in detail why it is not realistic to expect the prices for each and every product to be constrained under the new proposals. Yet Ofcom has not provided any evidence or reasoning as to why it considers that it is no longer necessary to constrain prices in this way (if indeed it now holds this view).

Historical disputes on Basis of Charges Condition

The discussion on removal of cost orientation as a remedy in these markets needs to be seen against the backdrop of BT's previous behaviour in terms of compliance with its cost orientation obligations. Ofcom is of course well aware of the recent disputes in which it found that BT had overcharged OCPs for PPCs by huge amounts, and has provisionally reached similar conclusions in relation to Ethernet services at various bandwidths.[4]

In both cases BT showed a lack of regard bordering on contempt for the need to ensure that it was able to demonstrate to Ofcom its compliance with the Basis of Charges condition. This was compounded by its failure to provide accurate or timely regulatory reporting information. Before Ofcom was even able to assess compliance, it was therefore forced to conduct a wholesale review of the accounts, which led to significant adjustments and restatements. In short, BT has shown itself to be entirely unwilling to behave in an appropriate manner where it is subject to the constraints of a charge control and a cost orientation obligation.

Ofcom must surely appreciate that OCPs are therefore extremely concerned and indeed baffled by the proposal to remove any constraint on BT in the markets under review. Indeed if anything it should be enhancing its scrutiny and enforcement of BT's compliance with its obligations. We fail to see what specifically in the revised charge control structure will prevent BT engaging in the behaviour that was the subject of the recent disputes. The previous 2009 LLCC had a similar mix of sub-baskets and sub-caps, and it failed to prevent BT pricing excessively – so what is the silver bullet that will prevent it this time?

[4] Determination to resolve disputes between each of Cable & Wireless, THUS, Global Crossing, Verizon, Virgin Media and COLT and BT regarding BT's charges for partial private circuits
http://stakeholders.ofcom.org.uk/binaries/consultations/draft_deter_ppc/PPC_final_determination.pdf
Draft determination of PPC higher bandwidth disputes:
http://stakeholders.ofcom.org.uk/binaries/consultations/ethernet_services/summary/ppc.pdf
Draft Determinations to resolve disputes regarding BT's charges for Ethernet services:
http://stakeholders.ofcom.org.uk/consultations/charges-ethernet-services/
http://stakeholders.ofcom.org.uk/binaries/consultations/prov-deter-cw-bt-ethernet/summary/amended_010312.pdf
http://stakeholders.ofcom.org.uk/binaries/consultations/dispute-verizon-bt-wes/summary/WES_Dispute.pdf

Charge controls in the absence of cost orientation

We consider that, given the changes in the UK business connectivity market that are envisaged by Ofcom, a charge control alone may not meet its desired objectives. We briefly describe our reasons for this view below.

First, by definition the charge control is speculative because it is forward-looking. It relies completely on costs being forecast accurately for the full period of the control. Ofcom and the industry hope that all of Ofcom's calculations and assumptions are correct, but there is simply no guarantee of this and it is by no means a foregone conclusion that prices will align fully with costs.

Second, the baskets are arguably wider than in the 2009 LLCC, in some cases extending across particular economic markets. Ofcom appears to place significant emphasis on the ability of BT to have maximum flexibility in deciding how to recover costs. While BT should not be constrained unduly, its previous behaviour suggests strongly that it will look to exploit the flexibility to the detriment of OCPs.

Ofcom has placed excessive weight on the desirability of allowing flexibility to BT, at the expense of the interests of competition and of end-users. In doing so, Ofcom has failed to pay sufficient attention to the risks in allowing BT flexibility. For example, for such flexibility to result in efficient (Ramsey-type) pricing outcomes, both Ofcom (in designing baskets) and BT (in implementing its pricing) would need to have excellent knowledge of the elasticities of different products. Yet there is no suggestion Ofcom has even considered this point. In Calls to Mobiles (2003)[5] the Monopolies and Mergers Commission (MMC) noted that Oftel had not produced any econometric evidence of elasticities, in the absence of which it would be inappropriate to attempt to apply a Ramsey approach:

> *If prices… were to be set… at Ramsey levels, that is, at levels which reflect customers' price sensitivity to different products or services, then the relative price elasticities of these services would need to be established*

Similarly, the MMC found that there was no reliable way of establishing price elasticities by the actual players in the market in such a way as could inform an efficient approach to pricing:

> *we were not satisfied that there was any way of establishing reliable estimates of elasticities of demand… with enough precision to inform*

[5] Monopolies and Mergers Commission: Vodafone, O2, Orange and, T-Mobile, Reports on references under section 13 of the Telecommunications Act 1984 on the charges made by Vodafone, O2, Orange and T-Mobile for terminating calls from fixed and mobile networks (published 18 February 2003). We note Ofcom's comments in the LLCC consultation (§6.23, FN185) about the CC's ruling on the last LLCC appeal; but those comments were made about baskets which were backed by a cost orientation obligation and are therefore distinguishable.

pricing decisions. Hence, we believe that there are problems in calculating reliable Ramsey prices

Note that this ruling was in the comparatively simple world of voice telephony services. The issues under consideration here – using multiple technologies, with a huge variety of end uses, and with baskets cutting across economic markets – are much more complicated. We would expect that Ofcom would need a very good reason indeed to depart from the approach set in this decision by the MMC. We would expect to see compelling evidence which would need to include:

- econometric analysis to back-up the basket structure and the values for X; and
- empirical data to support the idea that BT is in fact capable of pricing efficiently.

None of this is given in the consultations.

Third, we have concerns at the level of scrutiny and checks that BT may be subject to in order to determine whether it is meeting the envisaged glide path. It appears from the Annex to the LLCC[6] that BT is required to take "all reasonable steps" to meet the controlling percentages, but it is not clear what this means in practice or how Ofcom intends to verify BT's activity in this respect.

<u>Rationale for Ofcom's decision</u>

As indicated above, the Basis of Charges obligation is well-established and understood by both BT and the rest of the industry. Indeed its meaning and practical application have been exhaustively scrutinised over the last few years. Ofcom's proposal to remove it (or not to re-impose it) in the new price control package is a major change and signals a significant shift in thinking and policy. It signals that Ofcom intends to adopt a new tone in the way that it oversees and scrutinises operators with SMP, at least in the market under review. Without question, this is a major departure from where we are today, and its impact will be immediate and considerable. We are therefore greatly surprised and indeed alarmed by the striking lack of rationale for this proposal that Ofcom has set out in its documents. It is beyond belief that Ofcom considers the justification that it sets out is even close to adequate.

Ofcom's arguments in support of such a radical change are, in the main, set out in a single paragraph of the LLCC – namely paragraph 5.72. These can be summed up as follows:

[6] See page 145 of the LLCC Annex

- The absence of cost orientation will enhance regulatory certainty;
- The control is intended to bring prices in line with costs by the end of the control period; and
- The basket structure and sub-baskets can deal with excessive pricing and are focussed on areas where Ofcom believes there are specific excessive-pricing concerns; therefore imposition of cost orientation obligations would be disproportionate.

We consider that these are very weak arguments. Taking them in turn:

- In terms of certainty, we would argue that the Basis of Charges obligation is well understood and as indicated above it has been the subject of lengthy analysis not just by BT and industry, but by Ofcom and the courts. All relevant stakeholders are fully aware of how it works and what the respective obligations are. There is no basis to suggest that suddenly removing it will somehow improve certainty or that its continued inclusion would make things less certain. That is simply not the case.
- "*The control is intended to bring prices in line with costs by the end of the control period*". This is more a factual statement rather than an argument as to why cost orientation should be omitted. In any event, as explained above, the charge control on its own does not effectively control prices at the beginning of the period; and it assumes that the forward-looking view, taken now, of BT's costs at end-March 2016 is correct. This is almost never going to be the case.
- "*The basket structure and sub-baskets can deal with excessive pricing, and cost orientation would be disproportionate*." This is highly inconsistent with Ofcom's previous approach to this matter in the 2009 LLCC. As explained above, the baskets proposed by Ofcom are not materially different from those of the previous price control, when Ofcom considered cost orientation was necessary. Further, the sub-baskets on the whole deal only with comparatively small parts of the control and prices could fluctuate significantly within the basket. For example, the overall Ethernet control is RPI-12%, but the Ethernet "all other services" sub-basket is RPI-RPI. Already, this leaves a potential 12% differential between some Ethernet services.

- Turning to proportionality; Ofcom has not explained why it considers cost orientation to be disproportionate. BT is well aware of its obligations and it should no longer be in any way problematic for BT to do what is necessary to comply. If it did so, there would no longer be the need for Ofcom to resolve the type of disputes that have arisen regarding the Basis of Charges obligation. In any event Ofcom should be considering what is in the interests of consumers and competition ahead of any burden that may fall on BT (or the regulator for that matter). If Ofcom is suggesting that it would be disproportionate to impose cost orientation on BT because it would further constrain its prices, it is only necessary to look at the gap between DLRIC and DSAC for most products. The gap provides plenty of flexibility, and indeed Ofcom points out that in some instances prices are currently below the DSAC level.

Ofcom has taken the time and effort to go into considerable detail about how and why it has reached its conclusions in most areas, even when addressing relatively minor points of analysis. Yet with arguably the biggest single conclusion it has reached, which will have a fundamental bearing on the future of the market (and potentially the number of players in the market), it offers less than one substantive page of (very weak) reasoning. This is truly incomprehensible and Ofcom needs to revisit how it arrived in this position as a matter of urgency.

Transparency

We are also aware that Ofcom issued a call for inputs earlier in the year on cost orientation and regulatory accounting (to which Verizon provided a response) – and that Ofcom intends to issue a consultation on one or both elements of this work shortly. We would be very concerned if Ofcom were to introduce new thinking on these areas which is omitted (either unintentionally or deliberately) from the BCMR and LLCC documents. If so, this would appear to raise very serious issues about Ofcom's processes, decision-making and transparency. It is essential, in order for Ofcom to meet its public law obligations in relation to consultation, that the matters being considered by Ofcom are considered in full in this consultation, so that stakeholders may comment on them.

We also are highly concerned that Ofcom's proposals will lead to an end to BT's publication of cost accounting information, which has historically proved crucial to industry in scrutinising BT's behaviour. We cannot understand why Ofcom is content to see BT providing less accountability in the future, given what has gone on in the past. Even if the cost orientation remedy falls away, there is a need for BT to provide adequate reporting, not only to Ofcom but also to the industry. To do otherwise moves further away from the objective of regulatory certainty which Ofcom recognises is important in paragraph 5.72 of the LLCC document.

In this respect it is interesting to note that in the 2004 Regulatory Financial Reporting obligation statement, Ofcom also note the importance of such reporting obligations for charge controls as well as cost orientation:[7]

> "*Examples Ofcom requires good-quality financial information from dominant providers, in order to inform decisions and actions, include:*
> - *the need for a dominant provider to demonstrate its compliance with conditions for cost orientation and non-discrimination;*
> - *investigations into potential breaches of conditions, including potential anticompetitive practices, either based on complaints received or on Ofcom's own initiative;*
> - *monitoring obligations to ensure compliance with conditions, including deterring anti-competitive practices; and*
> - ***setting and monitoring price controls"*** *(emphasis added)*

It is not entirely clear whether BT's cost accounting obligations will fall away as a result of Ofcom's proposals. However it is difficult to see why, if BT does continue to produce cost accounting information for Ofcom's purposes anyway, it should not be expected to disclose the information to other interested parties.

Geographic Markets – WECLA

Verizon strongly disagrees with Ofcom's view on the degree of competition that exists in the Western, Eastern and Central London Area (WECLA). In our view, such an assessment is based on a flawed analysis of the competitive conditions in WECLA, largely due to distortions introduced by the approach Ofcom adopted in reaching such a conclusion.

By considering the entire WECLA as a single entity, Ofcom has misconstrued the competitive landscape by allowing the competitive conditions that appertain in the CELA to skew the overall competitive conditions that exist in the additional western zone of the newly designated WECLA. Ofcom should have undertaken a disaggregated analysis of the part of the WECLA which is not in the CELA, before considering whether competitive conditions across the WECLA as a whole were homogenous.

[7] Paragraph 2.24 of the 2004 Regulatory Financial Reporting obligation statement. http://stakeholders.ofcom.org.uk/binaries/consultations/fin_reporting/statement/finance_report.pdf

If Ofcom rejects this view then it should disclose disaggregated information about the extension area only in order to justify its findings. What is currently provided in the BCMR consultation document is data for the CELA as a whole and for the WECLA as a whole. What is required if Ofcom continues with its current proposals is for Ofcom to disclose the information which supports tables 25 and 26 of the BCMR consultation document but for the area of the WECLA which is not part of the CELA. Such a degree of transparency is necessary in order to demonstrate that the proposed de-regulation is based on solid facts and a true representation of the competitive landscape.

Verizon simply does not accept that there is a similar high density of business customers and network build by market players for the extended WECLA mapped out by Ofcom as there is in the Central and East London area.

We believe that a more accurate assessment of competitive conditions, based on a disaggregated approach, would inevitably lead to a conclusion that there is no justification to extend the existing geographic market in London. We therefore do not agree with Ofcom that a separate geographic market exists in WECLA, apart from the area designated in 2007/8, i.e. the existing CELA.

Dark Fibre

Verizon would urge Ofcom to give greater consideration to the general issue of passive remedies and in particular to the benefits that a regulated dark fibre offering would have for customers as a result of the increased level of competition.

With the emerging importance of 'cloud' services, the issue of access to data centres is becoming a critical issue and this is one area where a regulated dark fibre offering would be of particular value. For example, there are situations, and they are increasing as more and more data centres are developed, where access is required to data centres in areas where OCPs do not have infrastructure. In order to offer service in such situations the only available option, other than to extend the network which under most circumstances would not be cost effective, would be to rent a leased line product from BT/Openreach. However, such a solution could suffer from the issues of distance limitations and expensive connection and rental charges, in addition to the problem that a leased line may restrict the type of product that can be delivered to customers due to technical constraints. The ability to obtain dark fibre from BT would resolve all of these issues and the increased level of competition would result in a downward pressure on prices, greater consumer choice and ultimately better customer outcomes.

The option to extend the network mentioned above is, except in exceptional circumstances, not a viable option. ✂. Ofcom should clearly understand that dig decisions are not solely based on a simple matter of length of dig, which appears to be the major factor considered by Ofcom in the BCMR consultation. It is simply not the case that operators will base network build decisions on whether or not the dig distance required is less than 200 metres, such decisions ✂; dig distances are one element for consideration but are not ultimately determinative.

RPI v CPI

We now consider the approach taken by Ofcom with regards to deciding in favour of an RPI-X price cap linked to the RPI inflation index. In comparison to the previous charge control review, a more thorough explanation as to why the charge control should continue to be linked to the RPI index was provided within the consultation document; however we disagree with the rationale for following reasons:

First, Ofcom’s main reasons for retention of RPI remain focused on familiarity[8] and continuity,[9] regardless of the commercial and wider economic implications. (As something of an aside, it does not seem appropriate that Ofcom chooses to cite these factors given that it clearly does not see them as important in determining the merits of a cost orientation obligation). The WBA charge control statement calls for the “need for consistency “between the indexation of the price control and basis for establishing an allowed return”[10].

However, the RPI is recognised as more volatile than the CPI (see point three below) and it is also a poorer indicator of trends. The graph[11] below (Fig.1) compares the percentage changes over 12 months between the RPI and CPI up until July 2012. It shows that the RPI increased by 0.4 percentage points between June and July 2012 compared with a rise of 0.2 percentage points for the CPI for the same period. The larger rise attributable to RPI is due to the weighting differences, the impact of mortgage interest payments and housing price depreciation, and other differences between the two indexes with regards to coverage of goods and services. The Bank of England has used the CPI to assess the level of inflation within the UK since 2003, as it facilitates a better reflection of the “changes in consumer spending patterns relative to changes in prices of goods and services”[12]. It is therefore questionable as to why the price

[8] Leased Line Charge Control Consultation, paragraph 3.15
[9] Leased Line Charge Control Consultation, paragraph 3.19
[10] WBA CC statement paragraph 4.9
[11] ONS Graph showing Retail Prices Index compared with Consumer Prices Index http://www.ons.gov.uk/ons/rel/cpi/consumer-price-indices/july-2012/stb---consumer-price-indices---july-2012.html#tab-Retail-Prices-Index--RPI--compared-with-Consumer-Prices-Index--CPI---
[12] ONS Report on the Differences between the RPI and CPI Measures of Inflation, page 2 www.ons.gov.uk/ons/guide-method/user-guidance/prices/cpi-and-rpi/differences-between-the-rpi-and-cpi-measures-of-inflation.pdf

controls should continue to be linked to an inappropriate index which uses irrelevant factors such as the mortgage interest rates which contribute to its instability.

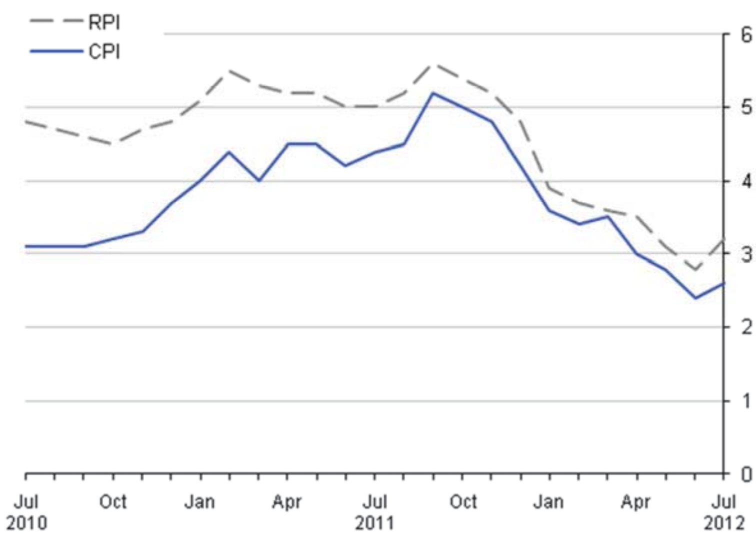

Figure 1 ONS Graph showing Retail Prices Index compared with Consumer Prices Index

Secondly, Ofcom seeks to support the argument in favour of maintaining stability by referring to a report by the Competition Commission (CC) in 2007. The report says that there is "no regulatory precedent in the UK for changing from the RPI index … precedent favours RPI"[13]. However, the economic picture has greatly changed since 2007, for example, the Government has now changed the inflation indexation on pensions to be linked to the CPI.

Thirdly, CPI has recently been found to be an appropriate measure by the Court of Appeal. The decision taken by the Government to move the annual indexation of public service pensions to the CPI was challenged at the Court of Appeal and was found to be lawful. The Court of Appeal assessed the differences between the two inflation indexes and found CPI to be "used as an inflationary measure in many other European countries, and so it was a better measure of inflation than RPI …. a better measure of changes in prices than RPI …. less volatile than RPI, and unlike RPI it would not have produced an unrealistic negative inflation rate for the year to September 2009."[14] These clearly identify reasons in favour of moving away from the established status quo.

[13] Competition Commission report paragraphs 3.21 & 3.22 - A report on the economic regulation of the London airports companies (Heathrow Airport Ltd and Gatwick Airport Ltd) http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep_pub/reports/2007/fulltext/532

[14] R. (on the application of Staff Side of the Police Negotiating Board) v SOS for Work and Pensions [2012] EWCA Civ 332 paragraph 73
http://login.westlaw.co.uk/maf/wluk/app/document?&suppsrguid=ia744c09700000139438608a101a858d6&docguid=I11156930747F11E1854A832195C87DDC&hitguid=IEF12075072EC11E186A3FF676EA0C302&spos=1&epos=1&td=1&crumb-action=append&context=4&resolvein=true

Finally, Ofcom has sought to identify some supposed practical difficulties of moving away from RPI inflation indexation[15] by reference to the RPI-X@20 review Recommendations Consultation document. This document highlighted that "corporate and government index-linked bonds continue to use RPI as the relevant index. We […] use information on the yields from RPI-indexed bonds when we assess a fair level for the allowed return on the RAV."[16] However, the consultation document also said that "there is a case for moving to CPI". We appreciate that there are practical issues that regulators must consider with a move to CPI, however when balanced against the economic gains we do not think that these difficulties should be the determining factor. We submit that despite the complexities of change, in the long run CPI inflation indexation would create a more stable economic outcome.

In terms of achieving a more accurate and representative measure of inflation, CPI appears far superior to RPI inflation indexation. We therefore strongly urge Ofcom to reconsider its approach on this matter.

Verizon Enterprise Solutions
August 2012

[15] Leased Line Charge Control Consultation, paragraph 3.20

[16] Ofgem Recommendation Consultation 'RPI-X@20 review and the RIIO model for network regulation' paragraph 5.9 http://www.ofgem.gov.uk/NETWORKS/RPIX20/CONSULTDOCS/Documents1/RPI-X@Recommendations.pdf

EXHIBIT 3

Table 25: Coverage of each alternative operator (excluding BT) in the CELA in 2007 by number of: i) business sites; and ii) postcode sectors (Table 13 of the January 2008 Consultation)

Communications provider	Businesses	Postcode sectors
Operator 1	99%	100%
Operator 2	97%	100%
Operator 3	55%	76%
Operator 4	20%	39%
Operator 5	17%	28%
Operator 6	17%	29%
Operator 7	9%	21%
Operator 8	7%	17%
Operator 9	7%	14%
Operator 10	4%	9%
Operator 11	4%	10%
Operator 12	4%	9%
Operator 13	3%	6%
Operator 14	2%	4%
Operator 15	1%	1%
Operator 16	0%	0%
Operator 17	0%	0%
Operator 18	0%	0%
Operator 19	0%	1%
Operator 20	0%	0%
Operator 21	0%	0%

Ofcom’s June 2012 BCMR Consultation, Table 25.

EXHIBIT 4

Table 26: Coverage of each OCP (thus excluding BT) by no of business sites and by postcode sectors in the WECLA and UK-wide in 2011

Communications provider	UK-wide		The WECLA	
	Businesses	Postcode sectors	Businesses	Postcode sectors
Operator 1	32%	43%	90%	99%
Operator 2	23%	42%	80%	96%
Operator 3	7%	9%	47%	74%
Operator 4	6%	13%	44%	76%
Operator 5	5%	10%	31%	50%
Operator 6	3%	5%	13%	32%
Operator 7	2%	7%	13%	37%
Operator 8	2%	5%	4%	7%
Operator 9	2%	3%	3%	10%
Operator 10	1%	2%	2%	8%
Operator 11	0%	0%	2%	5%
Operator 12	0%	0%	0%	1%
Operator 13	0%	0%	0%	2%
Operator 14	0%	0%	0%	1%

Ofcom's June 2012 BCMR Consultation, Table 26. An OCP is an Other Communications Provider.