WLA – Recovering the cost of investment in network expansion – Virgin Media's response

29 September 2017

Non-confidential submission

Summary

Virgin Media supports BT's commitment to expand its network to provide 10/1Mbps to 99% of premises by 2021/22 and we therefore are only providing a short response to this consultation. We believe that BT's offer is likely to avoid years of consultations and wrangling about the quantum of, and contributions to, an industry levy. The upshot of a voluntary commitment is that services will be provided sooner (deployment will start in 2018/9) and therefore customers will see the benefits of better broadband earlier. We have long maintained that, in the event a USO was imposed upon BT as the Universal Service Provider, a requirement to offer a minimum of 10/1Mbps would not be an unfair burden for BT, and its offer to do this voluntarily is evidence in support of our contention.

We agree that BT's investment should be recovered in part through wholesale charges provided that BT enters into *"a clear and public agreement with Government committing BT to make the investment in universal broadband".* We view this investment as akin to any other investment that BT chooses to make to expand or improve its network. The only likely 'difference' between this and other investment in network is that it might have a longer payment period, but this is not determinative of whether it should be included in wholesale charges. As Ofcom notes: *"[a]s with any network expansion, we would look to allow efficiently incurred costs in the charge control for services associated with that network expansion."* (6.4)

The same still incentives exist for BT to deploy its capital wisely as with any other investment; this would not necessarily be the case if the investment were funded via an industry levy. Moreover, it will want to deploy technologies that allow (or will allow) customers to buy, or upgrade to, superfast broadband (SFBB). Ofcom further protects against the over-recovery by determining the mix of technologies that minimises the cost of network deployment.

It is appropriate that Ofcom wishes not to disturb competition between copper and fibre through significant adjustments in relative prices. Recovering the costs of network expansion through the same mark-up over all broadband lines is a pragmatic way of achieving this outcome.

We provide answers to specific questions below.

Consultation Questions

Question 3.1: Do you agree with our approach to assessing the number of qualifying premises to include in our analysis? Please provide reasons and evidence in support of your views.

Virgin Media broadly agrees with Ofcom's proposed approach for sizing the number of qualifying premises as part of its cost estimates. We also agree that the mechanism to update this information in light of contemporary evidence would be expected to provide a reasonable estimate of forecasted volumes.

Question 4.1: Do you agree with our approach to assessing the technologies and technology mix that should be used as the basis for calculating the costs of BT's proposed rollout? Please provide reasons and evidence in support of your views.

We have not reviewed the logic behind Cartesian's technology choice algorithm in detail and so we do not provide comments on the accuracy of any assumptions of technical parameters that have been used or of the implied mix.

We would encourage continued interaction between Ofcom/Cartesian and Openreach to understand the extent to which the logic used to determine the technology mix accords with Openreach's modelling and the extent to which the outputs are therefore aligned. Such an approach should result in minimising the foreseeable risk of over or under-recovery. If Government and BT come to an agreement, we anticipate this will provide Ofcom with further data and certainty about the technical details of the rollout prior to Ofcom's Final Statement.

Unlike bottom-up modelling of BT's existing GEA product costs, we would expect there would be limited circumstances in which BT's and Cartesian's cost forecasts would materially differ. We would also anticipate that, to the greatest extent possible, Ofcom and BT should be able to converge on an estimate of the scale, technology mix and resulting cost of the rollout to ensure that BT has the incentive (and opportunity) to recover its efficiently incurred costs.

We are encouraged by Ofcom's calibration efforts to date[1] and would support further such engagement prior to the Final Statement.

Question 5.1: Do you agree with our proposed approach to modelling the costs of BT's proposed network expansion? Please provide reasoning for your answer.

Virgin Media provided comments on Ofcom's approach to cost modelling as part of the March 2017 WLA consultation and in response to the 2016 consultation on FTTC cost modelling. These comments still stand.

Bottom-up LRIC: We agree that using a LRIC methodology has the benefit of consistency with the approach to modelling adopted in the WLACC. In our previous responses we noted that BT's existing GEA product costs mean that bottom-up modelling is less appropriate than other methodologies. However, this is less relevant for these network expansion costs because the same characteristics (e.g., availability of historic costs) are not present.

[1] For example, those described in paragraphs 5.63-5.67 and Annex 8.

Scorched node: We agree that a scorched node approach would be appropriate. There is no clear rationale to select an alternative approach, such as scorched earth, and Ofcom's proposed approach has the benefit of having consistency with Ofcom's existing GEA cost methodology proposals.

LR-VDSL CPE: Excluding the potential costs of LR-VDSL CPE appears to be reasonable. If CPs deviate from their approach to SFBB (and do not self-provide CPE) and commercial arrangements do not result in terms which allow BT to fully recover these costs, this could be revisited as part of future reviews. However, it seems highly unlikely that both of these outcomes would occur. Ofcom's approach therefore seems sensible when balancing the relative risk of over or under recovery of costs.

FWA and satellite costs: We agree that it would be reasonable to exclude FWA and satellite costs from the charge control, for the reasons outlined by Ofcom. Namely, the potential lack of wholesale access obligation and the potential for these services to attract retail pricing which allows for cost recovery.

We also agree that attempting to include the qualifying premises under an alternative technology would lead Ofcom to mis-estimate BT's efficient costs.

Assessment duration: We have no specific comments at this time regarding the assessment duration adopted, although we do agree that aligning the assessment duration between models (if appropriate) would appear to be helpful for stakeholder transparency.

Ofcom notes that its proposed approach "*would also enable a more robust validation of the model assumption given that it would allow us to test whether the model produces realistic outputs beyond the charge control period.*" As noted in response to Q4.1, we would encourage Ofcom/Cartesian to ensure its own modelling and BT's are aligned to the greatest extent possible. Not only would this validation be necessary for Ofcom to be able to effectively '*test whether the model produces realistic outputs*', but it would provide greater certainty to stakeholders that the model would not be subject to fundamental challenge by BT in subsequent market reviews.

Indirect benefits: We agree that it would be inappropriate to seek to attribute any indirect retail benefits stemming from the investment to BT directly.

Depreciation: We agree that CCA depreciation (tilted annuity) would be more appropriate than economic depreciation. We agree that there is a relatively low risk of inaccurate cost attribution due to low network utilisation in early years.

We also believe there is a risk that if economic depreciation were adopted it may overestimate the proportion of costs that should be recovered in later years. Under economic depreciation, if any network elements costs were profiled over time using total bandwidth used, for example, there may be a risk that cost recovery is incorrectly loaded into later years if customers migrate to mobile broadband as effective coverage reaches these areas. In short, this investment is a solution to an edge case problem. Changes in technology or commercial factors can have the greatest impact on the extreme. This would be challenging to forecast today and so would risk BT over/under recovering costs and/or the need to revise BT's cost recovery profile, reducing certainty to stakeholders.

Question 6.1: Do you agree with our proposal to recover the costs over all broadband lines?

In our view, Ofcom's proposed approach to cost recovery across all broadband lines strikes the right balance. By design, the choice of method for cost recovery is somewhat arbitrary. Applying the six cost recovery principles is a reasonable approach, although as Ofcom notes, only a couple of these principles have any relevance to this consideration.

Despite these limitations, minimising the impact on allocative efficiency by spreading the cost as broadly as possible is appropriate and equitable. Minimising this impact without burdening voice-only customers with additional costs for service improvements they do not benefit from (and many of whom are elderly and/or vulnerable) also seems consistent with the principle of distribution of benefits.

Another implicit benefit of Ofcom's approach is the overarching alignment to distribution of benefits across industry. In the first instance, the cost of this investment would be recovered from wholesale access seekers who (along with their prospective customers) are the main beneficiaries. It is right that these CPs bare the cost given the potential to up and cross-sell services to these new customers.

Question 6.2: Do you agree with our proposed approach to implementing recovery from all broadband lines?

As we are not a wholesale purchaser of MPF/GEA, Virgin Media does not have any material comments at this time about the proposed mechanics for implementation Ofcom's approach to recovering costs across broadband lines.

However, we would encourage Ofcom to consider any and all appropriate regulatory financial reporting requirements that it may be appropriate to require of BT. Given limited information is currently available on the precise form of any potential agreement between Government and BT, it would be appropriate that financial details and rollout progress is sufficiently transparent to stakeholders. This reporting transparency would be particular important if any future agreement did include relaxations of regulatory obligations, for example, in cases where FWA and satellite solutions are adopted.